

Impediments to International SME Activity; Evidence and a Proposed Framework for Monitoring

Discussion Paper - February 2003

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1. AIM

This paper seeks to set out a framework for monitoring the impediments to international activity by SMES in APEC, with a view to providing a foundation for reducing these impediments wherever appropriate.

2. POTENTIAL GAINS FROM GREATER SME TRADE AND FDI

The potential gains to APEC from addressing impediments to the internationalisation of SMEs are large. The best available evidence from the "Profile of SMEs and SME Issues in APEC 1990 - 2000" makes it clear that SMEs are under represented in the APEC international economy. In the domestic economies, SMEs generally make up about 50% of GDP, and about 60% of private sector jobs. By contrast, SMEs contribute only about 30%, of exports on average. If this is taken on a weighted basis, the contribution falls to only 28.2%. The contribution to FDI by value by SMEs is only about 10%.

Some crude but robust modelling suggests that there is the potential for SMEs to add about \$1 trillion in trade and about \$150 billion in FDI per annum to the APEC economy if structural changes allow a simpler, more business friendly, more integrated APEC economy to emerge. This is based on the assumption that if impediments to SME internationalisation can be reduced, then SME exports will grow, and grow relative to larger firms. At present total exports in APEC are about \$3 trillion per annum, of which SMEs contribute about 30%, or about \$1 trillion. If SMEs were to realise their full potential, then they should contribute roughly the same as larger firms (that is about 50%, or about what they contribute in a fully integrated economy), or about \$2 trillion in exports each year, equal to the \$2 trillion contributed at present by large firms. This implies that if SMEs reach their full economic potential, SME exports would about double, from \$1 trillion to \$2 trillion, and total export trade in APEC would expand by 30%, from \$3 trillion to \$4 trillion. To put this in perspective, an extra \$1 trillion in trade each year is more than the combined economies of Canada and Australia, and about double the equivalent of all of ASEAN. It would be a significant addition to the APEC economy.

Reducing impediments can have a significant effect on growth potential of an SME. Based on a small survey of internationally active, high technology SMEs as part of the APEC TechnoForum in 1997, the package of initiatives that the respondents nominated as "very helpful" would, in their opinion, if implemented, be effective in increasing their rate of growth by somewhere between 20% and 50%. The initiatives regarded by almost all respondents as *very helpful* were "faster reduction of specific tariff barriers and/or non tariff barriers" (though not necessarily both together), "better access to government and large firm procurement for smaller international companies", "more access for display of technology and products", and "more direct access to APEC officials to alert them to the needs of firms in emerging industries".

3. WHAT ARE THESE IMPEDIMENTS?

There has been very little reliable research to identify the relative magnitude of impediments to SME internationalisation in APEC. We do know that there are very few cases where tariff or non tariff barriers (NTBs) are specifically targeted at foreign SMEs on the basis of their size. Impediments to increased international activity by SMEs can be quite complex. There are a host of factors which assist or impede the internationalisation of firms. These can be at border (tariffs, quotas, customs requirements) or non-border, non tariff barriers (such as domestic regulations, compliance requirements, discriminatory or predatory practices etc). The factors which impede internationalisation are often just the absence of factors which assist internationalisation, and vice versa. A factor which impedes one SME may also assist another in its quest for success abroad. For example, things which can assist or impede internationalisation are:

- Managerial experience, both generally and of specific aspects of international activity or markets abroad. As managerial experience increases, so usually does the probability of success. The speed of globalisation now means that many managers do not have as much time to acquire experience before they take their first steps abroad. This lack of experience can sometimes be compensated for by access to, and judicious use of, consultants and advisors by the SME's managers. "Cultural distance" can be important too; the more similar the cultural, regulatory, and business practices of the target economy to the home economy, the more easily transferred is managerial knowledge. For this reason many SMEs start off their internationalisation in target markets with small "cultural distances". Things which reduce cultural distances tend to reduce impediments to international activity by SMEs.
- Human resources and appropriately trained and skilled staff. This can include such things as language and cultural awareness training, as well as specific technical skills.
- Finance, both access to general finance, and to specific trade finance (such as credit guarantee facilities or foreign exchange hedging arrangements).
- Information, about opportunities, threats, regulations, laws etc. Even where information is available, SME managers sometimes are not aware of where to find it.
- Rule of law, or in its absence the arbitrary or discriminatory imposition of regulations and laws by corrupt or incompetent officials. This can also include enforcement of property rights, such as rights to tangible property (buildings, plant, equipment) and intangible property (patents, knowledge etc).
- Infrastructure, such as roads, ports, highways, telecommunications, warehouses etc.
- Unfair or predatory competition by other firms. This may include such things as dumping, or of unfounded allegations made by local firms of dumping by a firm seeking entry from abroad.
- Red tape and administrative compliance costs. These may impede in some cases because they fall disproportionately heavily on SMEs, simply because they tend to be fixed costs, and are thus higher on average on a smaller turnover. These may also assist some SMEs which have achieved and invested in obtaining certain knowledge or intangible assets (such as compliance certification).

There have been no surveys or research into the level of impediments to SME trade generally in APEC. However, an idea of the relative importance and diversity of some these factors can be obtained from the following two tables. These relate *only* to FDI by and to SMEs, and they are based on a survey carried out by the author for UNCTAD in 1996/97 which covered Myanmar, Philippines and Viet Nam as economies receiving inward FDI, and Korea, Singapore and Chinese Taipei as sources of outward FDI. The first table shows the relative importance of factors influencing inward FDI, and the second table shows factors affecting outward FDI. In each case a factor could be helpful (h) to a respondent, or a problem (p) for a respondent. The (h-p) column shows the percentage of respondents for whom that factor was helpful or very helpful, *minus* the proportion for which it was a problem or a major problem. If the figure is negative, then the problem cases outweigh the helpful ones. The key points to observe are that:

- There are many factors which assist and impede FDI and internationalisation by SMEs;
- The same factor may both assist and impede different SMEs;
- The main problem factors impeding the attracting of inward FDI (table 1) were things like corruption amongst minor officials (and to a lesser extent amongst senior officials), absence of local skilled staff, reasonably priced finance, roads infrastructure, tariffs and quotas and unfair competition;
- The main factors helping inward FDI were access to technology, skilled staff locally and abroad, low cost labour, suitable distributors etc.;
- The main factors posing problems for outward investors seeking to invest abroad (table 2) were business regulations, cultural differences, corruption, investment approval processes, tariffs, skilled staff etc.;

- The main factors helping outward investors were things like reasonably priced finance, skilled staff, restrictions on market access etc.

Table 1 - Factors contributing to problems or providing assistance to inward FDI in SMEs in host economies in Asia (Myanmar, Philippines, Viet Nam)

	SME-SME percentages			LE-SME percentages		
	h-p	p	h	h-p	p	h
skilled staff locally	-6	44	38	5	41	45
skilled staff abroad	21	12	32	32	14	45
access to technology	26	21	47	55	14	69
finding suitable distributors	9	24	32	27	14	41
reasonably priced finance	-6	35	29	-9	41	32
restrictions on market access	-21	29	9	-32	36	5
tariffs or quotas	-26	35	9	-36	45	9
unfair competition	-32	35	3	-27	32	5
distribution systems	-12	24	12	-14	27	14
business regulations	-15	32	18	-36	50	14
investment approvals	-15	35	21	-18	41	23
construction approval	-9	24	15	-14	32	18
local content requirements	-3	21	18	-9	23	14
corruption - minor officials	-56	56	0	-41	41	0
corruption - senior officials	-41	44	3	-27	32	5
telecommunications	-26	38	12	-59	73	14
roads infrastructure	-41	53	12	-59	64	5
dispute settlement	-9	21	12	-32	36	5
legal system	-18	32	15	-27	36	9
labour restrictions	-18	26	9	-18	23	5
attitude of workers	3	29	32	27	18	45
cultural differences	-21	29	9	-9	14	5
market liberalisation	15	9	24	18	9	27
business parks	9	12	21	18	0	18
business matching	3	9	12	5	9	14
low cost labour	38	9	47	36	14	50
govt management training	15	3	18	0	0	0
govt business advisory	6	6	12	5	0	5
govt trade missions	12	3	15	0	0	0
intelligence and information	9	21	29	-5	18	14
Chambers of commerce	12	12	24	5	5	9

See foot of table 2 for sources, and see text for explanation.

SME - SME; FDI by SMEs in the donor economy to SMEs in the receiving economy.

LE - SME; FDI by large firms to SMEs in the receiving economy.

Table 2 Factors contributing to problems or providing assistance to outward FDI from donor economies in Asia (Korea, Singapore, Chinese Taipei)

	Small investors percentages			Medium investors percentages		
	h-p	p	h	h-p	p	h
skilled staff locally	-17	47	30	-10	48	39
skilled staff abroad	-13	23	10	-13	26	13
access to technology	-17	40	23	0	23	23
finding suitable distributors	-3	27	23	-26	42	16
reasonably priced finance	3	37	40	-16	45	29
restrictions on market access	-3	30	27	-35	52	16
tariffs or quotas	-37	47	10	-52	61	10
unfair competition	-40	40	0	-48	52	3
distribution systems	-23	33	10	-55	55	0
business regulations	-57	60	3	-48	52	3
investment approvals	-40	50	10	-55	61	6
construction approval	-53	57	3	-39	45	6
local content requirements	-37	37	0	-45	45	0
corruption - minor officials	-53	53	0	-71	71	0
corruption - senior officials	-57	57	0	-74	74	0
telecommunications	-50	60	10	-55	61	6
roads infrastructure	-43	57	13	-55	61	6
dispute settlement	-23	33	10	-45	45	0
legal system	-30	47	17	-61	61	0
labour restrictions	-27	37	10	-45	45	0
attitude of workers	-27	43	17	-61	61	0
cultural differences	-60	60	0	-68	68	0
suitable partners	-20	37	17	-45	48	3
market liberalisation	-3	30	27	-19	29	10
business parks	-7	20	13	10	16	26
business matching	-13	27	13	-3	16	13
low cost labour	27	3	30	13	13	26
govt management training	17	3	20	16	3	19
govt business advisory	10	7	17	19	3	23
govt trade missions	17	7	23	13	10	23
intelligence and information	7	17	23	26	3	29
Chambers of commerce	-3	23	20	19	10	29
tax concessions	17	3	20	29	0	29
cultural connections	10	7	17	13	0	13
MNC affiliation	20	3	23	16	3	19

SOURCE: UNCTAD (1998) Handbook on FDI by SMEs; Lessons from Asia, p 47 - 51.

p - percent regarding this factor as a problem or major problem

h - percent regarding this factor as helpful or very helpful

h - p percent regarding this factor as helpful or very helpful minus percent regarding this factor as a problem or major problem.

The issue of addressing impediments to internationalisation by SMEs is important, simply because the potential gains are large. However, the forgoing suggests that the potential gains of expanded internationalisation by SMEs will not necessarily be achieved by ad hoc attempts to deal with specific impediments faced by individual SMEs. This is because the removal of an impediment for one SME may just simply make things worse for another SME. Some impediments have more impact on some types of SMEs in some economies. It is a matter of balance, and is part of a broader question of how to create a more conducive business environment for SMEs and entrepreneurs. The factors which affect the success of SME internationalisation are similar to or the same as those which affect the successful development of SMEs domestically, and they are an indicator of the quality of the business environment domestically and internationally. For example, the absence of rule of law and widespread corruption will not stop the emergence of SMEs, but it may mean that those most likely to succeed will be different (and less respectful of the law) than in an economy where the law is

enforced. The absence of managerial skills, or a lack of efficient and unbiased finance markets may not stop some SMEs setting up, but it will make it more difficult for them to expand and grow, and probably mean that costs are higher, and production less, than what might otherwise be possible in a more conducive business environment. Improving the business environment for international SMEs will also often improve the business environment for domestic SMEs as well.

To effectively address impediments to internationalisation thus requires some sort of framework, and an understanding of how SMEs seek to deal with the impediments already. It is to these two issues we now turn.

4. HOW DO SMEs DEAL WITH IMPEDIMENTS AT PRESENT?

At present if a smaller firm faces impediments to its international business activity it can:

1. Give up, or find another way to get around the problem. This is probably the most common approach, but it means that no one knows how much potential business, trade and investment is lost as a result, or how much is lost in unnecessary transaction and search costs. In some cases though this response might be the most appropriate and cost effective solution. For example where an SME manager faces an impediment arising from local regulators or regulations discriminating against a foreign firm, then it may be most cost effective to find and work with a local partner. The issue for the SME then moves to finding a suitable and trustworthy local partner. The issue for APEC is just how much economic benefit is lost as a result.
2. Make representations via existing channels in their "home" economy. This usually means approaching either a government office directly or an industry organisation, such as a Chamber of Commerce. The complaint or suggestion is then forwarded on via normal diplomatic channels on a bilateral basis. The problem with this is that usually SMEs are small, and individual complaints at a bilateral level are either easy to ignore, or to get lost amongst bigger trade issues. SMEs are thus often wary about initiating anything where they feel that their formal complaint may lead to retaliation; they usually have little to gain and much to lose from making their complaint known via formal diplomatic channels. Bilateral approaches also make it hard to monitor whether the issues are more widespread, and thus there is less incentive to look for more effective multilateral initiatives, which is where APEC offers real opportunities for improvement.
3. Initiate legal or formal procedures, for example by seeking legal resolution in the economy concerned or through the WTO, or international arbitration. Only a very small minority of SMEs adopt this approach. It is usually expensive, and often less than satisfactory. In some APEC cultures, recourse to such methods is regarded as a major failure in itself.

5. A PROPOSED FRAMEWORK FOR MONITORING IMPEDIMENTS - PRINCIPLES

The issue of impediments to SME international activity is complex. To be able to effectively reduce impediments to SME internationalisation it is necessary to have some sort of framework which allows us to monitor the overall impact of these impediments, so that efforts can be directed at where they will have most effect. APEC already has an existing system for impediment identification and reduction, and although this does not specifically address SMEs, it does address a wide range of issues of relevance to SMEs, such as for example: rules of origin; business people mobility; professional recognition; services; standards and conformance; competition policy; customs procedures; government procurement; intellectual property rights; and dispute mediation.

This suggests a framework which based on six main principles:

1. Build on and integrate with existing APEC impediment identification mechanisms;
2. Focus on those impediments to SME internationalisation where it is likely that APEC and member governments can have most effect;
3. Focus on those SMEs where the reduction of impediments is likely to have most beneficial effect;
4. Select a representative group of economies for monitoring purposes;
5. Use cost effective methods to monitor impediments on an ongoing basis.

6. Develop a simple transparent mechanism within the SME WG and APEC generally for addressing the impediments which are unnecessary and which have significant actual or potential negative effects on SME international activity.

The options for applying each of these six principles in a framework are now explored.

1. Integration with existing APEC impediment monitoring

Although APEC has an extensive system of impediment monitoring, the SME WG voice is usually not directed at or heard in these areas. Communication between the SME WG and the other relevant groupings (such as MAG, and GOS) could be strengthened in a number of ways, for example by setting up a sub group or working committee within the SME WG to act as a conduit and focal point, by including SME impediment issues as a regular issue on the agenda. Similarly there are opportunities to strengthen business-APEC cooperation, and facilitate the feeding of information about impediments to SME internationalisation into the SME WG and the APEC CTI processes via ABAC, and by the annual APEC Business Forum Meetings.

2. Focus on those areas where APEC and members can have most effect

There seem to be two main areas of impediments where there is the potential for APEC and member governments to have most effect.

A. those impediments where the SME itself can overcome the problem at relatively low cost, given suitable advice and assistance based on new or existing programs and advisory services.

SMEs frequently face difficulties in internationalisation, but the solution often rests primarily with the SMEs themselves. The problem or impediment arises because, for example, they: lack the necessary managerial experience; have difficult finding suitable partners; are not aware of where they can get relevant information about regulations which affect their activity; may not be able to put their case for finance in a way that convinces a financial provider to lend to them; and so on. APEC member economies *already* have developed extensive programs and services to assist such SMEs. The main issue is to identify where these systems are not working as well as they might, and where there are better, more cost effective ways of delivering them. Member governments do not need to provide and fund all of these services, but may play an important role in assisting the private sector to do so.

B. those impediments where potentially governments can do much to address the problem, but where individual SMEs can do very little, and where the impediment significantly raises costs and barriers to entry.

This is usually because the impediment arises from inconsistent or unnecessary regulations, corruption, lack of infrastructure etc. Some of these impediments are likely to be more intractable than others. For example, most regulations and laws are originally created for a purpose and to meet a need, but many also outlive their usefulness, or have unintended consequences. Changing laws and regulations usually imposes political and social costs. Similarly, infrastructure is an essential part of the business environment. As noted in "Profile of SMEs and SME Issues in APEC 1990 - 2000" many of the 2020 economies face a significant "digital divide", which can be seen as an important infrastructure component in the international competitiveness of their own SMEs. Improving infrastructure is intrinsically expensive, but governments can work with the private sector to overcome impediments.

3. Focus on those SMEs where impediments are likely to have most effect

It makes some sense to try to target those SMEs which are more likely to face impediments, and those SMEs where impediments are likely to have a bigger potential effect. For example, we know that a large amount of job creation seems to come from a small proportion of SMEs which are fast-growing. If these potentially fast growth SMEs are unnecessarily impeded then the effect on job and wealth creation may be larger than otherwise. About 80% of SMEs operate in service industries, and service industry SMEs tend to face more NTBs than Tariff barriers, so it equally makes sense to have a focus on services SMEs. One important aspect of impediments to SMEs is that they are often in leading or emerging industries. Thus, even though the impediment faced by an SME in biotech or

nanotechnology applications research may be small, the potential impact on the shape of the development of a new industry or market may be vary large if the impediment is not addressed effectively.

4. Select a representative group of economies for monitoring purposes

APEC has 21 member economies. To monitor impediments in *all* APEC economies would be expensive and make little sense. However, economies are likely to differ as to the relative importance of impediments and their ability to deal with them. It thus makes sense to develop a framework of monitoring which covers a reasonably representative mix of economies. For example, 2020 economies are more likely to face infrastructure impediments (which are usually more difficult to address directly), while 2010 economies are more likely to be concerned about IPRs and regulatory barriers. This suggests that impediment monitoring be based on a mix of developed and developing economies. It may also suggest some cooperation with OECD and the European community, to the extent that Europe is a major market (and source of impediments) for many APEC SMEs.

5. Use cost effective methods to monitor impediments on an ongoing basis

There are at least three broad ways of identifying impediments to SME internationalisation:

1. Surveying SMEs themselves. Large scale surveys on a regular basis would be prohibitively expensive, and not necessarily very reliable. However it may be useful to occasionally undertake more detailed and structured surveys to get a more accurate idea of the dimensions and perspective of a particular set of impediments. Some economies already carry out periodic surveys and produce annual white papers. It may be helpful to coordinate these on particular issues, so a better idea of the overall pattern of impediments is obtained. A simple, lower cost approach might be to set up a voluntary notification system where SMEs can file complaints over the internet, or with their local chamber of commerce, for further investigation.
2. Using the existing dispute resolution frameworks to identify emerging areas of impediments. This may be a useful supplement to other means of monitoring, but as noted above, relatively few SMEs seem to use the formal WTO or commercial arbitration methods of dispute resolution.
3. Use experts in government and facilitator organisations to help identify cases of impediments. Many economies have export and trade facilitation organisations (such as Australia's Austrade, Japan's Jetro, Korea's Kotra, Hong Kong TDC etc). Similarly, industry associations and chambers of commerce (including bilateral organisations such as the Australia - Korea Business Council) often assist members with internationalisation. Many of these organisations have experts who provide advice and assistance to SMEs and other firms within the context of SME export promotion programs. It may be possible to tap into this expertise in a way which helps identify existing and emerging areas of impediments.

The feasibility of different approaches needs to be investigated further. It is probably best to use some combination of all three options, but to put most emphasise the third, the expert approach. In any case it will be necessary to establish some process of follow up and review to determine whether a particular impediment identified is widespread or just an isolated incident, and if appropriate, how it might possibly be best addressed.

6. Develop a simple transparent mechanism within the SME WG and APEC to address impediments

At present impediments to trade are addressed via the IAP (Individual Action Plan) and CAP (Collective Action Plan) processes in APEC. The SME WG does not presently feed into these processes, but there is no reason why it should not be more active in this area. Part of the regular report of the SME WG to SOM and CTI could be specifically on impediments reduction. What is required is some sort of transparent process for identifying and monitoring impediments (covered in the above) and then couple this with a similarly transparent process for bringing these to the attention of the economy, or economies, concerned for action.

DRAFT #1 RECOMMENDED FRAMEWORK OF ACTION ON MONITORING IMPEDIMENTS TO SME INTERNATIONALISATION

1. Establish a trial project within the ambit of the SME WG, and in collaboration with MAG and with PECC to evaluate options for more effective identification and monitoring of impediments to SME international activity.

2. Seek the participation of a small trial working committee of APEC economies in the active identification and monitoring of impediments to SME international activity. This working committee could take a role as a trial sub-committee of the SME WG. The economies in the trial working committee should be a mix of 2010 (developed) and 2020 (developing), and should have some existing program or infrastructure in place for assisting the internationalisation of their SMEs. The following list is just a suggestion but the economies all have reasonably good agency support for such a project, and would give a good mix of interests. In addition, APEC should cooperate with the OECD to parallel the monitoring work with some of the European economies.

	Possible Agency?
<i>Australia</i>	? <i>Austrade</i>
China	? SETC
<i>Chile</i>	? <i>CORFO</i>
<i>Hong Kong, China</i>	? <i>TDC</i>
<i>Japan</i>	? <i>JETRO</i>
Korea	? KOTRA
Malaysia	? SMIDEC
Thailand	? OSMEP + Foreign Affairs
<i>USA</i>	? <i>Dept Commerce ITA + Ex Im</i>

2010 Economies are in *italics*, those not in italics are 2020 economies.

3. Assess the feasibility of different options for a trial program of monitoring of impediments to run over 12 - 18 months, with the intention of continuing it and expanding to more economies if it is cost effective to do so. Carry out discussions with representatives of selected agencies to determine the feasibility and design of an impediment notification system, based on the participation of experts in selected economies international agencies (table above).

4. Focus the main effort on:

A. those impediments where the SME itself can overcome the problem at relatively low cost, given suitable advice and assistance based on new or existing programs and advisory services.

B. those impediments where potentially governments can do much to address the problem, but where individual SMEs can do very little, and where the impediment significantly raises costs and barriers to entry.

C. selected target groups of SMEs, where it is considered by the SME WG members, experts and participating agencies that impediments are most likely to limit potential.

5. Develop a pro forma short reporting form (an APEC SME Impediment Report), which could be used by experts in the trial export promotion and facilitation agencies to notify APEC of potential impediments. This would be set up and operated electronically.

6. Establish a process in the SME WG for acting on impediments affecting SMEs. This process should dovetail and complement the existing APEC processes of IAPs and CAPs, as well as those of bilateral negotiation. How this should best be done needs to be discussed by the SME WG, but one option is possibly a small working committee within the SME WG to act as a focal point for assessing and evaluating the impediments reported. This working committee should report to the SME WG, which could then forward it as part of its report to SOM and CTI on possible steps to address the impediments. The SME WG could then have an item on its permanent agenda relating to impediments.