



Comparative analysis of development of SMEs in developed and developing countries

Viral M. Pandya

*Assistant Professor of Management, Gujarat National Law University,
Gandhinagar – India
Email: viralmpandya4@yahoo.com*

Abstract

The contribution of Small and Medium Enterprises (SMEs) in the development of world economy has been significant, both in terms of contribution to GDP and creation of employment opportunities. SMEs played a remarkable role in the development of several countries as they constitute a major part of the industrial activity both in developed or developing economies. For example, Taiwan and Japan are the countries having high economic growth guided by dynamic SMEs. Also the strongest growth of Columbia too coincides with fast SME growth. And many more countries can boast their growth by strong SMEs. The paper will primarily focus on the strategic importance of Small and Medium Enterprises (SMEs) and its role in the growth of economy, both in developed and developing countries. Also the parameters responsible for sustainable development of SMEs will be discussed in depth. Further the analysis of SMEs in context with developed and developing economies will be carried out as a comparative study supported by gap analysis.

INTRODUCTION

It is noted by Tambunan (2008) that Small and Medium Enterprises (SMEs) play a vital role in economic development, as they have been the main source of employment generation and output growth, both in developing as well as in developed countries. In developing countries, the roles of SMEs become more crucial as they have potential to improvement of income distribution, employment creation, poverty reduction and export growth. It also leads to the development of entrepreneurship, industry and the rural economy.

The term “SME” encompasses a broad spectrum of definitions. The definition varies from country to country. Generally these guidelines are based upon either headcount or sales or assets. For example as per the report of Dalberg (2011), Egypt defines SMEs as having more than 5 and fewer than 50 employees. Whereas Vietnam considers SMEs to have between 10 and 300 employees. However the Inter-American Development Bank defines SMEs as having a maximum of 100 employees and less than \$3 million in revenue. In Europe, they are defined as having manpower fewer than 250 employees and United States define them with employees less than 500 (Natarajan & Wyrick, 2011). As general guidelines, the World Bank defines SMEs as



those enterprises with a maximum of 300 employees, \$15 million in annual revenue, and \$15 million in assets.

Kachembere (2011) notes that SMEs are playing pivotal role in promoting grassroots economic growth and equitable sustainable development. It is not only the fact that high rates of economic growth contribute to economic and social development and poverty reduction. However, more it depends the quality of growth. Quality of growth includes the composition of growth, its spread and distribution and most importantly the degree of sustainability. Hence it becomes important to understand various factors responsible for quality growth through the route of SMEs.

Importance of SMEs

Recent studies show that economic growth of any country is closely linked with SME development. For example, as noted by Beck (2005) there is a robust, positive relationship between the relative size of the SME sector and economic growth. Also as noted by Ayyagari (2007), the contribution of formal SMEs in high – income countries amount to almost 50 percent of GDP on an average. It is also important to note that majority of employment generation is through the growth of SME sector only (Ardic, Mylenko & Saltane, 2011). Though it is observed that the role of SMEs is increasing significantly in respective national economies, SMEs are generally underrepresented in world trade (OECD, 2005). And measures are required to be taken to make its share significant.

SMEs in US and Japan

US and Japan are in the category of developed countries. Here the overview of SME sector has been given for both these countries. In US, SME enterprises are often called foundation enterprises, are the core of the country's industrial base (Piper, 1997). Looking statistically at the scenario of US SMEs, it is noted in the Commission's first report on SMEs (2010) that more than 99 percent of U.S. businesses are SMEs. And as per another report (2006), SMEs accounted for 99.9 percent of the 27 million employers and nonemployer nonfarm businesses in US. It is important to note that out of these total SMEs, service firms contribute to 88 percent (USITC, 2010). It is also important to note that during 2005-09, exporters of manufactured goods of US SMEs were larger and grew more rapidly in comparison with the domestic market.

Analyzing the composition of SMEs in US, it can be noted that that real estate and rental & leasing service is having highest share out of total SME sector. It contributes to 25 per cent of total. Similarly the whole sale trade contributes as a second largest segment (17 per cent) of total US SMEs (USITC, 2010).

Despite of comparatively good performance of SMEs, the share of US exports through SMEs is relatively small. There are several barriers that US SME sector faces,



especially in exports. The major barriers to export includes insufficient access to finance, high transportation costs, problems with domestic and foreign regulations, the small scale of SME production, burdensome foreign customs procedures, tariff and nontariff barriers, language & cultural differences, and lack of knowledge of foreign markets.

Similarly on the other end, in the case of Japanese economy, the contribution of small or medium-sized enterprises is more than 99% of total business. This has resulted in employment for majority of the population and accounted for a large proportion of economic output. However, most of the SMEs are not as well known as Japan's giants, but they play significant role as the backbone of the service sector and support as an essential part of the manufacturing and especially as strong export supply chain (Economist Intelligence Unit, 2010).

Analyzing statistically, on the contrary to US, Japan SME sector is having highest proportion is of retail business that is 20 per cent of total SME business. The second largest segment is of service industry, which contributes to 18 per cent of total SME share. Though Japan is also one of the developed countries, it also faces several problems like securing finance, finding right employees, lack of export orientation, and lack of innovation are the major issues for SME sector of Japan (Economist Intelligence Unit, 2010).

One can very well note from the brief analysis that despite of high SME growth, US and Japan are facing various issues of related to SME sector. Hence it becomes highly important for developing countries to tighten their efforts with more efforts.

SMEs in India & Indonesia

India and Indonesia are representing scenario of developing countries in SME sector. In India too, as other developing countries, the contribution of small and medium enterprises (SME) sector to manufacturing output, employment and exports of the country is quite significant. It is noted that in terms of value, the SME sector of India accounts for 45 per cent of the manufacturing output and 40 percent of the total exports. Also, the SME sector employs around 42 million people in over 13 million units throughout the country (Ghatak).

Similarly SMEs in Indonesia also play a significant role in economic and social development (Padmadinata, 2007). As noted by Indarti and Langenberg (2004), total number SMEs in Indonesia were 42.4 million in total and the contribution of the same was 56.7% of GDP, 19.4% of total export, and employed 79 millions of work force. However in 2006, total 48.93 million SMEs were established, with contribution of 53.28% of GDP & total 85.42 million peoples employed in the sector. Overall



contribution of these SMEs was 99.985 % of total enterprises in Indonesia (Padmadinata, 2007).

In nutshell, based on the brief analysis as above, it can be concluded that whether the country is developing or developed in nature, role of SME sector is very significant for overall health and growth of economy. Hence it becomes important for policy makers to analyze major factors contributing to the positive growth of the sector. Following section analyzes the most important elements responsible for sustainable development of SMEs in light of developed and developing countries.

Factors affecting SMEs' sustainability

As discussed, it is well evident that SMEs play a vital role in development of country. Importantly, it helps a lot to countries having low level of investment by offering many socio economic benefits (Gamage, 2003). However, the phenomenon of globalization and trade liberalization has created new opportunities as well as challenges for SMEs (OECD, 2004). These challenges faced by SMEs can be divided into two broad categories: (i) Organization Specific (ii) System specific. Among Organization specific challenges, the main problem SMEs are facing is the size. Due to small size series of problems are encountered. As per the study conducted by Hussain, Farooq and Akhtar (2011) it is noted that main constraints faced by small entrepreneurs are lack of finance, low human resource capabilities, and technological capabilities. Apart from this, poor management competences, lack of skilled manpower, deficiencies in marketing strategies, low efforts on R&D and lack of innovative technology are also prominent factors responsible for unstable growth of SMEs (Grimsholm & Poblete, 2010). As noted by Mahmood (2008), another important factor responsible for SMEs is lack of corporate governance structure in firm. It is noted that usually there is a lack of awareness among these enterprises regarding significance of corporate governance. And if awareness is there, there is a general aversion to adopting these practices because of high cost of implementation. On the other hand, looking at system specific factors hampering the growth of SMEs are competition, corruption, barriers to trade (Grimsholm & Poblete, 2010). Also role of government and specifically bureaucracies in the legal & regulatory framework are other important factors hindering the growth of SMEs (Aikaeli, 2007).

In light of the above discussion, the following section analyzes how developed countries have tried to overcome the above mentioned problems to strengthen SME sector. The scope of present paper is limited to study of organization specific factors only. This analysis will help policy makers of developing and other underdeveloped countries to formulate strategies accordingly.



Financial Aspect

As noted by Tung & Aycan (2008), insufficient access to financial resources and investment capital are significant barriers to growth for SMEs. These are the major challenges that have accounted for the high rates of failure among SMEs. It is worth noting that in developed country like US, in the first 3 years of operation only, 80% of ventures fail due to this reasons. However various initiatives have been initiated by policy makers in US to support and develop SMEs, such as the New Ventures Investor Forums. This forum brings together financial, government, and business communities to generate mechanisms to actively support SMEs. Also to ensure the sustainability of SMEs, business plan mentoring and management training for owners of SMEs are implemented. Based on above broad guidelines countries have formulated action plans but still there is a wide gap in upto the mark implementation of the same to overcome the issue of finance and can reduce the infant stage failure of small firms.

Human Resource Aspect

Success and failure of SMEs is not only related to only the financial aspect. It also depends on characteristics of the entrepreneur and many more key strategic factors (Menefee, Parnell, Powers & Ziemnowicz, 2006). As noted by Reynolds and Miller (1992) one of the key factors for fully developed new firm is the full time commitment of one or more individuals. More over as noted by Castanias & Helfat, 1991; Spender, 1993; Lei & Hitt, 1995; Conner & Prahalad, 1996, human resource factors form one of the most significant areas for success of a company.

As noted by Hornsby & Kuratko (1990), one of the biggest problems for small firms is recruiting, motivating, and retaining employees. It is concluded in a study of small companies by Chandler & McEvoy (2000) that there are positive effects of HR practices, which increased employee skills and motivation, and ultimately resulted in improving productivity. Also in one research study conducted at North Carolina (US), regarding effect of overall HR strategies including role of training and development in SME sector, it was found that there is a positive impact of professional HR practice on long term sustainability of small firms.

Today, in many large firms also, the HR dimensions have been overlooked as it does not contribute in quantifiable terms. Based upon above discussion, its worth noting that employees are backbone for firms irrespective of the size of firm. Hence healthy human resource practice will certainly contribute to sustainable development of SMEs.

Marketing Aspect

Another important factor contributing to success of SMEs is marketing. There is ample research evidence to prove that marketing plays a significant role in success



of SMEs. Marketing is also one of the biggest problems SMEs face in their business operations. In fact, it has been recognized as one of the most important business activities and essential element to the survival and growth of the enterprises (Stokes 2000b, Simpson & Taylor 2002). Gilmore (2001) reviews marketing limitations of SME as limited resources (such as financial, time and marketing knowledge), shortage of exclusive marketing techniques, and limitation in market influence. To overcome the disadvantages of SMEs in marketing, it is recommended (Kai, 2009) to form enterprise cluster to participate market competition and regional marketing. In comparison with a single small and medium-sized enterprise, there are several advantages of cluster marketing. As noted by Kai (2009) formation of enterprise cluster overcome the problems of slow information delivery, over high management cost and slow response to market demand. And as a result it enhances production efficiency and responsive ability of enterprises in the cluster. The significance of local clusters is evident from the experience of Italian SMEs (OECD, 2000). Clusters of firms in Italy have experienced considerably high levels of investment into process technologies, particularly in manufacturing automation and allied technologies.

Hence promoting cluster formation of SMEs with government / private efforts to overcome marketing problems is very important for sustainable SME sector.

Research & Development Aspect

Raymond and St-Pierre (2004) note that globalization has pressured SMEs to greater extent. Specifically in the manufacturing sector, SMEs are facing huge pressure to increase R&D, innovation and quality. It is observed that normally developed countries allocate about 3% of GDP to R&D activities (Grimsholm & Poblete, 2010). For developing countries it is essential for government to increase subsidies in terms of R&D support in order to gain competitive advantage over foreign competitors (OSMEP b, 2007; Morrison, 2006). It is well accepted fact in number of empirical studies relating R&D to firm size that large firms undertake considerably more R&D, however, more recent evidence suggests that SMEs play an important role in R&D activity also. Hence it is essential to integrate R&D strategies that will help considerably in innovation, quality improvement and product innovation.

Technological Aspect

Despite of globalization, significant section of developing countries' SMEs manages their business with traditional approach. This results in low level of productivity, low quality products and exploring to small and local market. It is noted that generally SMEs tend to have low productivity and as a result are weak in terms of competition. This is the result of using conventional technology and not having maximum utility of machinery. Due to limitation of funding it will not be possible for them to improve in technology (OSMEP, 2007 a). Developed countries are upgrading



their machinery time to time but it becomes difficult for SMEs of developing countries due to financing limitation mainly. Upgrading technology time to time and coping up with market demand will generate highly positive results for SMEs. There has to be efforts and incentives from policy makers to assist SMEs to adopt new technology.

Corporate Governance Aspect

As noted by Mahmood (2008), role of corporate governance is also essential factor for SMEs. For SMEs, corporate governance is all about the individual roles of the shareholders as owners and the managers. Also it is about establishing and following rules and procedures to manage and run the enterprise, setting up a system of checks and balances to stop abuses of authority and to ensure the integrity of financial statements.

FINDING AND CONCLUSION

It is evident from the paper that SMEs contribution is considerably high in economic development irrespective of the fact whether it is developed country or developing country. Not only financially subsidized promotion but the strategic implementation becomes very important for sustainable development of SME sector. Strategic implementation takes care of financial aspects, human resource, marketing, research and development, technology and corporate governance in SME sector. There are several lessons to be learned from developed countries' SME sector. We can conclude from the analysis that SME sector in developed countries is not only relying on credit availability or technological innovation. They have implemented all possible strategies for development of SMEs. Hence it is need of the hour for policy makers of developing and under developing countries to focus upon aspects as many as possible that helps SME sector to become real back bone of countries and fuel the economic growth.

REFERENCES

- Ardic, O., Mylenko, N., Saltane, V. (2011), "Small and Medium Enterprises A Cross-Country Analysis with a New Data Set", Policy Research Working Paper.
- Bouri, A., Breij, M., Diop, M., Kempner, R., Klinger, B., Stevenson, K. (2011), "Report on Support to SMEs in Developing Countries through Financial Intermediaries".
- Gamage, A. (2003), "Small and medium enterprise development in Sri Lanka: a review" .
- Ghatak, S. (n.d.), "Micro, Small and Medium Enterprises (MSMEs) in India: An Appraisal".
- Helen Reijonen, H. (2009), "Role and practices of marketing in SMEs", (Thesis, University of Joensuu).



- Lall, S. (2000), "Strengthening SMEs for international competitiveness", presented at The Egyptian Center for Economic Studies.
- Mahmood, S. (2008), "Corporate Governance and Business Ethics for SMEs in Developing Countries: Challenges and Way Forward".
- Menefee, M., Parnell, J., Powers, E., & Ziemnowicz, C. (2006), "The Role of Human Resources in the Success of New Businesses", *Southern Business Review*.
- OECD workshop, (2000), "Enhancing the competitiveness of SMEs through innovation, Conference for Ministers responsible for SMEs and Industry Ministers".
- OECD conference, (2004), "Promoting entrepreneurship and innovative SMEs in a global economy: towards a more responsible and inclusive globalization".
- OECD Conference, (2007), "Enhancing the Role of SMEs in Global Value Chains".
- Phukan, S. & Dhillon, G. (2007), "Ethics and information technology use: a survey of US based SMEs", *Journal of Information Management & Computer Security - IMCS*, vol. 8, no. 5.
- Tambunan, T. (2008), "Development of SME in ASEAN with Reference to Indonesia and Thailand", *Chulalongkorn Journal of Economics* 20 (1).
- The Economist, (2010), "SMEs in Japan A new growth driver?", Economist Intelligence Unit.
- Tung, R. & Aycan, Z. (2008), "Key success factors and indigenous management practices in SMEs in emerging economies", *Journal of World Business*.
- Kachembere, J. (2011), "SMEs hold key to economic growth", available at <http://www.thestandard.co.zw/business/32203-smes-hold-key-to-economic-growth.html> (accessed 4 July 2012).
- Padmadinata, U. (2007), "The Importance of SME Innovation Center in Indonesia SME condition in Indonesia", available at http://www.apec-smeic.org/newsletter/newsletter_read.jsp?SEQ=387 (accessed 20 June 2011).