Enhancing SME Participation in Global Value Chain

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• Global Value Chains (GVCs)
• Rationale for policy emphasis
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• SME engagement in GVCs: The Case of Penang Export Hub, Malaysia
Global Value Chains (GVCs)

Value chain
The full range of activity involved in bringing a product from its inception (the design stage) to its final consumer

Global value chain (GVC)
Value chain that is divided among multiple firms that spread across geographic boundaries
• Understanding of the structures and dynamics of GVCs is vital for crafting policies to promote SME engagement

• GVCs are not homogenous (contrary to the way the terms is widely used in the policy debate)

• Useful starting point for understanding the heterogeneity is the two-way classification:
  - Buyer-driven GVCs
  - Producer-drive GVCs
Buyer-driven GVCs

‘Lead firm’ in the value chain is the international buyer (a large retailer or a brand manufactures).

Common in diffused-technology products such as garments, footwear, toys and variety of handicrafts.
Producer-driven GVCs

‘Lead firm’ is the multinational manufacturing firm

Common in vertically integrated global industries such as electronics, electrical goods, automobiles, scientific and medical devices

Driven by ‘global production sharing’

A more suitable term would be ‘global production networks’ (GPN)
Rationale for policy emphasis

- GVCs have become much more prevalent and elaborate over the past few decades, as an integral facet of economic globalisation. (internationalisation of the value chain)

- The policy emphasis on joining GVCs is therefore a ‘natural’ response as part of policy transition from a inward-oriented to an outward-oriented development strategy
• What is the rationale for the emphasis on promoting SMEs’ engagement in GVCs?
  - Better employment and equity outcome of SME operations compared to large firms [greater capacity reduce poverty and inequality through labour absorption (mostly unsullied labour)]
  - Provide a ‘seedbed’ for future large national companies
  - Foster industrial linkages
  - Provide a foundation for the national R&D effort *

* This point is based on the experience of mature industrialised countries; whether it is applicable to developing countries is debatable
Policy options

A two-pronged approach:

- Policies to offset the disadvantages imposed upon SMEs by the prevailing trade and industry policy regime

- ‘SME-specific’ policies: policies specifically designed to remove impediments to their operations resulting from ‘natural’ market imperfections
  - SME-specific policies are effective only if they are part of an overall GVC-friendly policy package
  - These policies need to be crafted to suit the structural peculiarities of particular GVC
SME engagement in producer-driven GVCs: The Case of Penang Export Hub, Malaysia

Based on

and
my ongoing research
Penang

A state of Malaysia, located on the northeast coast of Malaysian Peninsula (See Map)

Area
Penang Island: 293 Sq. KM
Seberang Perai: 753

Population 1.52 million.

Resource base:
The least natural-resourced endowed state among the 13 Malaysia states,
Evolution of the export hub

- **1971-1975**
  The arrival of ‘Eight Samurai’ (National Semiconductor (NS), Intel, AMD, Osrum, Hewlett Packard, Bosch, Hitachi, Clarion) to set up plants for component assembly

- From the late 1980s, production base diversified with the entry of MNEs in consumer electronics and consumer peripheral industries
• Emergence of ancillary (supporting) industries
  - initially foreign vendors
  - Then, local vendors (some local firms became MNEs)

• By the mid-1980s an export cluster with a sizeable number of branch plants of electronics and electrical MNEs and a network of local SMEs was well established
Ownership stature of manufacturing firms in Penang, 2008

<table>
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<th>Firms (%)</th>
<th>Employment (%)</th>
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<td>Foreign-owned</td>
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<td>72.3</td>
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<td>SMEs</td>
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<td>(Number)</td>
<td>(1193)</td>
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Policies

A comprehensive policy package for promoting export oriented industrialization, with a specific focus on linking Penang to global electronics value chain

Overall policy package to attract MNE:

• Free Trade Zones
• Infrastructure development
• A ‘land bank’, which served the dual purposes of gaining budgetary autonomy and facilitating infrastructure development
• Investment promotion
Policies to foster GVC-SME links

- Institutional support for MNE affiliates to forge subcontracting relations with local firms, including launching vendor development programs
- Industrial estates (side by side with EPZs)
- Penang Skill Development Centre: Vocational training programs with a focus on vendor development
- Equal treatment of SMEs and MNE affiliate in providing duty-free access to imported inputs and other tax concessions
- Avoiding rescuing ‘failed firms’ (policy makers beloved in ‘creative destruction’)