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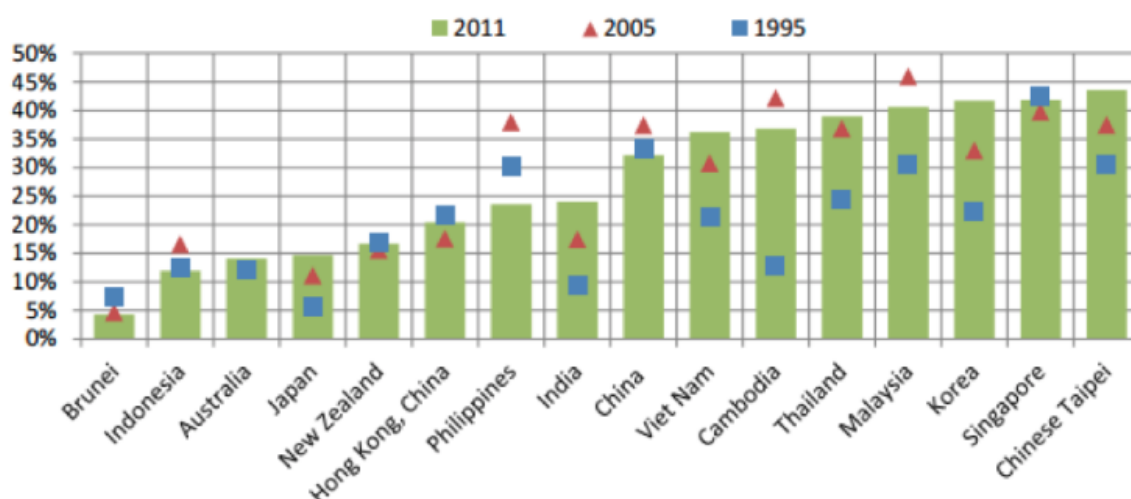
The participation of small business in Asian global value chains

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The international division of labour has opened up opportunities for firms, increasingly including small and medium-size enterprises (SMEs), to use relative cost advantages to specialise in different tasks in production processes. A country no longer needs to develop an advantage in the entire series of production activities to produce a final product and service. This offers opportunities for developing economies and their SMEs to add value in different stages of production in different locations, including different countries.

A number of countries in Asia and the Pacific are major participants in global value chains (GVCs). As shown in Figure 1, in 2011 the PRC, Viet Nam, Cambodia, Thailand, Malaysia, Korea, Singapore and Chinese Taipei had over 30% of foreign content in their exports; other economies reported less than 25%.

Figure 1. Foreign value-added share of gross exports¹





Recent statistical advances now allow international trade to be measured by 'value-added', as opposed to gross value which involves frequent double counting for international value chains. Measuring trade in value-added accounts for the share of services in total that enter value chains directly in manufacturing processes, in pre- or post-manufacturing stages, in post-retail services, and in recycling². This measurement has revealed that over 50% of world trade is in intermediate goods (excluding oil and fuel), and 75% to 80% of world trade is value-added³. SME participation also becomes apparent once indirect value-add that is embedded in manufactured exports is accounted for.

An embedded service is a service linked and related to the sale of merchandise or to the sale of another service; for example, after-sales support, technical assistance, training and finance.⁴ It can be a valuable component of the manufacturer's revenue and differentiate their product. This trend is already widespread in advanced economies and is becoming increasingly important in East and Southeast Asia.⁵ Further, businesses rely on services such as modern communications, banking and insurance, lawyers and accountants to run their business. All these services are said to be 'embodied' in the value of the final output of the business.⁶

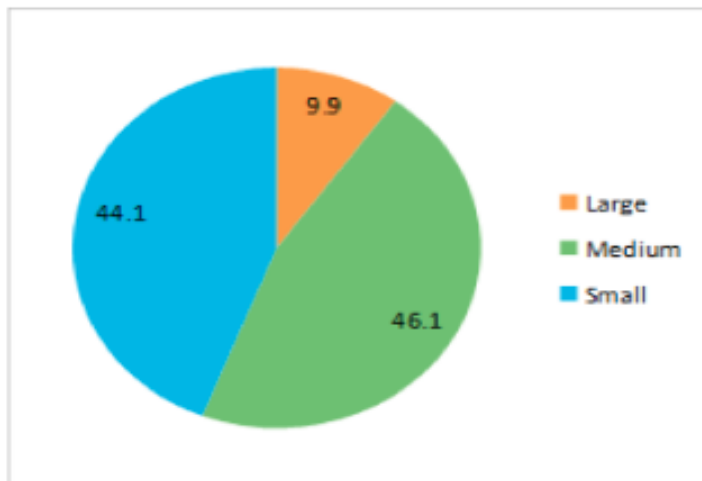
The traditional approach to compiling statistics on trade in services, using balance of payments data, ignores the fact many services are embedded or embodied in the goods and people that move across international borders.⁷

Smaller and developing economies tend to have higher shares of foreign value-add embodied in their exports; larger and more developed economies have a wider variety of domestically sourced intermediate goods available and are therefore less reliant on foreign imports of intermediates. Countries with substantial natural resources, such as Australia and PNG have lower ratios of foreign value-added in exports as mining activities require fewer intermediate goods in the production process⁸. In Australia, as in most economies, it is large firms that contribute by far the highest proportion to total exports (95.1%), as shown below in Figure 2. Less well known is that typically over 90% of exporting firms are SMEs.

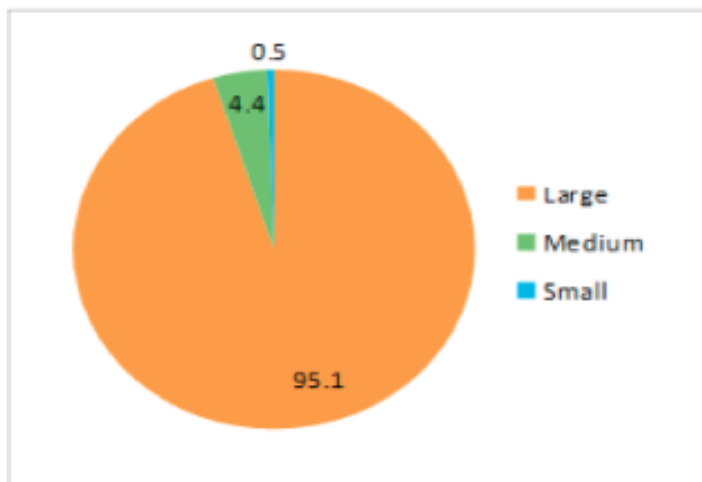


Figure 2: Australian small business exports in 2013-2014⁹

Contribution to number of exporting firms (%)



Contribution to value of total exports (%)



The valuable input of SMEs

The rise of clients demanding 'just-in-time' delivery and more frequent shipments of smaller quantities has enabled SMEs to fill niches derived from time constraints which prevent them being disadvantaged by scale. Fewer overheads and more flexibility means that exports and their coordination can be produced quickly, an advantage for SMEs. They also tend to be more geographically dispersed than larger firms and in their breadth of scope can help develop a broad-based industrial sector that can coordinate to contribute to innovative research and development that is reactive to industry needs. This can take the shape of industry clusters which have increased linkage opportunities for research and mentoring.



Linkages between large and small companies have a high impact on productivity, cost reduction and innovation. Value chain diversity that comes from including SMEs promotes inclusion and diversifies risk. Larger businesses who work within this model often have high corporate social responsibility programs which help them locate roles for SMEs in the GVCs from which both parties can benefit. Larger firms can leverage their capabilities to reduce compliance burdens and provide inclusive finance, research and development capacity, basic infrastructure, certification, and accreditation to assist SMEs' participation, which in turn creates value for the larger enterprises.

How ICT will change existing GVCs

Asia's dominance in GVC innovation has been driven by technological improvements that have benefited both large companies and SMEs with access to funding, mobile platforms, e-commerce opportunities and innovation.

In the current wave of globalisation, information and communications technology (ICT) is an increasingly productive complement to physical infrastructure in reducing the costs of locating suppliers, negotiating contracts, monitoring their implementation, and tracking the location and status of shipments. Communication and organisational technologies lower the marginal cost of coordination, making it easier to slice up production processes into more stages and disperse stages internationally¹⁰. This fosters a trend in Asia toward more vertical specialization, offshoring, foreign direct investment and intra-industry trade.

Modern supply chains integrate activities faster by systematic information sharing from internal and external sources.¹¹ Firms can now collect relevant information at each node along their networks. This rich data can be methodically analysed to optimise demand, supply, inventory, costs and service levels, creating both challenges and opportunities for SMEs. Technological advances will continue to change the role of SMEs in GVCs.

The role of the public sector

To help regulators in the region create a better business environment so local firms can readily source GVC opportunities, a *Public-Private Dialogue on Improving the Investment Climate for Global Value Chain Development* was convened in Malaysia in April 2016. This dialogue was run by the Australian APEC Study Centre from RMIT University under the sponsorship of Australia's Department of Foreign Affairs and Trade¹².



The public sector has a critical role to play in improving the investment climate for GVC development in general, and in addressing aspects of domestic market efficiency. Expanded access to financing and information about marketing opportunities helps SMEs find niches where they can contribute to GVCs. The public sector can ensure competition, such as in areas of cabotage laws and in preventing monopolies and cartelisation.

Public sector support can also take the form of supporting industrial parks, funding necessary infrastructure, and providing vocational training with curriculum which is responsive to the needs of companies who wish to employ the graduates. Public programs for supplier identification, vendor development, and certification can be conducted in a transparent, competitive fashion, again with selection criteria laid out by firms who will provide purchase contracts to those that qualify¹³.

Developing economies can foster the participation of SMEs in GVCs through trade liberalisation and facilitation, openness to foreign investment and protection of intellectual property rights. This may involve capacity building activities for government officials involved in managing GVC development. In the long run, policies that support the development of a highly skilled labour force and high quality infrastructure and logistics services will foster trade and investment, and GVC participation by SMEs. Learning from the experiences of others can contribute to new concepts and help avoid mistakes in the future. Regional cooperation fora such as APEC can also assist in this process.

¹ Source: OECD/WTO (2013), OECD-WTO: Statistics on Trade in Value Added, (database); Authors calculations, (accessed March 2016)

² *Mapping and Measuring Trade in Tasks in Global Supply Chains*. Presentation prepared for Workshop on Global Supply Chains and Trade in Value Added, 13-14 December 2013, Hong-Kong by Hubert Escaith of the World Trade Organisation. Available at: file:///ntapprdfs01n01.rmit.internal/el9/E01149/Ch9-Escaith-final-HE%20Mapping%20Supply%20Chains%20ADB%20HK%20Dec_2013.pdf

³ *Mapping and Measuring Trade in Tasks in Global Supply Chains*. Presentation prepared for Workshop on Global Supply Chains and Trade in Value Added, 13-14 December 2013, Hong-Kong by Hubert Escaith of the World Trade Organisation. Available at: file:///ntapprdfs01n01.rmit.internal/el9/E01149/Ch9-Escaith-final-HE%20Mapping%20Supply%20Chains%20ADB%20HK%20Dec_2013.pdf

⁴ Thomas Westcott (2011) *The importance of embodied services for trade and investment in the APEC region: Issues, conclusions and next steps*. Prepared for the Regional Forum on services trade policy: "Recognising the importance of open services to manufacturing trade and investment in the APEC region". Available at: <http://www.apec.org.au/docs/05-2012%20embodied%20services/05-2012%20Discussion%20Paper%20.pdf>



⁵ Thomas Westcott (2011) *The importance of embodied services for trade and investment in the APEC region: Issues, conclusions and next steps*. Prepared for the Regional Forum on services trade policy: "Recognising the importance of open services to manufacturing trade and investment in the APEC region". Available at: <http://www.apec.org.au/docs/05-2012%20embodied%20services/05-2012%20Discussion%20Paper%20.pdf>

⁶ Thomas Westcott (2011) *The importance of embodied services for trade and investment in the APEC region: Issues, conclusions and next steps*. Prepared for the Regional Forum on services trade policy: "Recognising the importance of open services to manufacturing trade and investment in the APEC region". Available at: <http://www.apec.org.au/docs/05-2012%20embodied%20services/05-2012%20Discussion%20Paper%20.pdf>

⁷ Thomas Westcott (2011) *The importance of embodied services for trade and investment in the APEC region: Issues, conclusions and next steps*. Prepared for the Regional Forum on services trade policy: "Recognising the importance of open services to manufacturing trade and investment in the APEC region". Available at: <http://www.apec.org.au/docs/05-2012%20embodied%20services/05-2012%20Discussion%20Paper%20.pdf>

⁸ OECD (2013). *Interconnected Economies: Benefiting from Global Value Chains*, OECD Publishing. Available at: <http://dx.doi.org/10.1787/9789264189560-en>

⁹ An Australian Bureau of Statistics, Table 5.1 *Characteristics of Australian Exporters, 2013–14*, Cat. No. 5368.0.55.006. Available at: <http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/5368.0.55.0062014-15?OpenDocument>

¹⁰ Baldwin R. & Forslid R. (2014). The development and future of factory Asia. In B. Ferrarini & D. Hummels (Eds.), *Asia and Global Production Networks* (pp. 338-368). Cheltenham: Edward Elgar.

¹¹ Baldwin R. & Forslid R. (2014). The development and future of factory Asia. In B. Ferrarini & D. Hummels (Eds.), *Asia and Global Production Networks* (pp. 338-368). Cheltenham: Edward Elgar.

¹² A background paper for the Dialogue was prepared by the Australian APEC Study Centre at RMIT University and is available at: <http://mams.rmit.edu.au/klnk5ekl756a1.pdf>. This article is largely based on that paper and the discussions during the Dialogue.

¹³ http://e15initiative.org/wp-content/uploads/2015/01/E15_NewIndustrialPolicy_Moran_FINAL.pdf