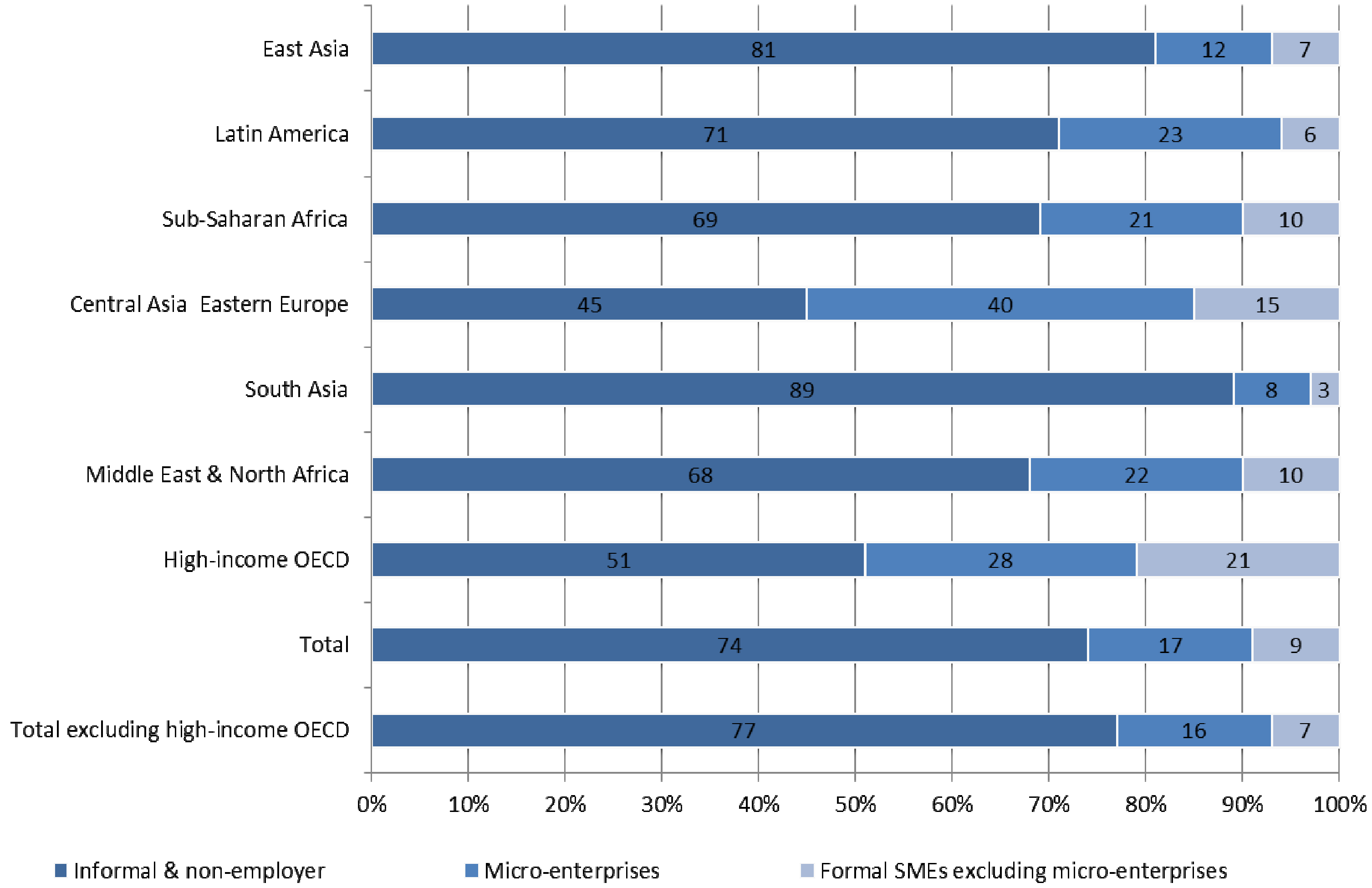
Policymaker training course on SME productivity and working conditions

SMEs: socio-economic relevance and constraints

Outline

1. The economic and social importance of SMEs
2. SME definitions
3. Heterogeneity within the SME sector
4. Main constraints

Estimated share of SMEs worldwide (2010)



Source: IFC

Estimated number of SMEs worldwide (2010)

Region	No of SMEs	Percentage of total SMEs worldwide	Total formal SMEs (millions)
East Asia	170-205	44-46	11-14
Latin America	47-57	10-12	3-4
Sub-Saharan Africa	36-44	8-10	3-5
Central Asia and Eastern Europe	18-22	3-5	2-4
South Asia	75-90	16-20	2-3
Middle East and North Africa	19-23	4-6	1-3
High-income OECD countries	56-67	12-14	11-14
Total	**420-510**	**100**	**36-44**
Total excluding high-income OECD countries	365-445	80-95	25-30

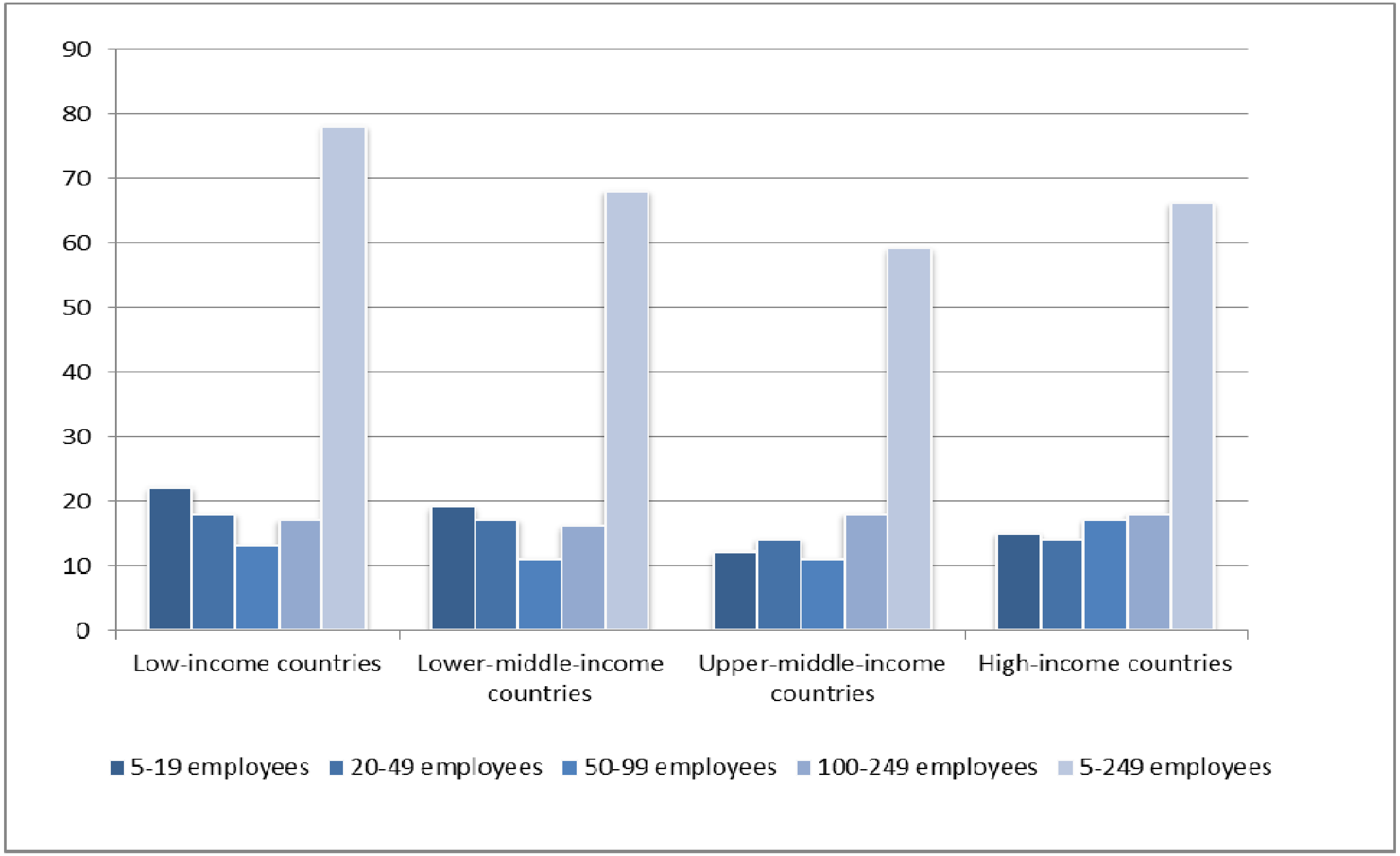
Source: IFC

SME are the core of enterprise population: they are the largest provider of employment (stock)

Employment shares by size class (medians)

Source: Ayyagari et al. (2011)

Employment shares across countries from different income groups, by size class (medians, 2011)



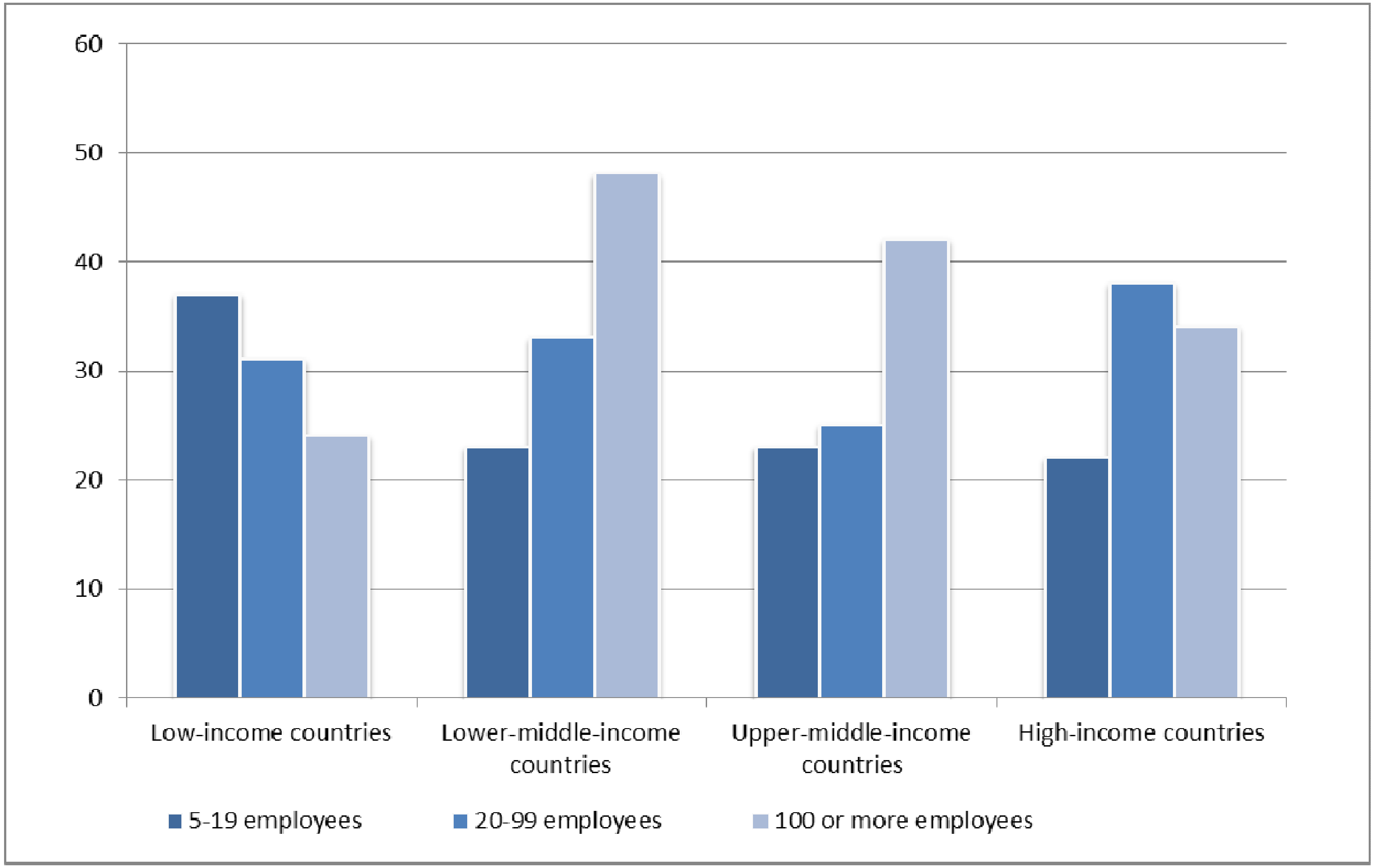
Source: De Kok et al (2013), based on Ayyagari et al.

SMEs are the core of enterprise population: they are the largest provider of employment (flow)

Job creation shares by firm size (countries with net job creation)

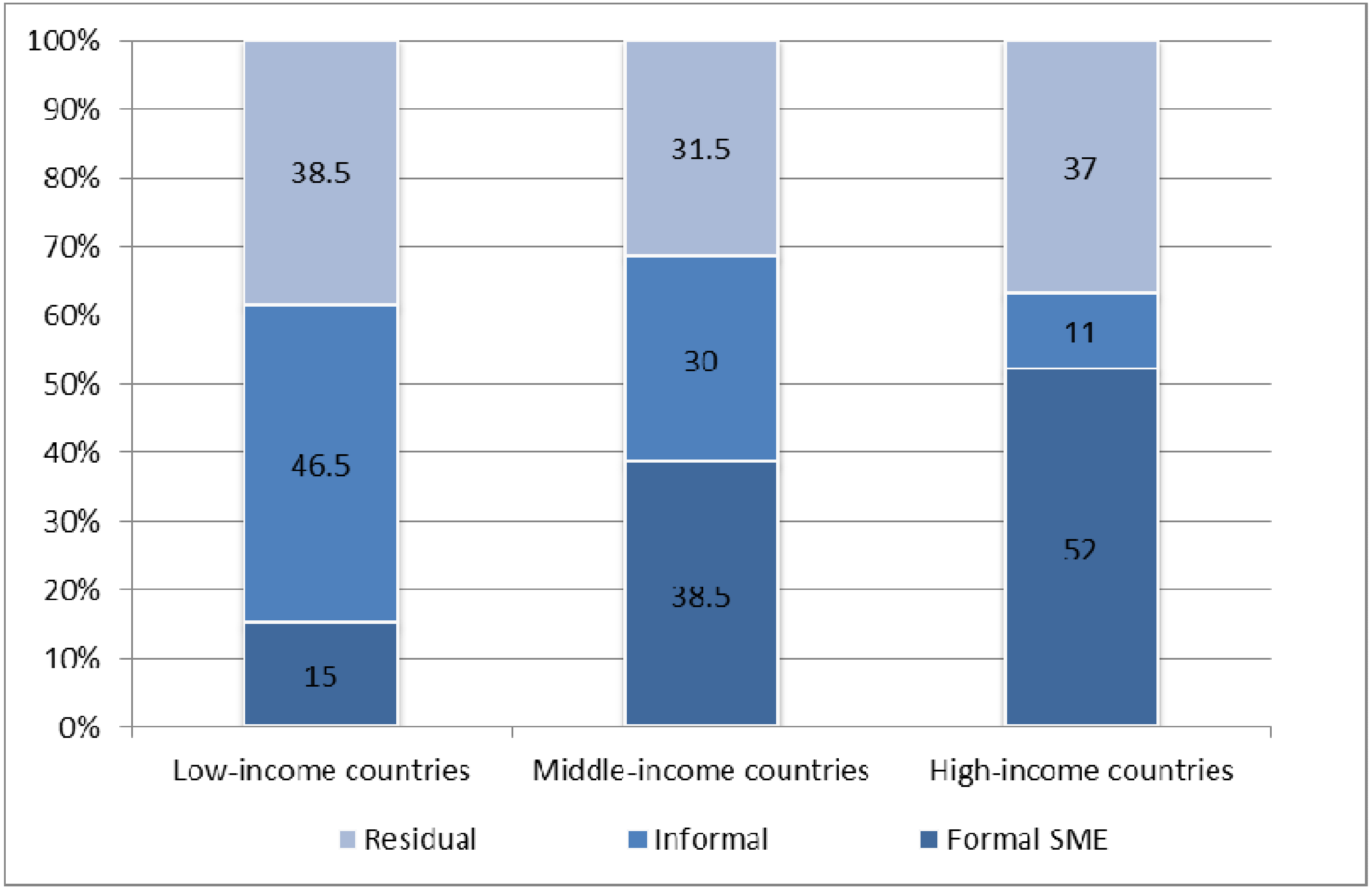
Source: Ayyagari et al. (2011)

Share of total net job creation by enterprise size class and country income group (medians, 2013)



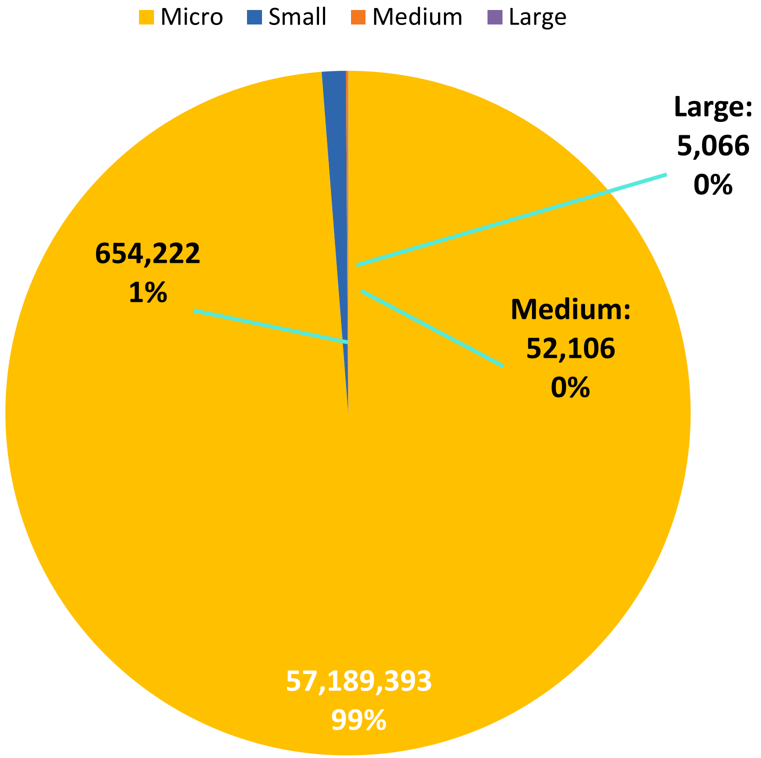
Source: De Kok et al (2013), based on Ayyagari et al.

SME share of GDP by country income groups (2003)



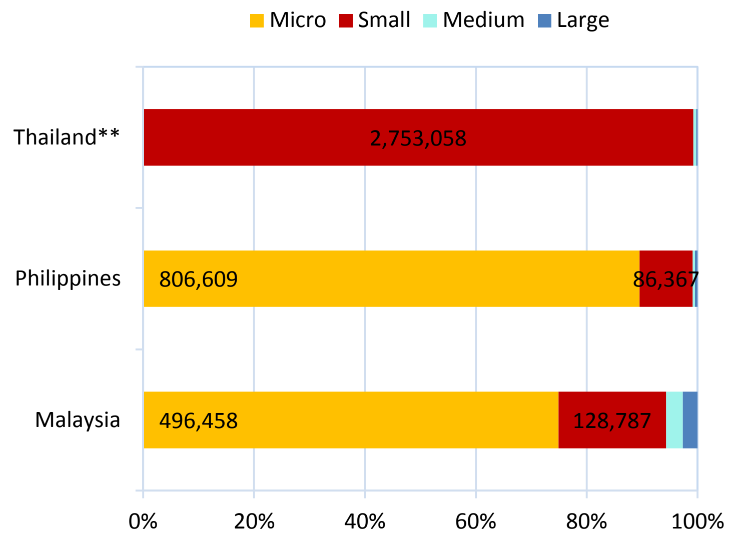
Source: Ayyagari et al. (2011)

Number of enterprises by firm size: Indonesia (2013)



Q The number of micro enterprises counted is very high. What is counted? All agricultural enterprises?

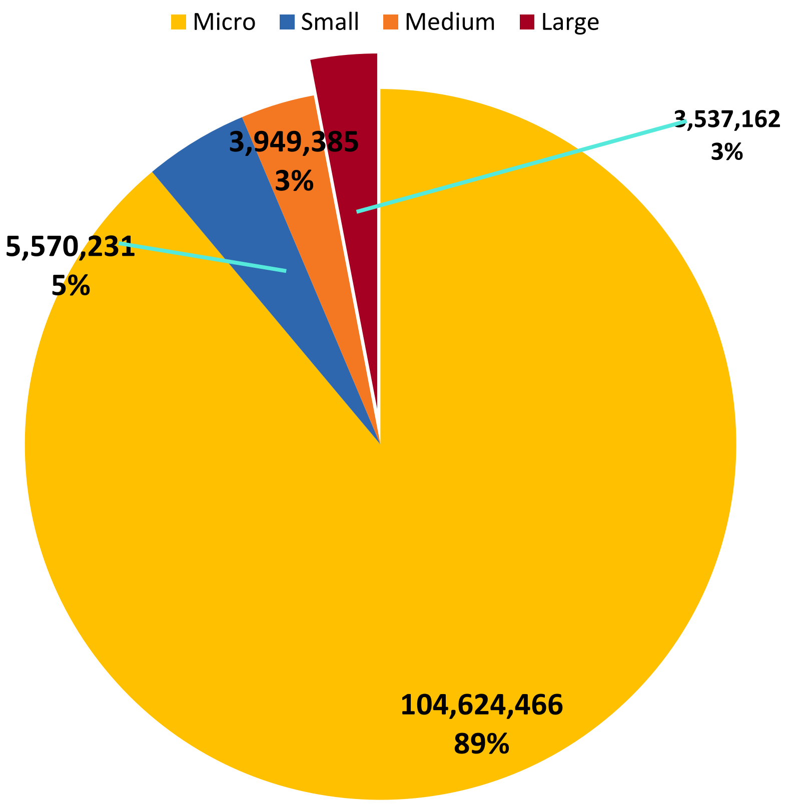
Number of enterprises by firm size: other ASEAN-5*



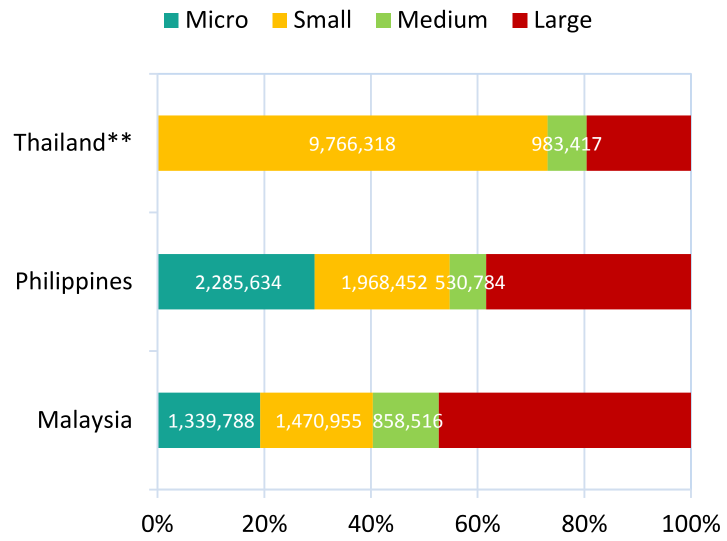
Notes:
* Excluding Vietnam
** Micro enterprises are not disaggregated in the data

Source: Ministry of Cooperatives and SMEs of Indonesia; Thailand (2015): Office of SME Promotion; Philippines (2015): Department of Trade & Industry; Malaysia (2010): Economic Census 2011

Employment share by firm size, Indonesia (2013)



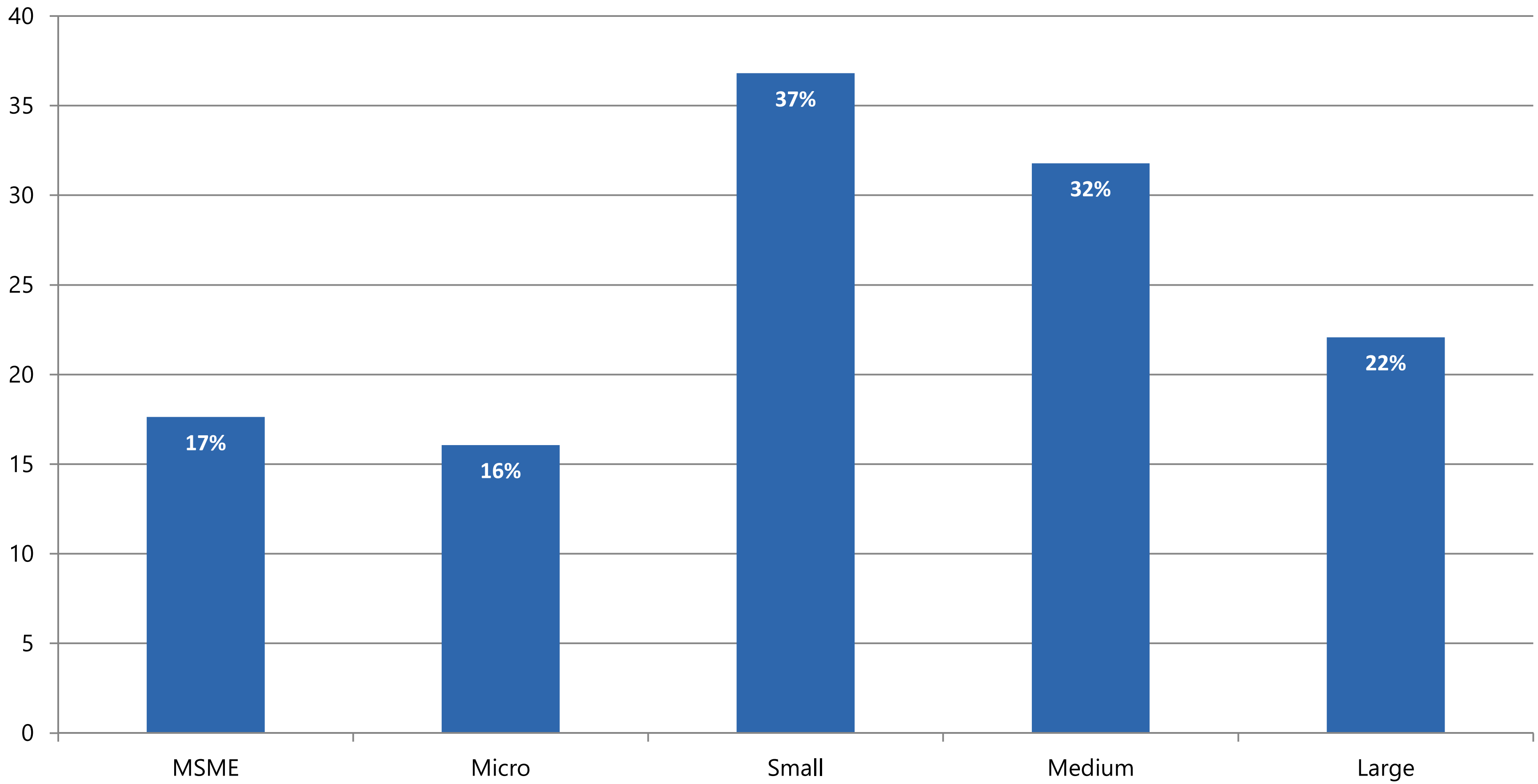
Employment share by firm size, other ASEAN-5*



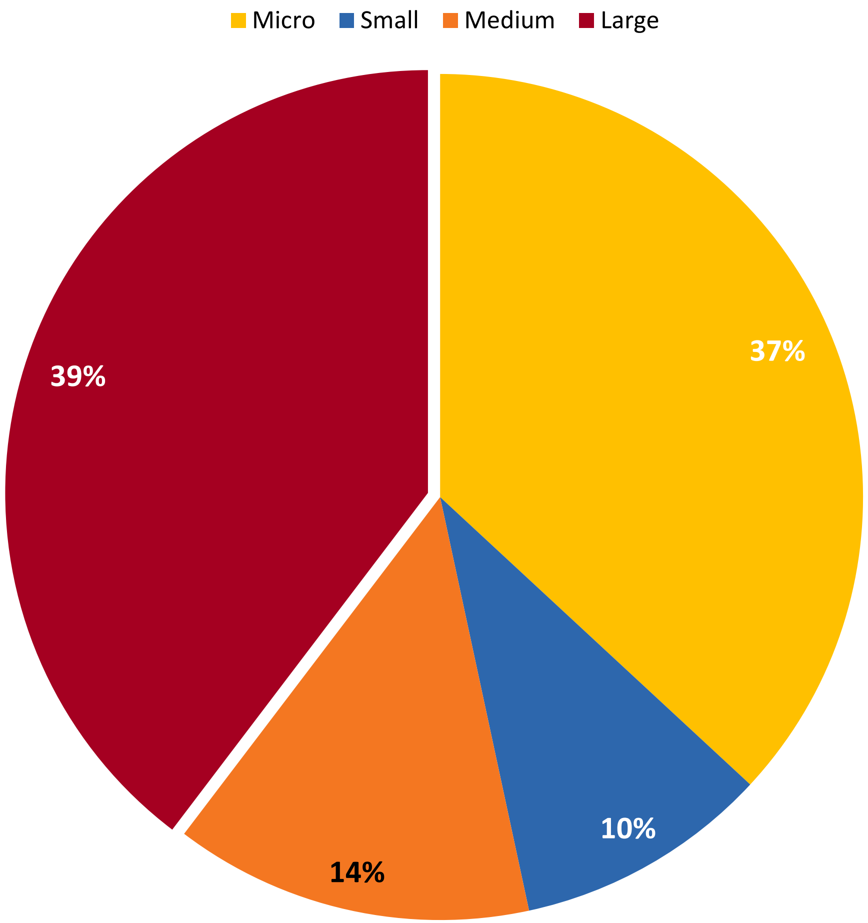
Notes:
* Excluding Vietnam
** Micro enterprises are not disaggregated in the data

Source: Ministry of Cooperatives and SMEs of Indonesia; Thailand (2015): Office of SME Promotion; Philippines (2015): Department of Trade & Industry; Malaysia (2010): Economic Census 2011

Employment 5-year growth rate, Indonesian MSMEs vs. large enterprises (2008-13)



Share of GDP by firm size, Indonesia (2013)



SMEs are essential for a competitive and efficient market:

- SMEs with high turnover and adaptability play a major role in removing regional and sector imbalances in the economy: they are a source of innovation and new products.
- Easy entry and exit of SMEs make economies more flexible and more competitive: it stimulates the reallocation of factors of production from less profitable to more profitable ventures.

SMEs are critical for poverty reduction

- Self employment is the only source of income for many poor people
- SMEs tend to employ poor and low-income workers and are sometimes the only source of employment in poor regions and rural areas
- SMEs pay taxes and fees to local and national authorities, which can be used to pay for inputs for development (infrastructure, education, health, etc.)

Outline

1. Rationale for SME policy: the economic and social importance of SMEs
2. SME definitions
3. Heterogeneity within the SME sector
4. Main constraints

Why have a definition for SMEs?

Elements to consider for definition

1. **Enterprise or establishment** as the unit of measure
   - Enterprise: an independent economic entity.
   - Establishment: a business unit belonging to an enterprise (a firm may have one or more establishments).
2. **Include employer enterprise or self-employed**
   - The OECD and EU definitions focus on firms with at least one paid employee.
   - Many countries consider an economic unit an enterprise even if it does not pay wages or salaries.

Elements to consider for definition (cont.)

3. Number of employees (paid) or workers (unpaid)

- The European Commission uses “Annual work units” (AWUs)
  - 1 full time employee = 1 AWU;
  - Part time employee = fraction of AWU.

4. Financial thresholds

- Balance sheet or turnover
- Need to correspond to the economic conditions of a country and are helpful when targeting policies for micro, small and medium sized firms

Elements to consider for definition (cont.)

5. The degree of autonomy or independence of a firm is of key importance:

- Full or partial ownership **by** another firm?
- Full or partial ownership **of** another firm?
- Full or partial ownership by a **venture capital firm**? By a **university**? By an **institutional investor**? By a **local authority**?

6. Sector of economic activity

- Capital/labour intensity in manufacturing and services firms

Which elements to consider depends on the objectives of the policies

SME Definitions: Indonesia*

Net assets (excl. land and buildings)		Total annual sales value
Rp500 million – Rp10 billion US$37,583 – US$751,654	**Medium**	Rp2.5 billion – Rp50 billion US$187,913 – US$3,758,270
Rp50 million – Rp500 million US$3,758 – US$37,583	**Small**	Rp300 million – Rp2.5 billion US$22,549 – US$187,913
Less than Rp50 million Less than US$3,758	**Micro**	Less than Rp300 million Less than US$22,549

Note: MSMEs should be a productive entity owned by an individual or an individual business unit; subsidiary firms or branch offices that are directly or indirectly owned and/or controlled by a larger firm are not counted. Foreign-owned and/or invested firms are also not regarded as MSMEs.
Conversion approximate – extracted 8/6/17 at 11.50.

Source: Law No.20/2008 on Micro, Small, and Medium-sized Enterprises

SME Definitions: East Asia and Pacific

Manufacturing			Services and other sectors	
Korea*	Malaysia		Malaysia	Korea**
Capital: ₩8 bn. or less (USD$ 33.8 mn.) Employees: Fewer than 300	Sales turnover: RM15 mn. ≤ RM50 mn. (US$ 3.5 mn. ≤ US$ 11.7 mn.) OR Employees: 75 to ≤ 200	**Medium**	Sales turnover: RM3 mn. ≤ RM20 mn. (US$ 702,897 ≤ US$ 4.7 mn.) OR Employees: 30 ≤ 75	Sales: ₩3bn. or less (US$26.7 mn.) Employees: Fewer than 300
Employees: Fewer than 50	Sales turnover: RM300,000 < RM15 mn. (US$ 70,289 < US$ 3.5 mn.) OR Employees: 5 to < 75	**Small**	Sales turnover: RM300,000 < RM3 mn. (US$ 70,289 < US$ 702,897) OR Employees: 5 < 30	Employees: Fewer than 10
Employees: Fewer than 10	Sales turnover: < RM300,000 (< US$ 70,289) OR Employees: < 5	**Micro**	Sales turnover: < RM300,000 (<US$ 70,289) OR Employees: < 5	Employees: Fewer than 5

Note: *Korea also delineates SME definition for mining, agriculture, waste management and real estate activities
Conversion approximate – extracted 8/6/17 at 11.50.

Source: Malaysia: SME Corp; Korea: 1996 Framework Act on Small and Medium Enterprises, SMBA)

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Heterogeneity within the SME sector mainly has to do with:

A) Size differences
B) Sectorial differences
C) Formality versus informality
D) Growth- versus livelihood orientation
E) All of the above

Heterogeneity: type of firm

Differentiation by:

Growth expectations

Gazelle

Extremely fast-growing SME

Management structure

Ant

Flat management structure

Gorilla

Hierarchical

Questions for group discussion:

- What different types of SMEs do you distinguish?
- Why are these distinctions relevant for policy design?

Opportunity vs. necessity-driven entrepreneurship

Literature commonly differentiates two forms of motivation to become entrepreneurs:

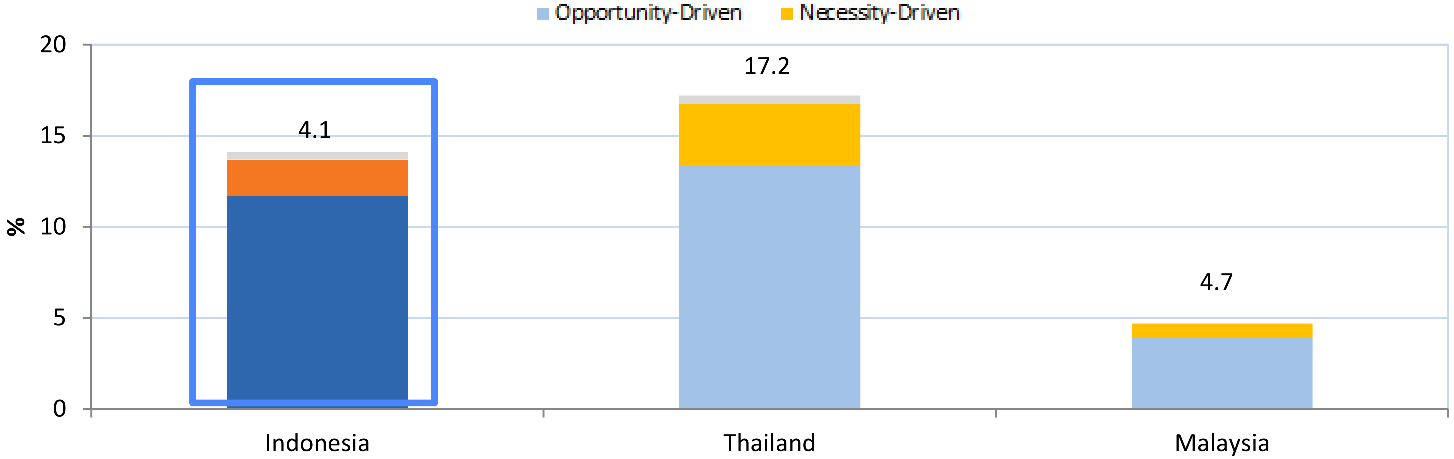
“*Necessity-driven*”: entrepreneurs **pushed** into entrepreneurship because other options for work are absent or unsatisfactory.

“*Opportunity-driven*”: entrepreneurs **pulled** into entrepreneurship out of choice

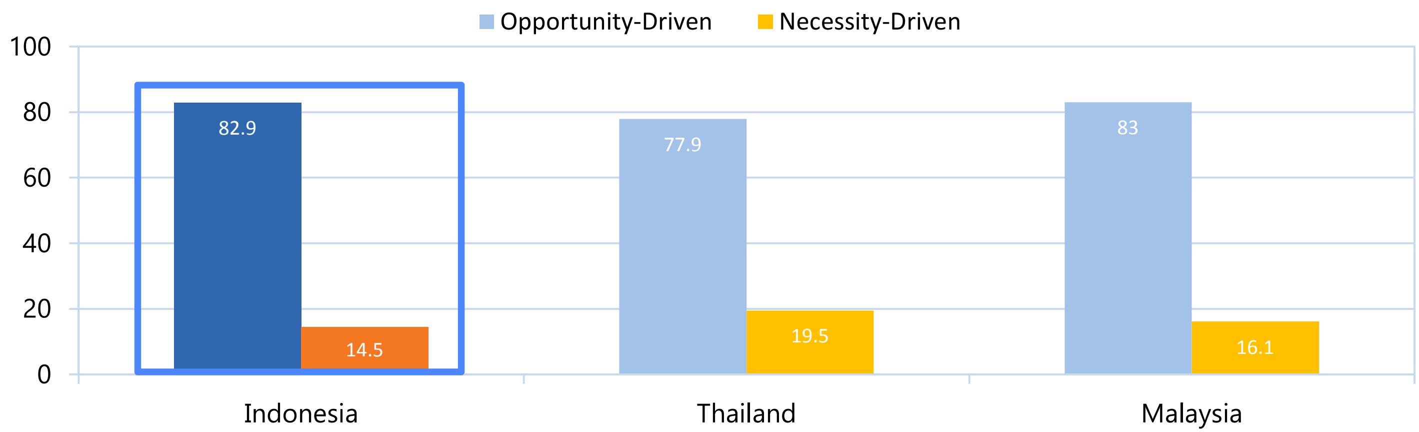
Type of entrepreneurship in Indonesia and peer countries

Heterogeneity: reasons for entrepreneurship

Total early-stage entrepreneurial activity* in 3 ASEAN-5 countries



Rate of necessity vs opportunity-driven entrepreneurship in 3 ASEAN-5 countries

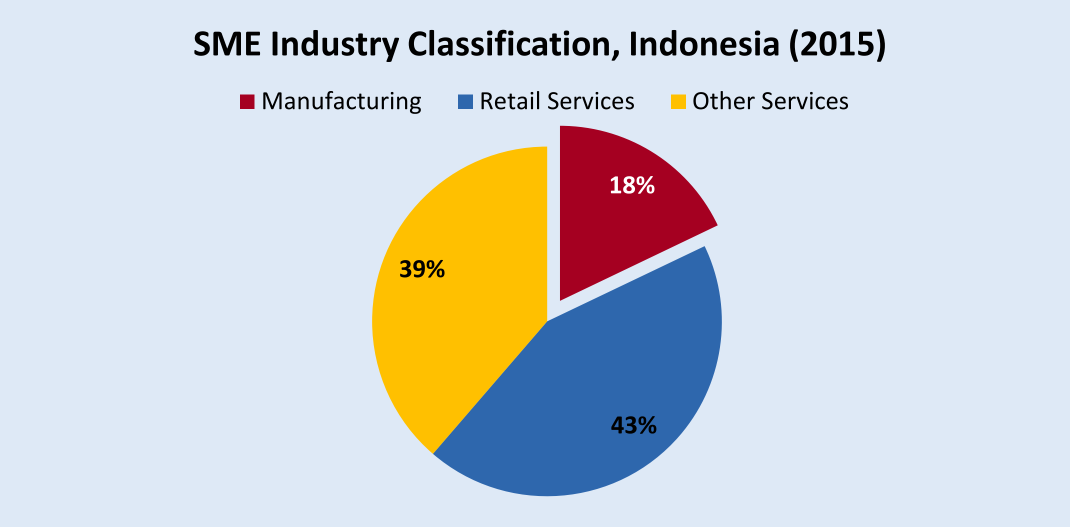


* Note: defined as share of 18-64 population who are either a nascent entrepreneur or owner-manager of a new business (3-42 months old)

Source: GEM Adult Population Survey (2016). The GEM APS is administered to be a representative national sample of at least 2000 respondents.

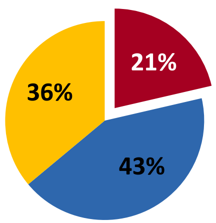
Countries have different patterns of SMEs

Heterogeneity: classification by industry

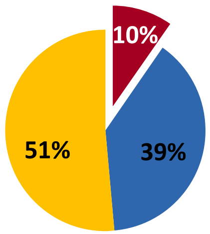


SME industry classifications in other ASEAN-5 countries

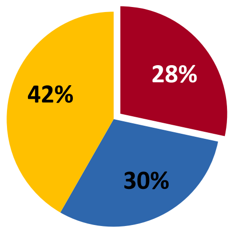
Philippines, 2015



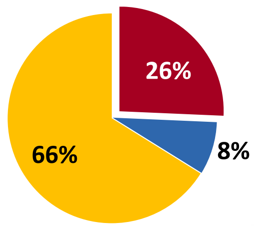
Malaysia, 2015



Thailand, 2016



Vietnam, 2015



Data Source: World Bank Enterprise Survey for different years.

A large share of SMEs forms part of the informal economy

Heterogeneity: formal vs. informal

Informal economy: "all economic activities that are, in law or practice, not covered or insufficiently covered by formal arrangements" (OECD)

In Indonesia, the ILO estimates that around 72.5% of the workforce* in the non-agricultural sector are informally employed (2009 data)

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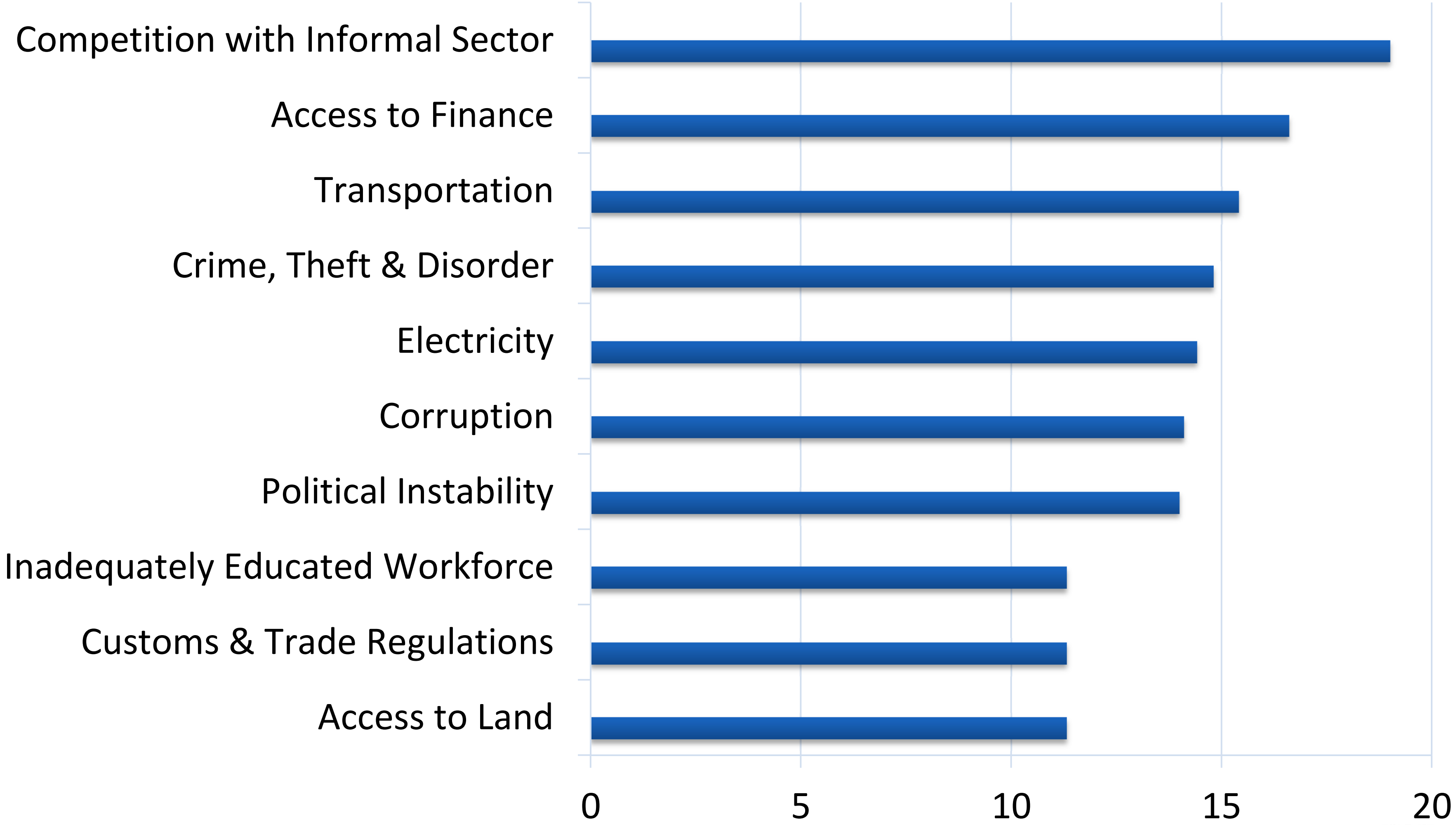
In my country, SMEs are

A) more productive than large enterprises

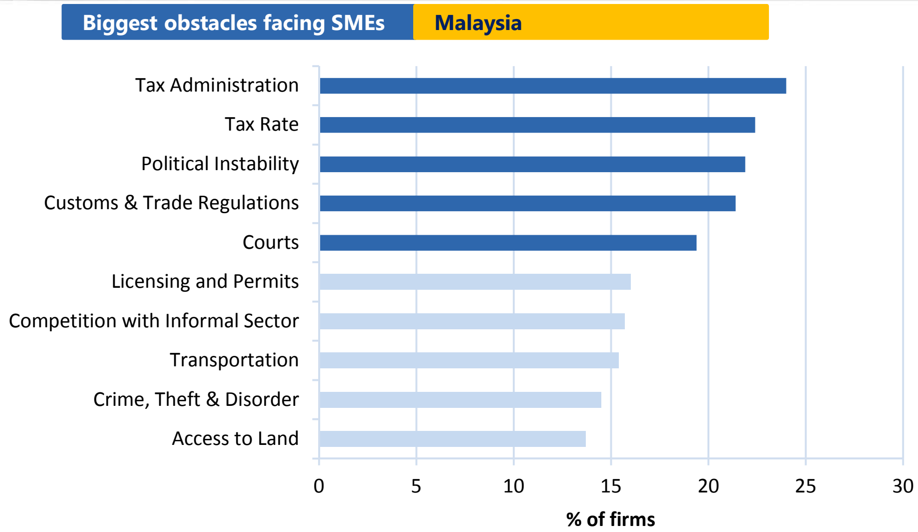
B) less productive than large enterprises

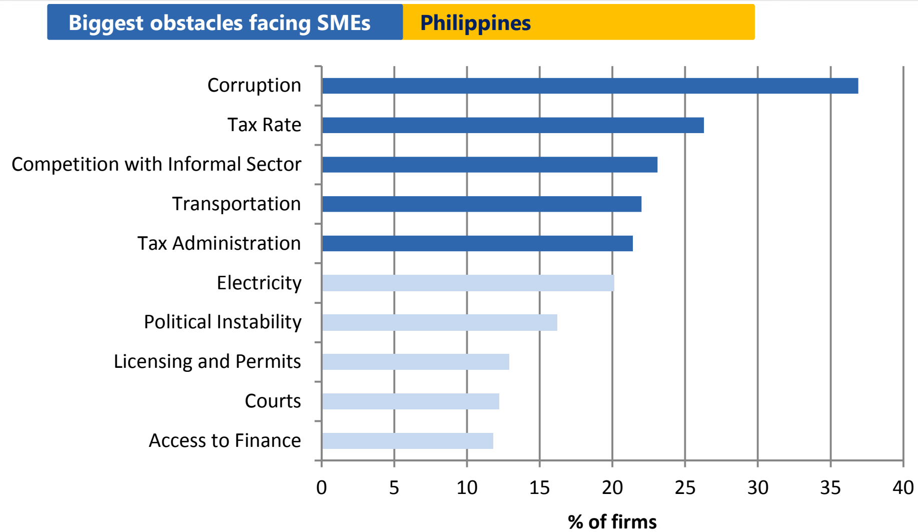
C) more or less equally productive as large enterprises

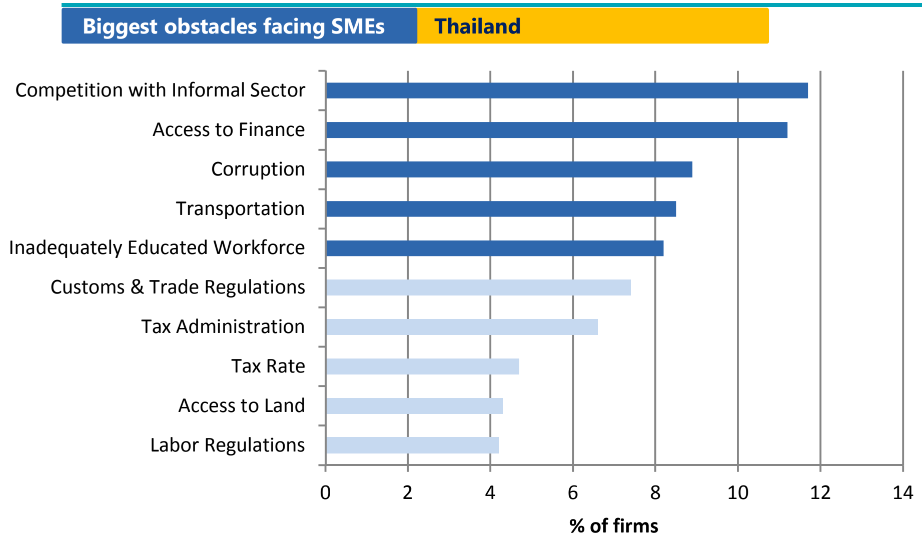
Top 10 business constraints facing Indonesian SMEs

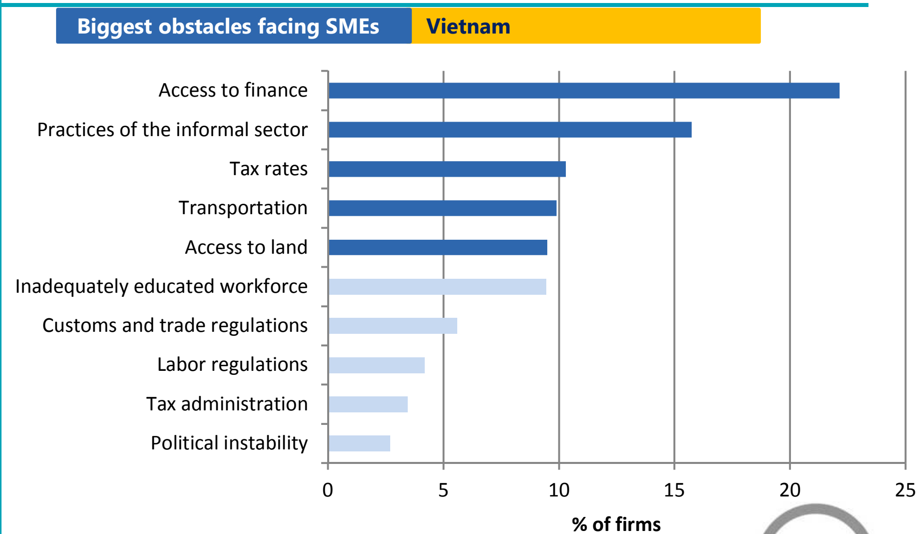


Main constraints









Source: World Bank Enterprise Surveys, all 2015, except Thailand (2016)

Constraints to growth

Constraints to the growth of SMEs

Market failures	Small size of SMEs	Limits in human capital
Restricted access to the credit market causes underinvestment for innovation, technology transfer and training	*Raise transaction costs and limit SME's ability to take advantage of opportunities*	*It impacts SME productivity and their ability to achieve their business objectives*

Thank you!

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