Impact of the Global Financial Crisis on SMEs

What happens on SMEs
through the global financial crisis?

ASIAN PRODUCTIVITY ORGANIZATION

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Impact of the Global Crisis on SMEs

Overview

What happens to SMEs during a global financial crisis? The Research Question

How have small and medium enterprises (SMEs) in Asia dealt with the global financial crisis? This is the main research question of this book. In general, SMEs are considered the basis of a national economy. Additionally, SMEs play various important roles and are one of the key drivers of innovation in society. Therefore, many economists have focused on SMEs as one of the most important research topics in their field of study.

Management of SMEs is much more vulnerable than that of large companies because their resources, such as human resources, are frequently restricted. This is especially prevalent in SMEs in the manufacturing industry as they are often subcontractors and their sales rely on a few important customers, such as multinational corporations (MNCs), in terms of business relations. Hence, economic changes have a large influence on SMEs, and they often need government support to help maintain business continuity. This is why many politicians have dealt with SMEs as an important issue on their political agendas.

Since the financial crisis in the USA and the UK, which included the subprime loan crisis in 2007 and the Lehman shock in 2008, a global financial crisis has occurred and has negatively affected Asian countries and their economies. Thus far, we have mainly studied and monitored the influences of this crisis on large MNCs such as Toyota, Samsung, Summit group, TATA, etc. However, the influences of the global financial crisis on SMEs still remains poorly understood. In actuality, we do not know what happens to SMEs in specific Asian countries as a result of the global financial crisis. However, Asia is consistently considered to be a leader in the world economy as "The Workshop of the World" in the manufacturing industry with high growth rates. Thus, we have decided to tackle this puzzle as the research topic in this APO project.

Experts from APO member economies gathered in Tainan, the Republic of China (ROC) in August 2009 to attempt to understand and analyze how SMEs in each Asian country have dealt with the global financial crisis, and attempted to suggest suitable government policy recommendations for curbing a potential crisis in the future. Members came from the following countries: ROC, India, Indonesia, Japan, the Republic of Korea (ROK), Malaysia, the Philippines, Thailand, and Vietnam. The industrial structures and positions of SMEs in each country are quite different from one another. For example, in Japan, ROC, and ROK, machinery industries, such as the production of automobiles or electronics, lead the economy. In contrast, agriculture is the main industry in several other APO member countries. Additionally, the contributions made by SMEs in the economy also differ between the various countries. For instance, because of industrial and historical features in Japan, there are a large number of SMEs that make up the bulk of the supporting industry within the country. These SMEs play important roles as the subcontractors to supply parts to assemblers, especially in the automobile industry. Therefore, it can be concluded that we must understand our own economic and industrial features to observe the influences of the global financial crisis on SMEs. Through the above discussion on our research question, we chose five countries, India, Japan, ROK, the Philippines, and Thailand, to examine in depth for this research project.

The points of issue in this book are as follows:

1) Country Situation

First, we will show and recognize the various economic changes that the above countries went through before and after the global financial crisis in statistical terms. Before the global financial crisis, many of the Asian countries and their companies enjoyed a booming economy that depended on the expansion of the North American market. For example, the rates of real GDP growth in 2006 to 2007 are 9.7% in India, 2.3% in Japan, 5.11% in ROK, and 7.1% in the Philippines. However, the global financial crisis strongly hit their economic drivers and made all of their governments and companies miss out on the booming economy. In fact, India and the Philippines recorded about a 10% growth rate, but they also faced the repercussions of economic depression. To analyze and compare the influences of the global financial crisis on SMEs, we have to know the economic changes for each country in detail.

2) Overview and Sector Level Analyses of SMEs

Second, we will attempt to define the role of SMEs in each country. Usually, SMEs are defined by their size, (i.e., by the number of employees and the amount of capital). For instance, in Japan and ROK, the manufacturing companies that have less than 300 employees are defined as SMEs. However, in the Philippines and Thailand the manufacturers that have less than 200 employees are SMEs. In other words, what we define as SMEs is clearly different in each country. Moreover, the economic contributions of SMEs in each country are also included in this book. We can easily predict that there is a large difference of the economic position of SMEs between high-tech countries, such as Japan, and the agricultural countries, such as the Philippines. To overcome this problem and to make comparisons more easily, we have completed sector level analysis of SMEs.

3) Case Study

Third, we will focus on several case studies of SMEs that dealt well with the global financial crisis. It can be concluded that the behavior of SMEs to combat the global financial crisis are distinctly different. In general, the management of SMEs depends on the CEO's personality and experience much more strongly than large companies that tend to be more bureaucratic. Some CEOs view the crisis as a good opportunity to improve their facilities or create new business relations with new customers because other companies remain pessimistic. Hence, in detail, we must focus on some case studies to understand and analyze how SMEs have dealt with the global financial crisis. If we conclude what happened to SMEs through the global financial crisis with statistics, we may not recognize the current situation of SMEs in each country. SMEs are seen as not only losers but also Pollyannas that can find quality business chances against the global financial crisis.

4) Government SME Policy against the Crisis and Policy Recommendation

As we mentioned, government policy and support are quite important for SMEs because many of them are usually vulnerable to economic changes. Therefore, fourth, we will reveal the government policy in each country that is related to the global financial crisis, such as monetary policy, fiscal policy, and trade policy. Considering those policies, we attempt to make policy recommendations for each country. For example, domestically, we suggest that governments should promote SMEs to enter the new industries for the low carbon society. In addition, governments should encourage SMEs in each country to be more international in order to cooperate and form international networks with each other from the various viewpoints such as the promotion of international trade. In other words, we can see that SMEs have the ability to absorb the risks of the global financial crisis because of the global network in Asia.

Through our discussions on this research project, we become able to understand the current situation of SMEs in Asian countries. Sometimes, it is difficult to recognize the real situation of SMEs even in your own country because there are a large number of SMEs. Thus, it is natural that borders and language barriers have made our views of SMEs in other countries rather unclear. We can insist that because of a lack of communication and relationships between Asian countries, the risk of the global financial crisis is maximized. If our SMEs have a global network and can collaborate with each other, it becomes much easier for us to find solutions to minimize and overcome the global financial crisis. This realization is the most important lesson to be gleaned from this research project.

India

By Anil Bhardwaj
Federation of Indian Micro and Small & Medium Enterprises (FISME)

1. INTRODUCTION

Since breaking its self-imposed isolation from world markets in 1991, the Indian economy has witnessed a period of sustained growth of greater than 6%. In 2003–04 and 2007–08, its annual growth rates reached an even higher orbit, marking the second highest growth momentum in the world with an average of 8.8%, next only to the People's Republic of China.[1] Per capita GDP growth also doubled to 7.3% (from 3.7% in 1980–91),[2] increasing per capita consumption and further fueling economic expansion. Growth of this magnitude catapulted India to become the world's twelfth largest economy in current prices, with a GDP of over USD1 trillion, and the fourth largest economy when measured by Purchasing Power Parity (PPP).[3]

2. COUNTRY SITUATION

Small and Medium Enterprises (SMEs) have played a pivotal role in this growth. With over 26 million business units contributing 40% of the country's industrial production and 35% of its direct exports, the SME sector consistently outperformed average industrial growth by over two percentage points during the 2003–08 period.[4] The growth was fairly broad-based for this heterogeneous sector, which produces over 8,000 products.

Sustained high economic growth has raised expectations of even higher growth. However, the growth momentum started losing steam in 2007–08 and recorded a sharp decline after the onslaught of the global financial crisis in September 2008.

Pre-Crisis State of Affairs

It is important to briefly review the state of affairs of the Indian economy prior to September 2008. On the external front, the growth period from 2003–04 to 2007–08 was characterized by a rapid expansion of trade (both exports and imports), a phenomenal rise in portfolio and foreign direct investment (FDI), a dramatic rise in exports of services, and an inflow of funds tapped by the private sector through private placements and External Commercial Borrowings (ECBs). "The capital inflows were far in excess of the current account financing requirements."[5] On the domestic front, this excess liquidity fueled the growth of sectors such as housing and real estate, automobiles, communications, and household goods. It also led to capital expenditure for expansion in these sectors, as well as in export-intensive sectors: namely textiles, transport, automobiles and components, communication, and pharmaceuticals, including the acquisition by Indian companies of assets abroad.

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1 Economic Survey 2008–09.

2 Arvind Virmani 2008.

3 Government of India, 2008, and Country Report, World Bank, 2008.

4 Annual Report, 2008–09, Ministry of MSME. MSMEs are officially characterized in India as Micro, Small and Medium Enterprises (MSMEs). The basis of definition as per the MSMED Act is investment in plants and machinery (excluding the value of land and buildings): Micro as investments of up to INR2.5 million; Small from 2.5 million to 50 million, and Medium, from 50 to 100 million.

5 Economic Survey, 2008–09.

Table 1. Drivers of Economic Growth in India (2002–03 to 2007–08)

	Segment	Percentage
1	Manufacturing	16%
2	Trade	14%
3	Communication	11%
4	Agriculture	10%
5	Construction	10%
6	Real Estate/Housing/Business Services	8%
7	Banking and Insurance	8%
8	Other Services	7%
9	Transport by Other Means	6%
10	Other	10%

Source: Arvind Virmani, Economic Advisor, Ministry of Finance, 2008

Table 2. Rate of Growth at Factor Cost in 2004–05 Prices (%)

	2005–06	2006–07	2007–08	2008–09	2009–10
Agriculture, Forestry, Fishing	5.2	3.7	4.7	1.6	−0.2
Mining & Quarrying	1.3	8.7	3.9	1.6	8.7
Manufacturing	9.6	14.9	10.3	3.2	8.9
Electricity, Gas, & Water Supply	6.6	10	8.5	3.9	8.2
Construction	12.4	10.6	10	5.9	6.5
Trade, Hotels & Restaurants	12.4	11.2	9.5	5.3	8.3*
Transport, Storage & Communication	11.5	12.6	13	11.6	–
Finance, Insurance, Real Estate Business	12.8	14.5	13.2	10.1	9.9
Community, Social & Personal Services	7.6	2.6	6.7	13.9	8.2
GDP at Factor Cost	9.5	9.7	9.2	6.7	7.2

Source: CSO

Table 3. Share Contributions to GDP Growth (Demand) (%)

	GDP Growth	Private Consumption	Government Consumption	Investments	Net Exports	Statistical Discrepancy
Q1 2007	9.2	60.0	10.4	36.3	−0.8	−5.8
Q2 2007	9.0	58.5	8.7	37.5	−7.0	2.3
Q3 2007	9.3	58.9	8.4	35.0	−5.1	2.9
Q4 2007	8.6	52.1	11.5	35.0	−4.3	5.7
Q1 2008	7.8	58.0	9.6	36.6	−1.3	−2.8
Q2 2008	7.7	55.5	8.3	39.2	−10.5	7.6
Q3 2008	5.8	57.4	12.5	35.3	−8.5	3.3
Q4 2008	5.8	51.4	13.4	35.7	−2.9	2.4
Q1 2009	6.1	55.6	9.9	36.1	1.6	−3.2

Source: Ministry of Statistics and Program Implementation, available at: http://www.mospi.nic.in, downloaded 31 August 2009. Asian Development Outlook, 2009 Update.

During the latter part of the 2003–08 period, global commodity prices, chiefly oil, food, metals, and fertilizers, started rising and peaked in 2008, just before the crisis. The inflation rate rose sharply in India from 2007 on, and reached the double-digit mark in the first quarter of 2007–08, peaking at nearly 13% during the July–Sept. quarter of 2008.[6] Worried by the over-heating economy, the Reserve Bank of India (RBI), the country's central bank, began to close taps on liquidity by raising interest rates and restricting the money supply. The following period was marked by high inflation and high interest rates. Thus, at the threshold of the global crisis, the Indian economy was constrained by high inflation, high interest rates, and a tightening of liquidity. The economy did show signs of a slowdown, though not with serious consequences.

Table 4. Key Economic Highlights

	Economic Indicator	2006–07	2007–08	2008–09	2009–10
1	Real GDP Growth Rate (%)	9.7	9.1	6.7	7.2
2	Inflation: WPI 52–Week Average (%)	5.4	4.7	8.4	1.6
3	CPI Industrial Workers (%)	6.7	6.2	9.1	11.4
4	Unemployment Rate (%)*	7.8	7.2	6.8**	–
5	Trade (USD billion)				
	a. Exports	128.89	166.16	189.00	–
	(% Change)	(22.6)	(29.0)	(13.6)	(–20.3)
	b. Imports	190.67	257.63	307.65	–
	(% Change)	(24.5)	(35.5)	(20.7)	(–23.6)
	c. Trade Balance	61.78	91.47	118.65	–
6	Business Conditions Index	–	–	–	–
7	Consumer Sentiment Index	–	–	–	–
8	Exchange Rate (USD and Local Currency)	45.25	40.26	45.99	47.94
9	Non-Performing Loans/Total Loans				
	a. Gross NPA (% to Gross Advances)	2.5	2.3	2.3	–
	b. Net NPA (% to Net Advances)	1.0	1.0	1.1	–
10	Foreign Reserves (USD billion)	199	309	252	283.5
11	Others (If Any)				
	a. Gross Fiscal Deficit (Center) (% of GDP)	3.3	2.6	5.9	6.5
	b. Industrial Production Index (% Change)	11.6	8.5	2.6	–
	c. Bank Credit Growth (%)	28.1	22.3	17.5	13.9

Source: *Estimate. CIA Factbook. **Projected figures prior to crisis.

[6] Economic Survey 2008–09.

3. CRISIS IMPACT ON SMEs

3.1 Overview of SMEs

In India, SMEs are officially characterized as Micro, Small and Medium Enterprises (MSMEs). The definition as per the MSMED Act is based on investment in plant and machinery, excluding the value of land and buildings (Table 5). As per the 4th Census of MSMEs, there are close to 26 million such units in India, which provide employment to over 60 million people (Table 6).

Table 5. Investment in Plant and Machinery Excluding Value of Land and Buildings

Enterprise	Investment in Plant and Machinery Excluding Value of Land and Buildings
Micro	INR2.5 million (USD55,500 or less)
Small	INR2.5 million to 50 million (from USD55,500 to 1.1 million)
Medium	INR50 million to 100 million (USD1.1 million to 2.2 million)
Large	Exceeding INR100 million (over USD2.2 million)

Table 6. Micro, Small and Medium Enterprises (MSME) Sector in India (million)

Attribute	Registered	Unregistered	Total
Number of Enterprises	1.52	24.57	26.09
Manufacturing	0.95	6.36	7.31
Service Enterprises	0.58	18.20	18.78
Employment	9.47	50.25	59.72
Manufacturing	7.84	14.75	22.59
Service Enterprises	1.63	35.50	37.13

Source: Summary Results of 4th Census of MSMEs, reference year 2006–07, Ministry of MSMEs, Government of India.

3.2 Impact of Crisis on SMEs by Sector-Level Analysis

The global financial crisis emerged around August 2007 from the structured investment instruments of subprime mortgage lending in the USA. The initial impact was confined to the USA and to some extent, financial institutions in Europe. Immediately after the first signs of the crisis, the inflows to emerging economies increased substantially, leading to theories of "decoupling." However, the portfolio inflows then reversed, leading to the crash of stock markets in many emerging economies, including India.

The mid-September 2008 collapse of Lehman Brothers, one of the largest investment banks in the world, led to a full-blown meltdown of global financial markets. It marked the watershed and led to the loss of confidence in global financial markets.

The direct impact of the crisis on the Indian financial sector was noticed through exposure to toxic financial assets and money, as well as in foreign exchange markets. Because exposure to subprime securities by Indian banks had been very limited, the impact on the financial sector was initially minimal. But as the global crisis deepened, deleveraging and risk aversion led to the slowing of the Indian economy. Repatriation of investments by Foreign Institutional Investors (FII) and a drying up of external financial sources for the Indian corporate sector, especially securities abroad (External

Commercial Borrowings) resulted in a fall of more than 45%, from USD33 billion in 2007–08 to USD17.5 billion the following year. The paralysis of financial markets and an eventual worldwide collapse of commodity prices precipitated a fall in exports, which impacted the real economy.

Thus, the impact in India was visible in two spheres: finance and demand. As a result, industries faced a financial crunch due to:

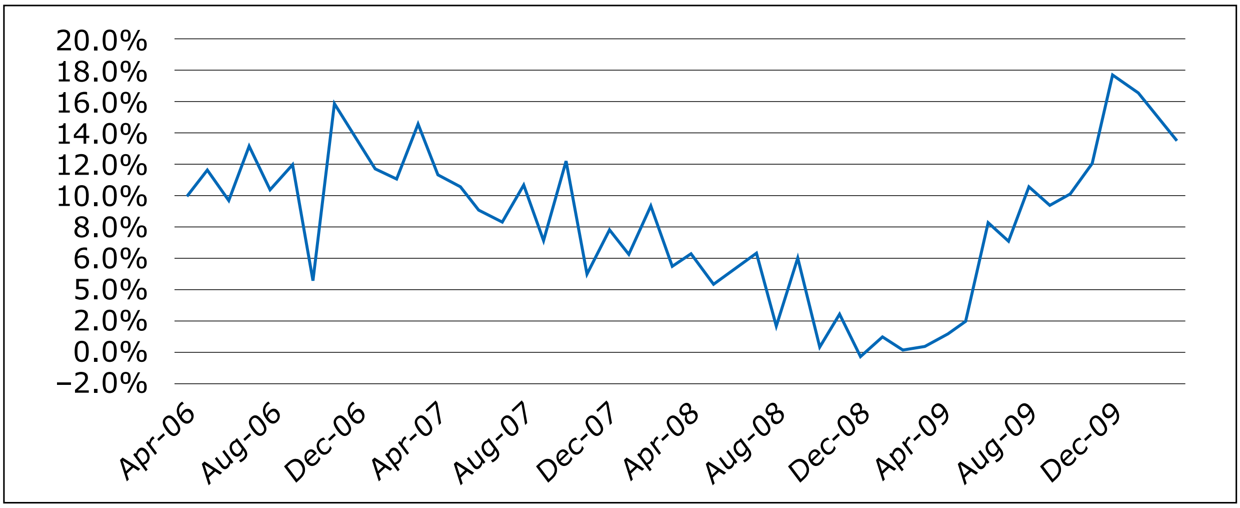
- A severe liquidity shortage at banks as the corporate sector sought funds due to foreign sources suddenly drying up. The situation was compounded by the prevailing tight liquidity policy of the RBI prior to the crisis. The latter had also severely constrained the financing of Non-Banking Finance Companies.

- In the aftermath of the crisis, MSMEs faced huge hardships in simply carrying out day-to-day functions. On one hand, payments for MSME accounts receivable were delayed by large buyers who were short on cash themselves. On the other hand, banks became extremely averse to risk and chose to cut back lending. As a large number of industries, both small and large, were in the midst of expansion plans, servicing loans became a casualty and in many cases, the possibility of default began to loom large.

Table 7. Sectoral Deployment of Bank Credit (USD billion)

	Priority Sector			Industry (Medium & Large)	Wholesale Trade (Food)	Other Sectors	Non-food Gross Credit
		in:					
Year	Total	Agriculture	Small Industries				
2006–07	141.30	51.20	26.20	128.80	11.14	119.04	400.28
2007–08	166.08	61.19	43.30	149.34	12.38	161.73	489.53
2008–09	203.53	75.26	57.18	177.20	14.98	182.58	578.29

Source: RBI



Source: CSO

Figure 1. Year-on-Year Growth in Index of Industrial Production (IIP)

The economy had manifested a demand-driven recession for the following reasons:

- As global demand plunged, merchandise exports started falling and the growth in value terms declined from a positive 29% in April–August 2007–08 to minus 20% in 2009–10. During the same period, imports declined from the high growth rate of 24.5% to a negative 23.6% (Table 4). The sharpest declines in exports were seen in sectors such as Textiles and Garments, Gems and Jewelry, Leather, and Engineering, including Auto Components. All were sectors that had been dominated by SMEs, and an adverse impact on employment resulted (Table 6 and Figure 2).

- As the scenario turned from one that had been characterized by excess liquidity and cheap finance to that of a liquidity crunch and high interest rates, demand disappeared in sectors that had been riding on excess liquidity, such as housing and real estate, automobiles, and household goods. It sent shock waves down the entire supply chain and impacted a very large segment of the Indian economy. Immediately after the financial crisis, industrial growth dropped to minus 0.4% in October 2008 compared to 12.2% in the same period the previous year. Manufacturing output, which accounts for nearly four-fifths of the total weight of the Index of Industrial Production (IIP), fell to 1.2% in October after peaking at 13.8% the previous year. The average growth rate in October–November 2008 turned negative for the first time in 13 years: minus 1.83% (See Figure 1).

- In view of the prevailing financial conditions, private capital expenditures by small and large firms came to a grinding halt. Projects driven by the private sector, including infrastructure, were adversely affected (Table 2). The growth in consumption expenditures, both private and government, fell to 3.3% in the first half of 2008–09, half that of the corresponding period in the previous year. In the second half of 2008–09, private consumption fell further to 2.5%, dragging GDP growth down to 5.8% (Table 3).

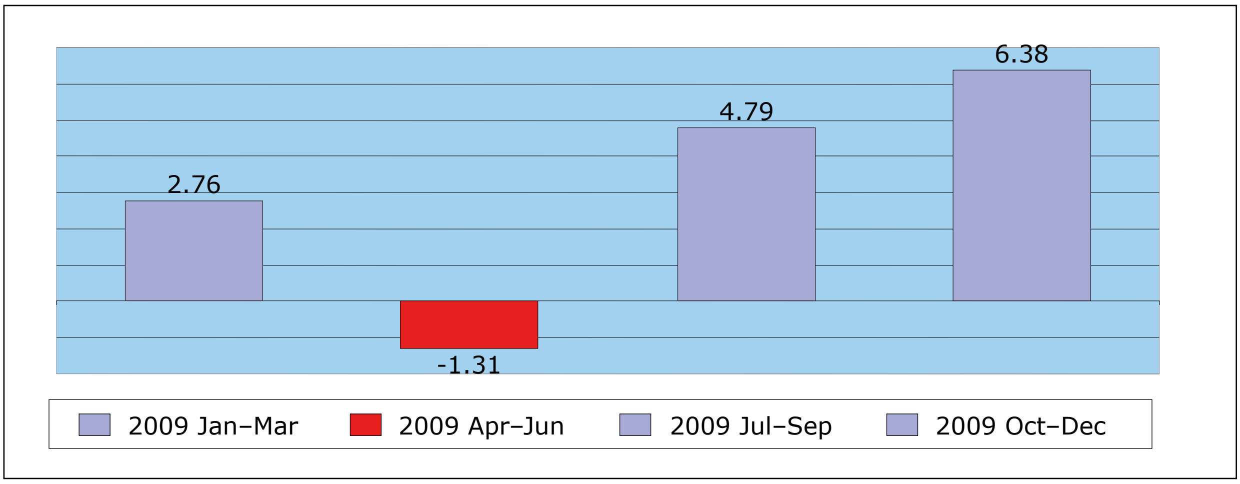


Figure 2.
Quarterly Employment Change from Previous Quarter in Labour-Intensive Industries

Table 8. Composition of Exports by Major Markets

	Percentage Share					CAGR[7]	Growth Rate			
	2000–01 Apr–Mar	2007–08 Apr–Mar	2008–09 Apr–Mar	2008–09 Apr–Mar	2009–10 Apr–Sept	2000–01 to 2006–07	2007–08 Apr–Mar	2008–09 Apr–Mar	2008–09 Apr–Sept	2009–10 Apr–Sept
Primary Products	16.0	15.5	13.3	13.2	12.7	16.9	38.2	−2.4	44.5	−32.4
Agriculture and Related Products	14.0	9.9	9.1	9.1	9.0	10.4	43.0	4.4	53.7	−30.9
Ores and Minerals	2.0	5.5	4.2	4.1	3.7	40.4	30.5	−14.6	27.2	−35.6
Manufactured Goods	78.8	64.1	66.4	64.8	69.2	16.2	21.8	17.7	45.4	−24.9
Textiles Including Finished Garments	23.6	11.2	10.2	9.2	11.1	7.5	12.0	4.4	13.0	−14.7
Gems and Jewelry	16.6	12.1	15.1	15.9	17.8	13.7	23.2	42.1	82.4	−21.7
Engineering Goods	15.7	20.7	21.6	21.3	19.8	24.9	27.2	18.7	48.8	−34.6
Chemical and Related Products	10.4	13.0	12.3	11.5	13.1	24.6	22.2	7.2	29.0	−20.3
Others	12.5	12.6	11.8	11.0	12.7	24.5	19.3	6.0	29.3	−19.6
Leather and Leather Manufacturers	4.4	2.1	1.9	1.9	2.0	7.5	16.1	1.5	17.6	−24.2
Handicrafts including Handmade Carpets	2.8	0.9	0.6	0.6	0.5	1.5	7.2	−25.8	−12.8	−33.7
Petroleum, Crude and Products	4.3	17.8	14.9	17.8	14.2	46.3	53.6	−4.6	49.9	−44.0
Total Exports	100	100	100	100	100	19.0	29.0	13.6	48.1	−29.7

[7] Compound Annual Gross Rate (CAGR).

Table 9. Quarterly Growth Rates of GDP at Constant Prices 2004–2005 (%)

Sectors	2007–08					2008–09					2009–10		
	AN	Q1	Q2	Q3	Q4	AN	Q1	Q2	Q3	Q4	AN	Q1	Q2
Agriculture													
Agriculture, Forestry & Fishing	4.7	3.1	3.9	8.7	2.1	1.6	3.2	2.4	−1.4	3.3	−0.2	2.4	0.9
Industry													
Mining & Quarrying	3.9	1.1	4.6	4.5	5.1	1.6	2.6	1.6	2.8	−0.3	8.7	7.9	9.5
Manufacturing	10.3	12.1	10.3	10.7	8.3	3.2	5.9	5.5	1.3	0.6	8.9	3.4	9.2
Electricity, Gas & Water	8.5	10.2	9.1	7.1	7.8	3.9	3.3	4.3	4.0	4.1	8.2	6.2	7.4
Services													
Construction	10.0	10.7	13.1	9.6	7.1	5.9	7.1	8.0	3.0	5.6	6.5	7.1	6.5
Trade/Hotels/Transport/Communications	10.7	11.9	9.5	10.7	10.9	7.6	10.8	10.0	4.4	5.7	8.3	8.1	8.5
Financing, Insurance, Real Estate & Business	13.2	14.0	13.8	13.3	11.9	10.1	9.1	8.5	10.2	12.3	9.9	8.1	7.7
Community, Social & Personal Services	6.7	4.2	7.0	5.3	9.8	13.9	8.7	10.4	28.7	8.8	8.2	6.8	12.7
GDP at Factor Cost	9.2	9.3	9.4	9.7	8.5	6.7	7.6	7.5	6.2	5.8	7.2	6.1	7.9

The crisis hit India in the third quarter of 2008. Until then, as per Table 9, the average rate of growth in manufacturing had been greater than 10%. The growth rate became a single digit in the fourth quarter and remained such for the next eight quarters. A sample survey conducted in January 2009 by the Economic Times and the Federation of Indian Micro and Small & Medium Enterprises (FISME) revealed that 90% of responding MSMEs said their sales had been adversely affected by the slowdown.

Table 10. MSME Survey - January 2009

Questions	Responses
Have your domestic sales been impacted during the last quarter (Dec. 08–Mar. 09)?	Over 90% said sales were adversely affected.
Do you see any change now?	Over 40% said the situation has improved since March.
Have your export sales been impacted in the last quarter (Dec. 08–Mar. 09)?	Over 90% said sales had been affected.
If yes, is it the same now or do you see any change for the good?	Over 30% said the situation was improving after March.

Source: (FISME and Economic Times) Respondents: Online-12, Fax-1, Email-28, Telephone-12; Total= 53

The Director General of Foreign Trade (DGFT), Ministry of Commerce and Industry, carried out a more detailed survey of export units during the period of August–October 2008. In the survey, 121 exporters revealed losses in export contracts of USD400 million. Job losses were mentioned in the range of 65,000. Concerning value, the minerals sector was the most severely hit, followed by MSME-dominated sectors of gems and jewelry, textiles and garments, auto components, leather, plastics, and so forth (Table 11).

Table 11. Sample Survey on Impact of Slowdown on Exporting Units (August–October 2008)

	Product Group	Number of Units Surveyed	Loss in Export Orders (INR million)	Cash Loss (INR million)	Job Losses
1	Leather & Leather Products	15	1,376.20	145.89	865
2	Marine Products	6	200.56	347.52	220
3	Minerals & Processing (Granite, Ore)	5	2,665.35	1.91	105
4	Auto Components	12	4,791.00	782.0	9,391
5	Coconut Fiber & Fiber Products	2	61.36	9.60	260
6	Spices	3	213.00	70.00	
7	Garments & Textiles	18	1,422.82	204.86	5,799
8	Handlooms	4	110.00	47.50	138
9	Fruits, Vegetables & Food Items	12	208.06	80.83	75
10	Gemstones & Jewelry	8	1,256.74	4.99	947
11	Handicrafts	12	389.74	102.73	1,167
12	Jute Goods	2	53.40	15.00	300
13	Engineering Goods	6	818.00	152.10	140
14	Chemicals	9	1,218.71	4,788.64	35,950
15	Drugs & Pharmaceuticals	5	916.06	170.33	150
16	Plastics	1	2,200.00	310.00	
17	Misc. Products	1	20.00	20.00	10,000
	Grand Total	121	17,921.00	7,253.90	65,507

Source: Director General of Foreign Trade, India Ministry of Commerce & Industry

3.3 Impact of Recession on Indian Textile and Clothing Sector: Case Study of Ludhiana Cluster

- **Indian Textile and Clothing Industry**
The Indian textile and clothing industry currently has a total market size of USD52 billion, of which USD32 billion is in domestic household consumption and USD20 billion in exports. It generates direct employment for more than 35 million people. In addition, the industry also generates significant employment through forward and backward linkages. The large amount of skilled and unskilled activity in the industry makes it extremely important from the perspective of inclusive growth.

Table 12. Indian Textile Sector Highlights (2008–2009)

	Indicators	Size
1	Total Size of Indian Textile Industry	USD52 billion
	Domestic	USD32 billion
	Exports	USD20 billion
2	Contribution to Indian GDP	4%
3	Contribution to Industrial Production	14%
4	Employment (direct)	35 million

The fundamental strength of the Indian textile industry comes from its strong production base of a wide range of fibers and yarns, from natural fibers, such as cotton, jute, silk, and wool, to man-made fibers such as polyester, rayon, nylon, and acrylic. The accompanying Table 12 highlights the presence of the entire value chain of the textile industry in India, from raw materials to yarn and fabrics to garments.

With an easing of restrictions in international textile markets following the Multi-Fiber Agreement (MFA) and rising demand due to higher economic growth in India after its economic liberalization, the textile industry expanded in a big way by taking advantage of emerging opportunities. This boom was further fueled by government support policies, particularly the Technology Upgradation Fund Scheme (TUF).

- **Impact of Recession on Indian Textile Industry in General**
Though the sector experienced slower growth in demand, particularly in exports since 2007 due to the rise of the rupee against the US dollar, the onslaught of the September 2008 financial crisis hit export demand in the two biggest Indian export markets: the EU and USA. Export growth fell from 12% in April–March 2007–08 to 4.4% in April–March 2008–09 and plunged into negative territory at minus 14.7% in April–March 2009–10 (see Table 8; Textiles Including Finished Garments).

With the textile and clothing industry having witnessed debt-funded capacity expansion driven primarily by interest compensation under TUF, the drop in production resulted in the underutilization of capacity, which led to an inadequate absorption of fixed costs and weak debt coverage. The decline in production and worsening financial performance of the textile and garments industry resulted in job losses during the crisis period (Table 11).

A Labour Bureau report on the impact of the economic slowdown in the October–December 2008 period puts the job loss figure at a half-million (Table 13). The report further indicates that job losses in textiles were around 1% of the total workforce employed in the sector. While the survey shows an increase in employment for January–March 2009, the latest information available from the Bureau has losses in the textile sector at 0.15 million (150,000) in the subsequent April–June 2009 period. The table clearly reveals that the maximum brunt of the slowdown has been borne by exporting units.

Table 13. Labour Bureau Survey: Employment Trends

Segment	Apr 08–Mar 09	Apr–Sep 08	Oct–Dec 08	Jan–Mar 09
Textile Sector	0.307	0.206	–0.107	0.208
Textile Sector: Direct Category Workers (Avg. Monthly Changes)	0.43	0.53	–0.50	1.15
Contract Labor (Avg. Monthly Changes)	–0.09	0.16	–0.38	–0.29
Textile Non-Exporting Units (Avg. Monthly Changes)	1.13	1.29	0.02	1.78
Textile Exporting Units (Avg. Monthly Changes)	–0.48	–0.40	–1.09	–0.06

Source: India Labour Bureau

- **Impact of Recession on Ludhiana Textile Industry**
  A leading industrial city in the northern Indian state of Punjab, Ludhiana is an important center for textiles and allied industries. It is aptly termed the industrial capital of the region, with nearly 21% of all industries in Punjab and more than 28% of the state's output. Ludhiana is one of the principal producers of woolen and acrylic knitwear, as the local textile industry makes use of both natural fibers (like cotton, silk, jute and wool) and man-made or artificial fibers (such as polyester, rayon, nylon, acrylic and blended fibers) to produce a wide range of fabrics and finished garments.

  Products from Ludhiana textile industries are classified mainly into two broad categories: Woven and Knitted. The former includes shawls, blankets, and fabric for suits and shirts, while the latter includes jerseys, cardigans, pullovers, jackets, and socks, along with cotton and man-made casuals such as T-shirts, sportswear, and undergarments. Around three-fourths of the industry units are engaged in the production of material for dresses, shirts and suits targeted for the domestic market. Exports are generally in the knits and woolens category.

Table 14. Percentage of Products from Ludhiana

	Product category	Composition
1	Dress Material	50%
2	Suit and Shirt Material	20%
3	Knits	15%
4	Woolens	15%

The Ludhiana textile industry has more than 10,000 industrial units, comprising exporters, brand producers, and large-scale manufacturers. Consisting of both registered and unregistered units, almost 95% of the finished garments, textiles and hosiery industries in Ludhiana are small-scale. Large units number less than 50. The cluster provides employment to more than 400,000 people and caters largely to the domestic market, while exports constitute only 15% to 20% of its total output.

Against the backdrop of the economic slowdown, our research team conducted detailed, structured interviews with representatives in the following segments of the cluster (Table 15):

Table 15. Number of Interviewees from Different Segments

	Segment	Number
1	MSMEs	20
2	Workers	25
3	Associations	2
4	Labor Contractors	3
5	Cluster Development Agency	1
6	Export Promotion Council	1
7	Transporters	3

Based on their feedback, the analysis is divided into: the pre-slowdown, or "Business as Usual," "Impact of Recession," and "Coping Strategies."

- **Business as Usual Scenario**
  Prior to September 2008, the highlights of the Business as Usual scenario were:

a) *Raw Material Prices:* The government raised Market Support Prices (MSP), or prices at which it procured agricultural produce. Cotton was up by 40% from INR1,950 to 2,800 per quintal, while international prices fell by 40%. The prices of chemicals also rose.

b) *Dollar Parity:* In 2007–08, exporters had been reeling under severe competitive pressure because of a continued weakening of the dollar against the rupee.

c) *Interest Rates:* The specter of high inflation led the Reserve Bank of India to continue tightening liquidity, which resulted in rising interest rates between 2004 and 2008. Banks and financial institutions became more and more reluctant to lend to MSMEs.

d) *Dwindling Support for Exports:* In September, the government reduced by 2% to 5% the duty drawback on exports for different products, including textiles, resulting in further pressure on margins.

e) *Labor Availability:* The Ludhiana textile industry, which had over the years become highly dependent on migrant labor from the Eastern States (Eastern Uttar Pradesh, Bihar, and Jharkhand), was in a pinch as it faced shortages of manpower due to the emergence of other options for workers.

f) *Skilled Workers:* The cluster faced a general shortage of skilled workers.

g) *Gender Issues in Hiring Workers:* Traditionally in Punjab, the workforce consisted of male workers. However, because of the entrepreneurial culture in Punjab, local youth were increasingly inclined to start their own businesses or go abroad to pursue greener pastures. The availability of male workers was steadily falling, and the need to tap into the female workforce became increasingly clear.

h) *Management:* Due to the informal nature of the cluster and the seasonality of production (e.g. in woolen products), the approach of employers toward workers has been ad hoc and short term-oriented, and the practice of contracted labor widespread.

- **Impact of Recession (October 2008–March 2009)**
  As mentioned earlier, there had been a sudden and definite reversal in exports after September 2008. The major recessionary period was from October 2008 to March 2009, when the volume of hosiery exports from Ludhiana's industries fell sharply. The impact of recession was mixed and characterized by:

a) *Inventory pile-up (especially woolens):* Because of the delayed onset of winter, inventory drawdown had been poor. It was exacerbated because of the sudden financial crisis, and buyers began postponing or canceling orders.

b) *Payment delays:* The first reaction of most foreign buyers had been to delay payment, which gravely affected the liquidity of firms. However, no cases of payment defaults had been reported. It became more precarious as Indian banks were simultaneously facing a severe liquidity crunch. The situation eased by December 2008, after a massive infusion of liquidity by the Reserve Bank of India.

c) *Impact on profitability:* Increases in interest rates, minimum wages, and raw material prices, together with longer payment cycles, eroded the profit margins of businesses. Immediately after the crisis, buyers started renegotiating contracts for reductions in prices, which further skewed margins.

d) *Impact on labor:* Unlike the situation at several other textile production centers, the slowdown did not result in massive unemployment. If an export unit had to cut its workforce, there were many units catering to domestic markets, which were ready to absorb workers amid a prevailing shortage of labor.

e) *Slowdown in investments:* Capital expenditure for expansion in the textile and hosiery industries had been put on hold. Banks had also turned away from project financing.

- **Coping Strategies**
  The units in the cluster coped with the challenges of the business slowdown and labor issues with both strategic and tactical moves. Businesses responded tactically by delaying payments down their supply chains. Also, many exporters renegotiated contracts with buyers and also modified their contracts of exotic forex derivatives with banks. In addition, many exporters, particularly medium- and large-size, shifted their focus to the domestic market. Some went for product diversification and the development of their own brands and retail tie-ups. Some even diversified into businesses other than textiles.

Table 16. Coping Mechanism of Ludhiana-Based Textile Units

Actions	Tactical Moves	Strategic Moves
Business challenges	• Delaying payments to suppliers down the chain • Shifting bonus payments from fixed to per-piece basis	• Shift to domestic market • Business diversification • Product diversification • Brand development
Labor	• Contract renegotiations	• Cutting labor costs with multitasking • Local skill development • Focus on development of female workers

Source: Survey results

The strategic moves brought forth interesting and important trends amid a shortage of workers, particularly skilled ones. The medium and larger units had started focusing on automated processes, employing fewer but better-skilled people. The strategy served twin objectives of reducing costs and paying higher compensation to fewer workers, which leads to greater retention. Secondly, there was an advantage to training local unemployed youth, particularly women. The women in Punjab had never seriously been considered part of the potential workforce. Until this time, their involvement had been limited to ad hoc, handicraft work in textiles and garments. This new trend underlines a dramatic shift in society's way of thinking, as well as that of employers. A number of programs have gotten underway, in which young women are trained in the necessary skills to handle sophisticated textile machinery.

Table 17. Case I: Warsaw International, Tirupur

1	Company name	Warsaw International
2	Contact details (optional)	33-b, Vaikkal Thottam, Sherief Colony, Tiruppur, Tamilnad -641604 ph: 0421-2214542 fax: 2211451
3	Products manufactured	Knitted T-shirts for export market
4	Sales	Domestic Export Total 2006–07 nil 40 crore 40 crore 2007–08 nil 45 crore 45 crore 2008–09 nil 41 crore 41 crore 2009–10 nil 43 crore 43 crore
5	Problems faced	Until 2006–07, exports were on a growth trend, but since the latter part of 2007, the entire industry began a downslide because of external factors such as: • Wild currency fluctuations • Abnormal price hikes in all raw materials and processing costs • Squeezing of prices by buyers • Unavailability of sufficient skilled laborers • Lack of necessary R&D support by government agencies for technology upgrades A few buyers, including some major brands (e.g., Karstadt in Germany), closed down business which resulted in a huge loss of exports and export proceeds. **On currency:** Almost all exporting units were battered due to wild currency fluctuations. **On finance:** Buyers started asking for payment delays, which resulted in a severe financial crunch for the entire industrial spectrum. Here again, almost all the industrial houses had opted for one-time restructuring of their existing loan terms. Furthermore, Warsaw International was compelled to opt for multifold increases in financial assistance such as bank credits. **On labor:** There was constant pressure to raise wages, due to unforeseen price increases in consumer goods and food products. Production costs rose by 25% compared to the previous year. Bank interest payments were higher by 3% compared to the corresponding period the previous year. The drop in sales turnover was 30% compared to the corresponding period the previous year.
6	How did you resolve the problem? Have government policies helped?	1. More financial assistance from banks. 2. To keep running the factory, we accepted orders from buyers in spite of the risks involved. 3. By adopting the above measures, we retained labor to the maximum extent possible. 4. We involved ourselves in real cost cutting measures by joining the MSME to bring in lean manufacturing techniques, to minimize excess costs, and increase productivity. The following government measures helped: 1. An interest subvention of 2% for export credits. 2. A focus license of 2% for a period of six months, for export turnover in selected markets. 3. The RBI instruction to restructure existing loan terms. 4. The release of TUF subsidies.

Source: Survey results

Table 18. Case II: Peejay Imports and Exports, Ludhiana

1	Company name	Peejay Imports and Exports
2	Contact details (optional)	Sanjeev Gupta
3	Products manufactured	Sweaters, T-shirts, Jackets
5	Nature of problems faced due to crisis	1. Low volume of orders 2. The rates were very low 3. No regularity in orders and nervousness on the part of buyers, leading to frequent changes and last-minute cancellations 4. Too much fluctuation in currency rates 5. Complete uncertainty in business
6	How did you resolve the problem? Have any government policies helped?	We shifted our focus to local markets by starting our own brand for the domestic market and entering into tie-ups with large MNC brands. As our factory was a socially compliant unit, we were able to get orders from international brands that were conducting business in India. Government policies have not been helpful, as the few incentives provided were too meager, and fluctuations in currency exchange rates were beyond government control. If the government had made considerable reductions in interest rates, it could have made some impact. The banks offered to reschedule loans, but they were too selective and not very forthcoming.

Source: Survey results

4. GOVERNMENT SME POLICY IN RESPONSE TO THE CRISIS

India's central government has been quite nimble. It responded to the crisis in a swift manner, with initiatives to address problems faced by MSMEs and other vulnerable sectors of the economy. It reassured people on the stability of the system, by infusing substantial liquidity. It also initiated a number of countercyclical measures.

On the monetary front, the RBI pumped sufficient liquidity through substantial reductions in the Cash Reserve Ratio and Statutory Liquidity Ratio, signaled an easing of the interest rates through repo- and reverse-repo rates, and improved access to External Commercial Borrowings (ECBs).

To supplement the monetary measures, a massive fiscal stimulus package was infused to pump-prime the economy, and a series of steps were taken to stop the fall in exports.

4.1 Monetary Policy

Between August 2008 and March 2009, the RBI's successive policy announcements helped to reduce reverse repo and repo rates to 6% and 3.5%, respectively, down from 9% and 5%. The RBI also announced a set of measures that included a further liberalization of its policy on ECBs, by raising ceilings and adding eligible sectors such as the housing sector, Non-Banking Finance Companies (NBFCs), and so forth.

To further increase the flow of credit, a Special Purpose Vehicle with USD5.5 billion was designated to provide liquidity support for NBFCs.

Coverage under the Credit Guarantee Scheme for MSMEs expanded and was made more lucrative for banks. The export credit refinance limit for scheduled commercial banks was raised from 15% to 50% of outstanding export credit available for refinancing export-oriented units. Banks were advised to use the special refinance facility for amounts up to 1% of their Net Demand and Term Liability for the purpose of extending finance to micro and small enterprises.

4.2 Fiscal Policy

To provide a countercyclical stimulus via planned expenditure, the government decided on additional spending of up to USD4.5 billion in 2008, mainly for critical rural infrastructure and social security projects. Further, state governments were allowed to raise additional market loans to 0.5% of their gross state domestic product, which amounted to about USD6.5 billion, for capital expenditures. In addition, steps were taken to ensure full utilization of the funds that had been provided. The total spending program for the year rose to USD66.7 billion.

As an immediate measure to encourage additional spending, barring a few exceptions, an across-the-board cut of 4% in the ad valorem central VAT rate took effect for the remainder of the fiscal year.

Housing is potentially a very important source of both employment and demand for critical sectors. There is a large, unmet need for housing in the country, especially for middle- and low-income groups.

To support the financing of large infrastructure projects, the government authorized the India Infrastructure Finance Company (IIFCL) to raise USD2.25 billion through tax-free bonds (by 31 March 2009) to refinance bank loans of longer maturity for eligible bid-based infrastructure projects. IIFCL was permitted to raise further resources to support a program of USD22.25 billion in the highway sector.

4.3 Trade Policy

A credit line of USD1.2 billion was made available to the EXIM Bank as pre-shipment and post-shipment credit. Export credit for labor-intensive exports such as textiles (including handlooms, carpets, and handicrafts), leather, gems and jewelry, marine products, and the MSME sector provided an interest subvention of 2% until March 31, 2009, which was later extended for a year.

A government-backed guarantee for exports was made available to the Export Credit Guarantee Corporation to the extent of USD77.50 million. An additional allocation for export incentive schemes for rupees at USD77.50 million was made available for the textile and leather sectors.

To help exporters overcome losses incurred due to currency fluctuations, the government restored the Duty Entitlement Pass Book, a program for reimbursing indirect taxes.

Duty drawback benefits on certain items, including knitted fabrics, bicycles, agricultural hand tools, and specified categories of yarn, were increased with retrospective effect from 1 September 2008.

4.4 Other Policies

To facilitate the flow of credit to MSMEs, the RBI announced a refinance facility of USD1.5 billion for the Small Industries Development Bank of India for incremental lending, either directly to MSMEs or indirectly via banks, non-bank financial companies, and State Finance Corporations. An additional allocation of USD35 million was made to the textile industry for the Technological Upgradation Scheme. Public Sector Banks were asked to offer need-based, ad hoc Working Capital Demand Loans for up to 20% of existing fund-based limits for units that had an overall fund-based credit facility of up to INR100 million.

A moratorium period was extended for loans availed by MSMEs where project implementation had been delayed. Banks were advised to take up a second restructuring of SME accounts on a case-by-case basis. Banks were also advised that, with immediate effect, interest rates for loans to micro industries would be reduced by 100 basis points for all existing and new loans.

4.5 Impact of Measures:

Measures taken by the central bank and the central government have proved helpful. On the trade front, the decline in exports was successfully arrested. In November 2009, export growth turned positive and has since remained firm. As a matter of fact, thanks to positive global cues, export growth has jumped, marking a 34% gain in February 2009 and 54% gain in 2010 (Figure 3).

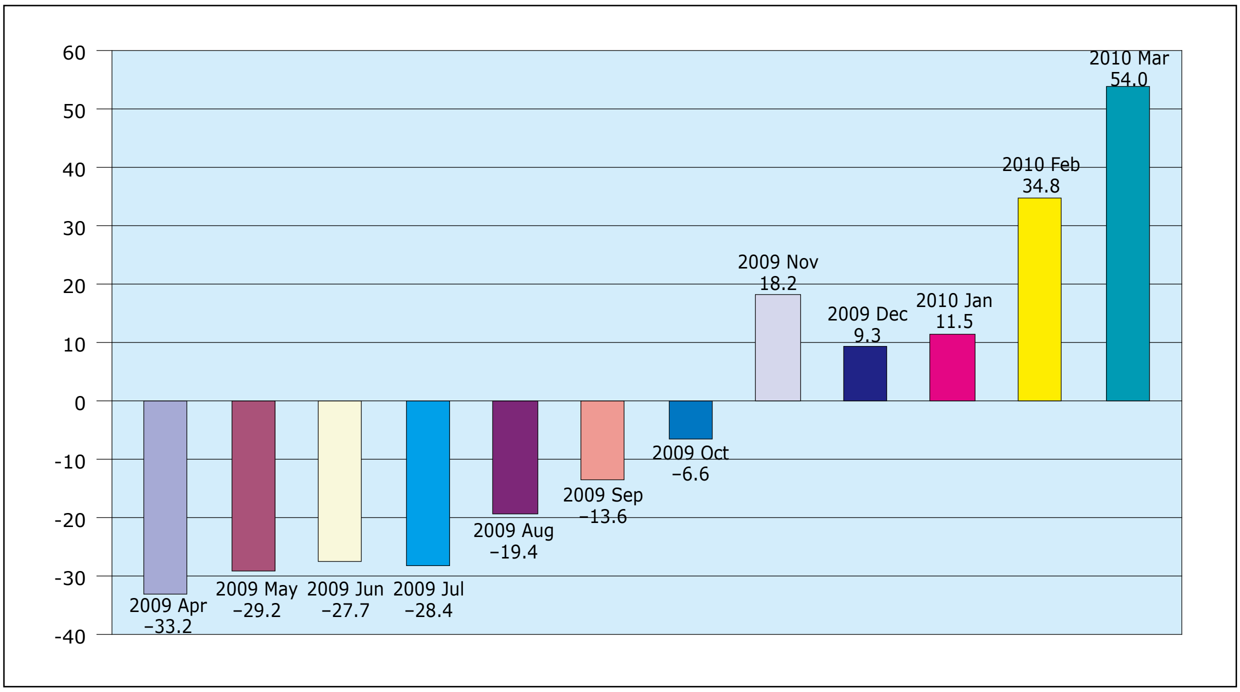


Figure 3. Quarterly Growth in Exports (%)

Similarly, domestic growth also returned to pre-crisis levels. As seen in Figure 4, the Index of Industrial Production in the first quarter of 2009 was barely 1.1%. It reached double-digit levels by August 2009 and has remained there.

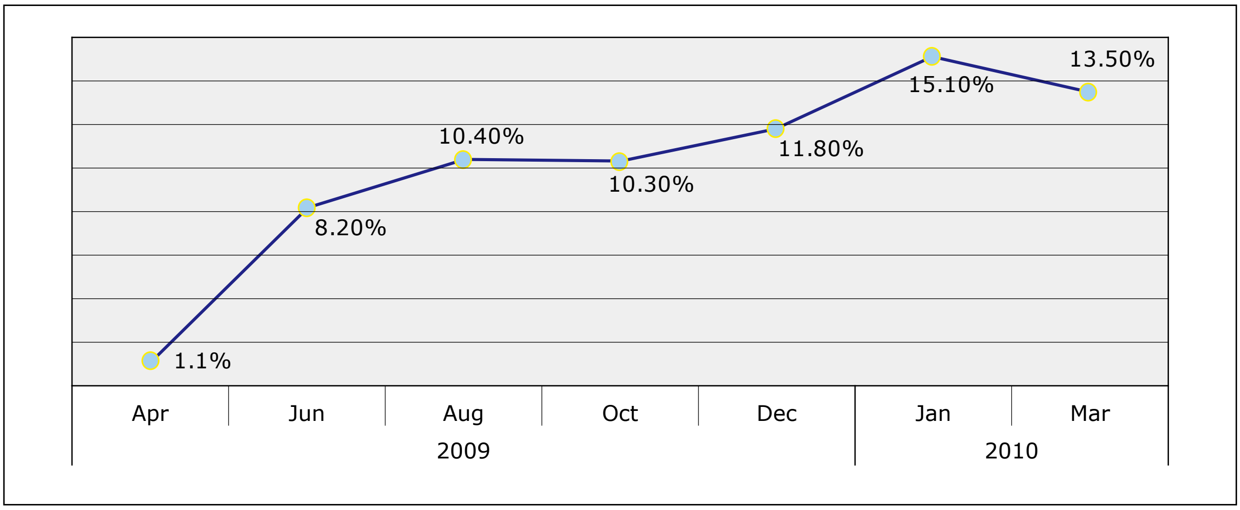


Figure 4. IIP Growth

5. POLICY RECOMMENDATIONS

The opening remarks in the Economic Survey (2009–10) outline the ordeal faced by policymakers at the beginning of the fiscal year and the results that had become visible by the end of the year. "The fiscal year 2009–10 began as a difficult one. It was also a year of reckoning for the policymakers, who had taken a calculated risk in providing substantial fiscal expansion to counter the negative fallout of the global slowdown. Inevitably, India's fiscal deficit increased from the end of 2007–08, reaching 6.8% (budget estimate, BE) of the GDP in 2009–10. The continued recession in the developed world, for the better part of 2009–10, meant a sluggish export recovery and a slowdown in financial flows into the economy. Yet over the span of the year, the economy posted a remarkable recovery, not only in terms of overall growth figures but, more importantly, in terms of certain fundamentals, which justify optimism for the Indian economy in the medium to long term," the survey says.

Interesting insight could be drawn from India's experience of successfully handling the crisis. India's response was swift, and it took calculated risks for growth.

First, to address the impact of the crisis and also the resultant loss of jobs, India did not wait for the trickle-down effect of economic growth from stimulus packages. Instead, it launched a massive government-sponsored employment guarantee program, which ensured 100 days of employment to people in villages who did not have other gainful work. Besides ensuring social and political stability, the move provided an extra cushion for falling demand in the economy.

Second, the central bank and the central government acted in tandem to address a range of related issues in monetary policy. They both desisted from measures such as interventions in foreign exchange markets and allowed markets to determine the rupee's value. In addition, officials avoided unnecessary import restrictions or export subsidies.

Third, a number of support programs were launched for MSMEs and for employment-intensive sectors, which achieved results. Further, the institutional mechanism for dialogue between the government and MSMEs was significantly strengthened. A taskforce to study MSME issues was set up by the Prime Minister himself, and pending reforms were fast-forwarded. The development of a modern insolvency mechanism for MSMEs was set in motion.

Exports comprise less than 20% of India's GDP, while services constitute 55%, limiting the impact of a temporary fall in manufacturing. Services provided a cushion for the Indian economy. Furthermore, a large domestic market that is in the midst of a demographic dividend mode provided an added blessing.

Japan

By Satoshi Yamamoto
The Economic Research Institute (ERI)

1. INTRODUCTION

From 2002 to 2007, Japanese companies enjoyed the Izanami Economic Boom, the longest period of economic expansion since the end of World War II. This was mainly due to success in the Japanese automobile industry. Many SMEs in Japan achieved high sales and profits during this period. However, because of the global financial crisis and subprime loan problems beginning in 2007 and the Lehman shock in 2008, Japanese SMEs faced a sudden change in the economic environment. What happened to Japanese SMEs as a result? How did they deal with and overcome the global financial crisis? In this section, I attempt to answer these questions through quantitative and qualitative analysis. Additionally, it will be shown how Japanese SMEs have evolved their business and management style as a result of the crisis.

2. COUNTRY SITUATION

2.1 2006 and 2007 (Yearly Basis)

Subprime loan problems in 2007 and the August 2008 Lehman shock in the USA have affected Japanese SMEs in many ways. To describe this influence, we should first explain the macroeconomic situation in Japan prior to the global financial crisis.

In Table 1, we show the real GDP growth Rate, inflation rate, and unemployment rate in 2006 and 2007. In spite of the subprime loan problems in the USA and the UK in 2007, many Japanese industries, especially in manufacturing, such as automobiles and machinery, experienced a booming economy.The yen was weak and trade expanded to North American and Asian markets.

Table 1. Real GDP Growth Rate, Inflation Rate, and Unemployment Rate

	2006	2007
Real GDP Growth Rate	2.0%	2.3%
Inflation Rate	0.3%	0.0%
Unemployment Rate	4.1%	3.9%

Source: Ministry of Internal Affairs and Communications, "Labour Force Survey"
Ministry of Internal Affairs and Communications, "Consumer Price Index"
Cabinet Office, Government of Japan, "SNA Statistics"

Table 2. Exports, Imports, and Trade Balance

	2006	2007	Growth Rate: 06/07
Exports	648.0	722.8	11.5%
Imports	580.0	629.8	8.6%
Trade Balance	68.0	93.0	36.6%
USD1.00	JPY116.1	JPY117.4	1.1%

USD billion
Source: Ministry of Finance, "Trade Statistics of Japan"

As seen in Table 2, exports increased by over 10% and the trade balance rose by almost 40% in just one year, from 2006 to 2007. However, symptoms of recession had already existed in the Japanese economy during this period. For example, we can refer to the Leading Index, one of the key business conditions indexes, or the Consumer Confidence Index (CCI) in Table 3 and Table 4.

Table 3. Business Condition Index: Leading, Coincident, and Lagging Indexes

	2006	2007	Growth Rate: 06/07
Leading Index	102.4	97.4	–4.9%
Coincident Index	103.7	104.6	0.9%
Lagging Index	105.0	105.3	0.3%

2005=100
Source: Cabinet Office, Government of Japan, "Indexes of Business Conditions"

Table 4. Consumer Confidence Index

	2006	2007	Growth Rate: 06/07
CCI	48.3	44.7	–7.5%

2005=100
Source : Cabinet Office, Government of Japan,
"Monthly Consumer Confidence Survey Covering all of Japan"

Table 5. Non-Performing Loans/Total Loans

	Mar 06	Sep 06	Mar 07	Sep 07
Total Loans	3,888.1	3,920.0	4,013.1	4,140.0
Quarterly Growth Rate	–	0.82%	2.37%	3.16%
Non-Performing Loans	113.6	104.5	101.7	103.4
Quarterly Growth Rate	–	–8.09%	–2.67%	1.72%
NPL Ratio	2.92%	2.66%	2.53%	2.50%
Quarterly Growth Rate	–	–0.26%	–0.13%	–0.04%
USD1.00	JPY117.7	JPY118.2	JPY117.8	JPY114.8

USD billion
Source: Financial Service Agency, "Status of Non-Performing Loans"

Table 6. Foreign Reserves

	2006	2007	Growth Rate: 06/07
Foreign Reserves	895.3	973.4	8.72%

USD billion
Source: Ministry of Finance, "International/Reserves/Foreign Currency Liquidity"

In 2007, the Leading Index was below 100, with a 2006–07 growth rate of –4.9% and the CCI also fell at the same time. On the other hand, Japanese financial markets continued to grow, with increased lending and a diminishing non-performing loan (NPL) ratio as shown in Table 5. In addition, the Japanese government purchased dollars in an attempt to maintain the yen level, which led to an increase in foreign reserves as indicated in Table 6.

2.2 2008 (Quarterly Basis)

After the Lehman bankruptcy in September 2008, the Japanese economy clearly began to tumble. It can be observed that the growth rate of Japan's real GDP turned negative in the second quarter of 2008, as seen in Table 7. Due to weakened overseas markets, especially in the USA, exports from Japanese industry were seriously beaten down. In particular, Japan's trade balance became negative in the second quarter of 2008, when the volume of imports exceeded that of exports. This was the first such situation for Japan since the second oil crisis in 1979–80. The cause may be that in 2008, the prices of oil, metal, materials, and other commodities surged to record highs. From the Business Condition Indexes (Table 9) and the CCI (Table 10), it is easy to see that the situation for businesses and consumers began to become more and more fragile.

Table 7. Real GDP Growth Rate, Inflation Rate, and Unemployment Rate

	2008 Q1	2008 Q2	2008 Q3	2008 Q4
Real GDP Growth Rate	1.4%	–2.1%	–1.0%	–2.7%
Inflation Rate	–0.1%	0.9%	1.0%	–0.7%
Unemployment Rate	4.0%	4.0%	4.0%	3.9%

Source : Ministry of Internal Affairs and Communications, "Labour Force Survey"
Ministry of Internal Affairs and Communications, "Consumer Price Index"
Cabinet Office, Government of Japan, "SNA Statistics"

Simultaneously, Japanese financial markets also shrank and the NPL ratio increased, at least for September 2008. In addition, foreign reserves were maintained at a level around USD1,000 billion. It can be concluded that the subprime loan problem was quite harmful for the Japanese economy, which had been dependent on overseas markets through imports and exports.

Table 8. Exports, Imports, and Trade Balance

	2008 Q1	2008 Q2	2008 Q3	2008 Q4
Exports	203.7	198.3	204.9	180.2
Quarterly Growth Rate	–	–2.65%	3.36%	–12.07%
Imports	185.1	189.7	206.2	186.8
Quarterly Growth Rate	–	2.5%	8.73%	–9.43%
Trade Balance	18.6	8.6	–1.3	–6.6
Quarterly Growth Rate	–	–53.83%	–115.29%	–
USD 1.00	JPY 103.4	JPY 105.1	JPY 107.5	JPY 94.7
Quarterly Growth Rate	–	1.68%	2.27%	–11.92%

USD billion
Source: Ministry of Finance, "Trade Statistics of Japan"

Table 9. Business Condition Index: Leading, Coincident, and Lagging Indexes

	2008 Q1	2008 Q2	2008 Q3	2008 Q4
Leading Index	93.3	91.6	89.3	81.5
Quarterly Growth Rate	–	–1.89%	–2.48%	–8.73%
Coincident Index	104.0	102.6	99.8	93.3
Quarterly Growth Rate	–	–1.31%	–2.76%	–6.51%
Lagging Index	103.8	100.9	98.1	94.5
Quarterly Growth Rate	–	–2.76%	–2.74%	–3.67%

2005=100
Source: Cabinet Office, Government of Japan, "Indexes of Business Conditions"

Table 10. Consumer Confidence Index

	2008 Q1	2008 Q2	2008 Q3	2008 Q4
CCI	36.8	33.9	31.0	28.0
Quarterly Growth Rate	–	–7.8%	–8.65%	–9.58%

Source : Cabinet Office, Government of Japan,"Monthly Consumer Confidence Survey Covering All of Japan"

Table 11. Non-Performing Loans/Total Loans

	Mar. 08	Sep. 08
Total Loans	4,821.1	4,611.7
Quarterly Growth Rate	16.45%	–4.34%
Non Performing Loans	114.2	115.9
Quarterly Growth Rate	10.39%	1.56%
NPL Ratio	2.37%	2.51%
Quarterly Growth Rate	–0.13%	0.15%
USD 1.00	JPY 99.90	JPY 106.03

USD billion
Source: Ministry of Finance, "International Reserves/Foreign Currency Liquidity"

Table 12. Foreign Reserves

	2008 Q1	2008 Q2	2008 Q3	2008 Q4
Foreign Reserves	1,015.6	1,001.5	995.9	1,030.6
Quarterly Growth Rate	-	-1.38%	-0.57%	3.49%

USD billon
Source: Ministry of Finance, "International Reserves/Foreign Currency Liquidity"

Table 13. Real GDP Growth Rate, Inflation Rate, and Unemployment Rate

	2009 Q1	2009 Q2	2009 Q3
Real GDP Growth Rate	−3.1%	0.7%	0.3%
Inflation Rate	−1.3%	0.0%	−0.3%
Unemployment Rate	4.6%	5.2%	5.4%

Source: Ministry of Internal Affairs and Communications, "Labour Force Survey"
Ministry of Internal Affairs and Communications, "Consumer Price Index"
Cabinet Office, Government of Japan, "SNA Statistics"

Table 14. Exports, Imports, and Trade Balance in 2009

	2009 Q1	2009 Q2	2008 Q3
Exports	117.2	131.0	285.0
Quarterly Growth Rate	−34.94%	11.71%	117.66%
Imports	126.3	121.9	282.4
Quarterly Growth Rate	−32.39%	−3.48%	131.67%
Trade Balance	−9.1	0.0	11.8
Quarterly Growth Rate	–	–	–
USD 1.00	JPY 95.5	JPY 96.7	JPY 92.5
Quarterly Growth Rate	0.77%	1.33%	−4.39

USD billion
Source: Ministry of Finance, "Trade Statistics of Japan"

For instance, in the Business Condition Index, the Leading Index and Coincident Index improved in the second quarter of 2009. The quarterly growth rate of the CCI also returned to positive ground in the second quarter. We can observe from the NPL ratio in Table 17 that Japanese financial markets were in almost the same situation as in 2008. Additionally in the third quarter, foreign reserves rose to the highest level in four years.

Table 15. Business Condition Index: Leading, Coincident, and Lagging Indexes

	2009 Q1	2009 Q2	2009 Q3
Leading Index	75.3	78.4	84.8
Quarterly Growth Rate	−7.65%	4.16%	8.16%
Coincident Index	86.0	87.4	91.6
Quarterly Growth Rate	−7.82%	1.63%	4.81%
Lagging Index	89.5	84.8	83.0
Quarterly Growth Rate	−5.36%	−5.22%	−2.16%

2005 = 100
Source: Cabinet Office, Government of Japan, "Indexes of Business Conditions"

Table 16. Consumer Confidence Index

	2009 Q1	2009 Q2	2009 Q3
CCI	27.3	35.2	40.0
Quarterly Growth Rate	–25.66%	28.9%	13.53%

Source : Cabinet Office, Government of Japan,
"Monthly Consumer Confidence Survey covering All of Japan"

Table 17. Non-Performing Loans/Total Loans

	Mar. 09
Total Loans	5,047.3
Quarterly Growth Rate	9.45%
Non Performing Loans	121.0
Quarterly Growth Rate	4.37%
NPL Ratio	2.4%
Quarterly Growth Rate	–0.12%
USD 1.00	JPY 98.81

USD billion
Source: Financial Service Agency, "Status of Non-Performing Loans"

Table 18. Foreign Reserves

	2009 Q1	2009 Q2	2009 Q3
Foreign Reserves	1,018.5	1,019.2	1,052.6
Quarterly Growth Rate	–1.17%	0.06%	3.28%

USD billion
Ministry of Finance, "International Reserves/Foreign Currency Liquidity"

3. CRISIS IMPACT ON SMEs

3.1 Overview of SMEs

To begin, we need to take a look at how SMEs are defined in Japan under the Small and Medium Enterprise Basic Law. As we can see in Table 19, the designation is determined by the number of employees or the amount of capital. If an establishment meets at least one of the two criteria, we can say that it is an SME.

Next, we present the numbers of companies according to their size and sector as shown in Table 20. Generally in Japan, we consider an establishment as being an SME unit, so we shall adopt this concept in our paper. In 2006, the total number of establishments in non-primary industries was 5,702,781. At the time, SMEs accounted for about 99% of non-primary industries in Japan. They comprised 99.4% of 548,159 establishments in manufacturing and 99.0% of 4,602,739 in wholesale services.

Third, the numbers of employees by size and sector in Japan are shown in Table 21.

Table 19. Definition of SMEs in Japan

	Small and Medium		Small
	Number of Employees	Amount of Capital	Number of Employees
Manufacturing and Others	≦300	≦JPY300 million	≦20
Wholesaling	≦100	≦JPY100 million	≦ 5
Retailing	≦ 50	≦JPY 50 million	≦ 5
Other Services	≦100	≦JPY100 million	≦ 5

Source: Small and Medium Enterprise Agency,
"White Paper 2009 on Small and Medium Enterprises in Japan"

Table 20. Number of Companies by Size and Sector in 2006

	SMEs				Large Businesses		Total	
			Small Businesses					
Industry	Number	% of Total	Number	% of Total	Number	% of Total	Number	% of Total
Non-Primary Industry Total	5,652,091	99.1%	4,276,779	75.0%	50,690	0.9%	5,702,781	100%
Mining	3,018	99.9%	2,695	89.2%	4	0.1%	3,022	100%
Construction	548,654	100.0%	515,376	93.9%	207	0.0%	548,861	100%
Manufacturing	544,629	99.4%	461,061	84.1%	3,530	0.6%	548,159	100%
Service	4,555,790	99.0%	3,297,647	71.6%	46,949	1.0%	4,602,739	100%
Electricity, Gas, Heat, and Water	2,962	97.1%	1,602	52.5%	87	2.9%	3,049	100%
Information and Communications	56,925	96.0%	32,823	55.3%	2,391	4.0%	59,316	100%
Transport	129,125	99.6%	92,755	71.6%	502	0.4%	129,627	100%
Wholesaling/Retailing	1,581,012	98.7%	1,087,866	67.9%	20,536	1.3%	1,601,548	100%
Finance and Insurance	83,637	99.6%	67,869	80.8%	348	0.4%	83,985	100%
Real Estate	318,446	100.0%	312,847	98.2%	91	0.0%	318,537	100%
Food, Drink, and Accommodations	781,804	99.4%	568,788	72.3%	4,363	0.6%	786,167	100%
Medical, Healthcare, and Welfare	304,325	97.8%	146,107	47.0%	6,823	2.2%	311,148	100%
Education, Learning Support	168,468	99.0%	121,637	71.5%	1,653	1.0%	170,121	100%
Compound Services	47,887	97.7%	25,825	52.7%	1,110	2.3%	48,997	100%
Services: Not Otherwise Classified	1,081,199	99.2%	839,528	77.0%	9,045	0.8%	1,090,244	100%

Business Establishments
Source: Small and Medium Enterprise Agency, "White Paper 2009 on Small and Medium Enterprises in Japan"

Table 21. Number of Employees by Size and Sector in 2006

	SMEs				Large Businesses		Total	
			Small Businesses					
Industry	Number	% of Total	Number	% of Total	Number	% of Total	Number	% of Total
Non-Primary Industry Total	41,984,086	77.8%	13,836,078	25.6%	11,962,719	22.2%	53,946,805	100%
Mining	31,744	94.8%	19,760	59.0%	1,753	5.2%	33,497	100%
Construction	4,012,030	96.8%	2,639,034	63.7%	132,007	3.2%	4,144,037	100%
Manufacturing	7,365,782	74.2%	2,512,611	25.3%	2,555,465	25.8%	9,921,247	100%
Service	30,574,530	76.7%	8,664,673	21.7%	9,273,494	23.3%	39,848,024	100%
Electricity, Gas, Heat, and Water	120,781	66.8%	12,614	7.0%	59,959	33.2%	180,740	100%
Information and Communications	813,004	51.1%	145,044	9.1%	779,101	48.9%	1,592,105	100%
Transport	2,603,782	90.7%	591,920	20.6%	266,829	9.3%	2,870,611	100%
Wholesaling/Retailing	9,766,305	79.0%	2,754,800	22.3%	2,600,285	21.0%	12,366,590	100%
Finance and Insurance	1,176,527	82.4%	461,147	32.3%	251,921	17.6%	1,428,448	100%
Real Estate	968,727	95.9%	751,234	74.4%	41,295	4.1%	1,010,022	100%
Food, Drink, and Accommodations	4,394,520	90.3%	1,358,690	27.9%	474,320	9.7%	4,868,840	100%
Medical, Healthcare, and Welfare	3,196,264	66.3%	403,959	8.4%	1,626,170	33.7%	4,822,434	100%
Education, Learning Support	1,102,771	69.4%	224,660	14.1%	486,600	30.6%	1,589,371	100%
Compound Services	445,372	63.0%	76,754	10.9%	261,151	37.0%	706,523	100%
Services: Not Otherwise Classified	5,986,477	71.2%	1,883,851	22.4%	2,425,863	28.8%	8,412,340	100%

Business Establishments
Source: Small and Medium Enterprise Agency, "White Paper 2009 on Small and Medium Enterprises in Japan"

Table 22. Value Added in Manufacturing in 2008

	Value Added	% of Total
Total	982.0	100%
Large Business Establishments	447.5	45.6%
Small and Medium Business Establishments	534.4	54.4%
Small Business Establishments	101.4	10.3%
USD1.00=JPY102.7		

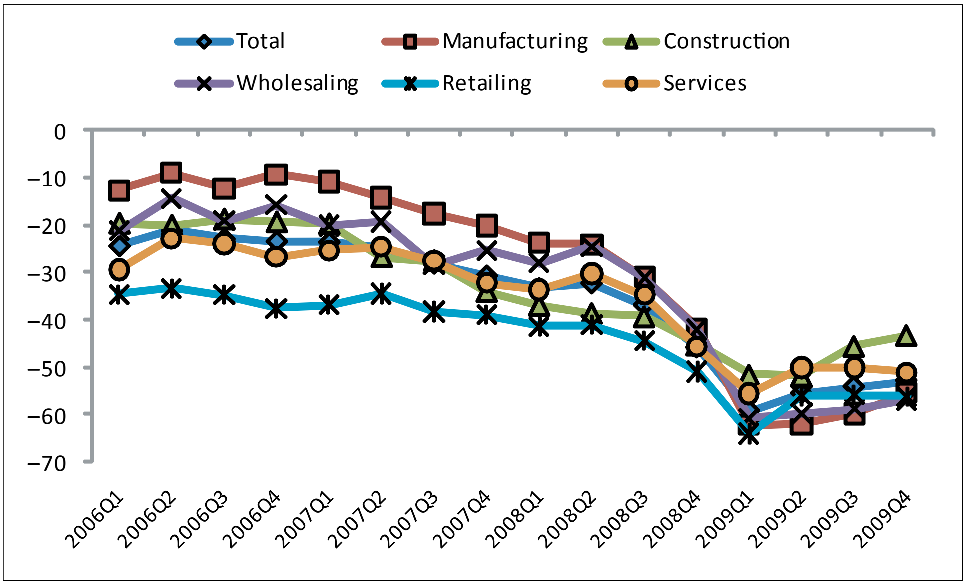
USD billion
Source: Ministry of Economy Trade and Industry "Census of Manufacturing, Preliminary Report"

The total number of employees in Japanese non-primary industries was 53,946,805 in 2006, and 77.8% of them belonged to SMEs. There were 9,921,247 employees in manufacturing, 74.2% of whom worked at SMEs. Similarly, 76.7% worked for SMEs in the service sector. We can also note from Table 22 that in 2008, SMEs created over half the total value added in manufacturing. Considering these observations, it can be concluded that in terms of manufacturing production, job opportunities and so on, SMEs hold important postitions in the Japanese economy. Thus, it is important for us to analyze how the global financial crisis has affected Japanese SMEs.

3.2 Crisis Impact on SMEs by Sector-Level Analysis

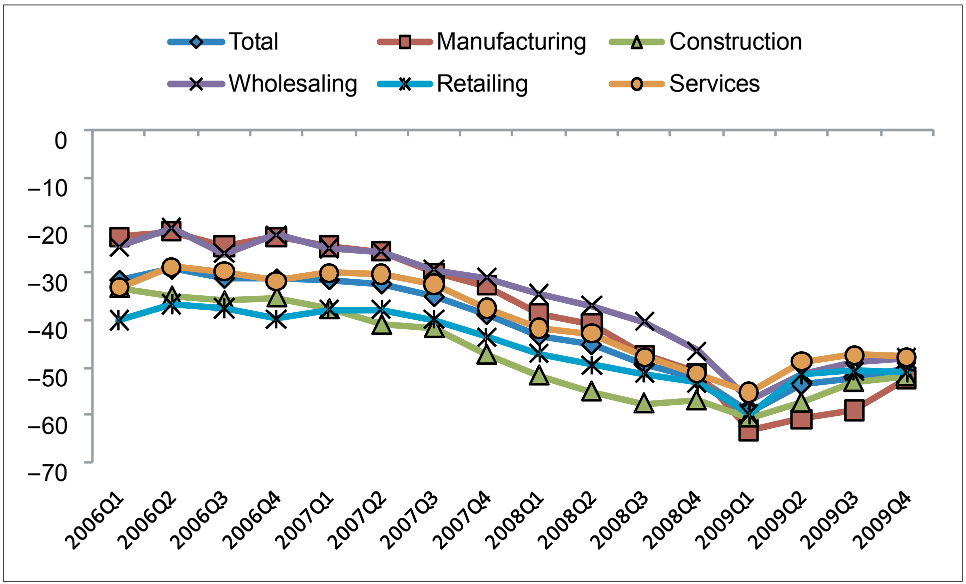
From the many interviews conducted with SME managers in Japan by the Economic Research Institute, Japan Society for Promotion of the Machinery Indusry (ERI-JSPMI), it was revealed that many SMEs faced serious declines in sales and orders in late 2008 and early 2009. For example, in manfacturing, such as the automobile industry or electric machinery industry, many SMEs were suppliers that provided parts to assemblers under subcontract relationships. Hence, the effect of the global financial crisis continued for several months longer compared with large companies in Japan. In inteviews, many typical SMEs such as dye and mould makers or parts manufacturers had experienced around a 70% decrease in monthly orders from their customers in December 2008 or January 2009 as compared to the same period the previous year.

Figure 1 and Figure 2 show the DI, or Difference Index, in the trends of sales and operating income of SMEs in each industry, such as manufacturing, construction, wholesale, retailing and other services from the first quarter 2006 to the third quarter 2009. The DI is the index that reflects the opinions of SME managers and their view of the current period compared to the previous period. In Figure 1 and Figure 2, the DI of both sales and operating income were lowest in the first quarter 2009. This is similar to the results of our interviews with Japanese SMEs.



Source: Bank of Japan, "Short-term Economic Survey of Enterprises in Japan"

Figure 1. Trend of DI in Sales at SMEs in Japan

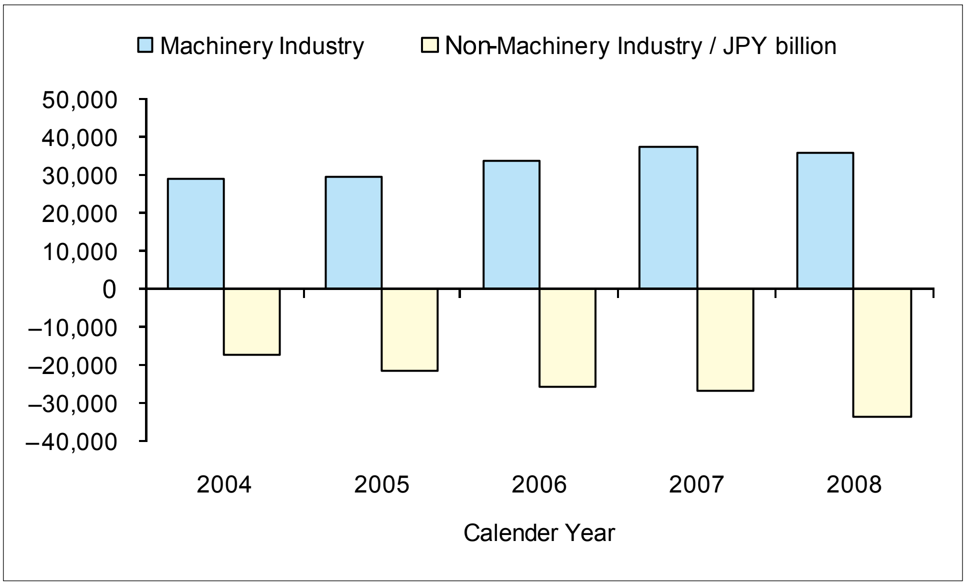


Source: Bank of Japan, "Short-term Economic Survey of Enterprises in Japan"

Figure 2. Trend of DI in Operating Income of SMEs in Japan

3.3 Cases of SMEs in the Machinery Industry

In this paper, we want to focus on actual cases of SMEs in the Japanese machinery industry during the global financial crisis. The machinery industry consists of general machinery, electric machinery, transportation machinery and precision machinery, and plays a very important role in the Japanese economy. For instance, there are many large global companies such as Toyota, Honda, Sony, and Hitachi, which have led the Japanese economy in recent years as shown in Figure 3.



Source: Ministry of Finance, "Trade Statistics of Japan"

Figure 3. Japan Trade Balance:
Comparison of Machinery Industry to Non-Machinery Industry

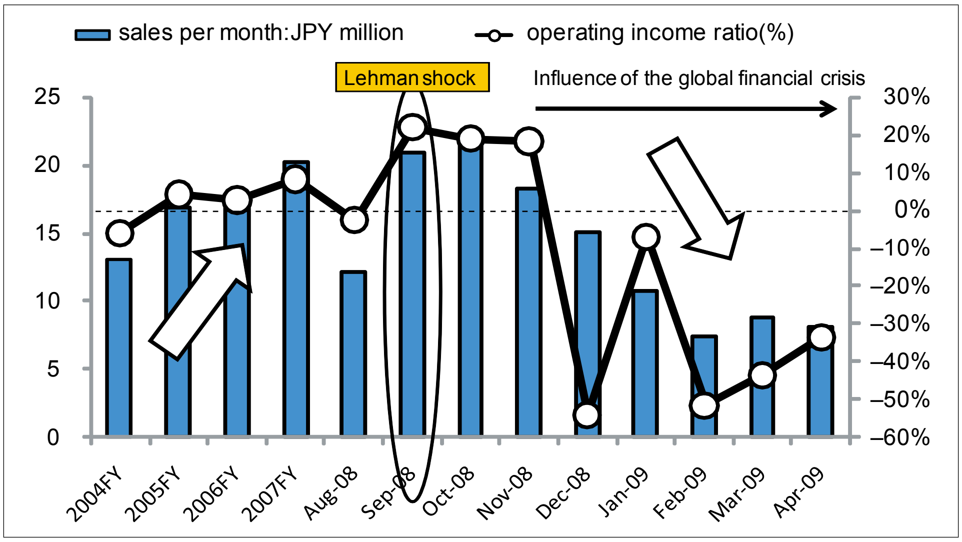
The Japanese machinery industry, of which almost 98% of firms are SMEs, has a significant characteristic that is called the "Subcontract System." Many SMEs in this industry are suppliers that provide the parts or processing services to large manufacturers. Prior to the subprime loan problem and the Lehman shock, large Japanese companies had relied on export sales in overseas markets such as the USA or the People's Republic of China. The global financial crisis affected overseas markets, mainly the USA market, and many large Japanese companies experienced diminishing sales and profits, and decreased their orders to SMEs. At that time, SMEs in Japan were hit with a slump in sales and profits.

The Case of Company A

Next, we will analyze how the global financial crisis affected individual SMEs in Japan. To understand this puzzle, we will focus on the case of Company A, a typical and excellently run small business in Japan. Here is some basic information on Company A:

- Its number of employees is 12.
- Its capital is 20 million yen.
- It is located in Kanagawa prefecture, adjacent to Tokyo.

Why did we choose this company as our case study? There are three reasons. First, Company A owns precision machining technology, called "Jig Grinder," to process parts or dyes and moulds with highly skilled labor. Because of that specific technology, the SME has subcontracting relationships with over 300 companies, including large car makers in Japan. Second, the number of employees at Company A is only 12. Thus, it is defined as a small business and not a medium-size business, and it is officially honored as one of the best factories with special technology in Kanagawa prefecture. Third, the ratio of operating income to sales of this company had been over 20% before the global financial crisis. For these three reasons, Company A can be considered to represent an excellent Japanese small business.

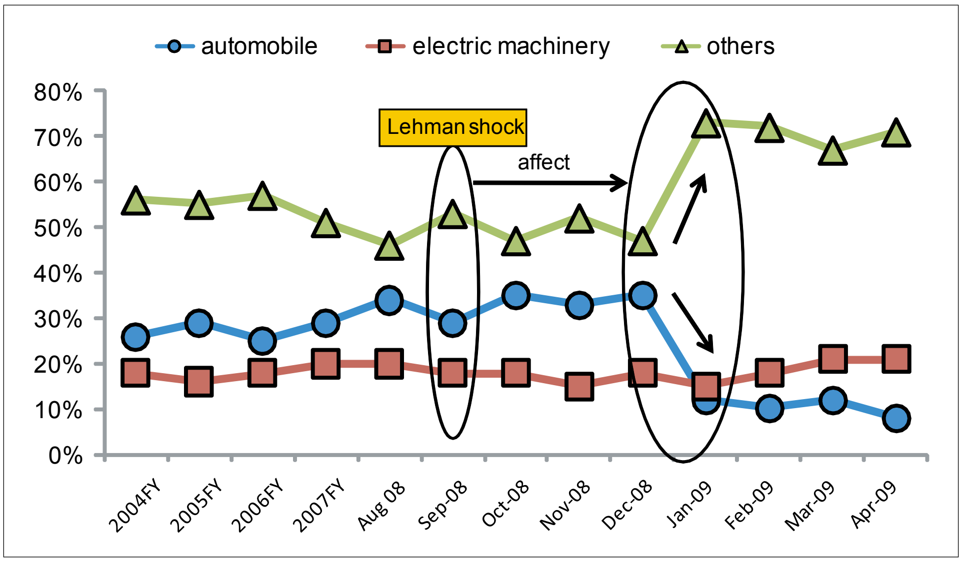


1) FY (fiscal year) is from August to July.
2) Sales and operating income ratio to sales from FY2004 to FY2007 are monthly averages.
Source: Company A's Financial Data

Figure 4. Sales per Month and Operating Income Ratio to Sales

The trend in sales and operating income ratios for Company A before and after the global financial crisis is revealed in Figure 4. We can observe that after December 2008, the influence of the global financial crisis became serious for the company. From interviews conducted by ERI-JSPMI, it can be presumed that other SMEs, especially in the machinery industry, experienced similar situations.

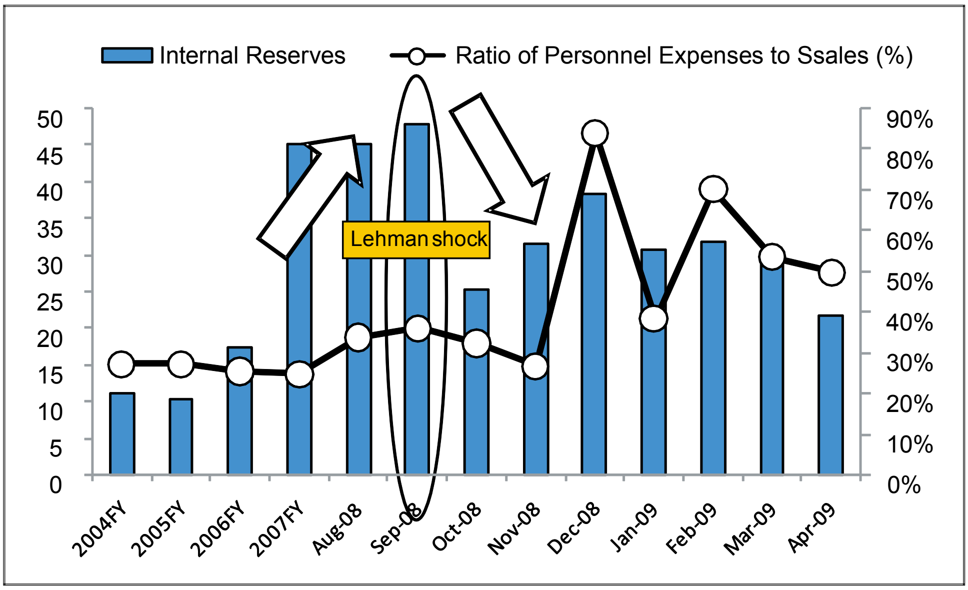
Why then did sales at Company A fall? We show the received orders at Company A in Figure 5. It is clear that because of the decrease in orders from the automobile industry, Company A encountered a diminishing sales and operating income ratio. Before the global financial crisis, when Toyota became the world's top maker and seller of automobiles ahead of General Motors, the Japanese automobile industry was going through a booming period. Many SMEs in Japan that relied on orders from the auto industry were able to achieve high profits during the period from February 2002 to October 2007, often called the "Izanami Economic Boom."



Source: Company A's Financial Data

Figure 5. Received Order Items at Company A

By looking at Figure 6, we can see that Company A accumulated internal reserves during the Izanami Economic Boom. We know from our interviews that many Japanese SMEs had also built up reserves, because most experienced the economic recession from 1993 to 2004, often referred to as the "lost decade." It can be hypothesized that the decisions made by managers of SMEs before the global financial crisis had been based on a strategy of risk-aversion. Because of the accumulation of internal reserves, Company A did not need to lay off employees, despite the increased ratio of personnel expenses to sales after December 2008.



Source: Company A's Financial Data

Figure 6. Internal Reserves and Ratio of Personnel Expenses to Sales

As revealed in Figure 4, Company A did not have a high volume of orders. However, the company thought it should regard the situation as an opportunity to improve the workplace, including human resources and equipment, and to consider other strategies for the future. Prior to the global financial crisis, Company A had received orders that exceeded its production capacity. Hence, they could not find enough time to proceed with the aforementioned. After the order slowdown, the company used video cameras to find excessive tasks in the operation process and make improvements to increase productivity. Second, they developed a strategy to enter next-generation industries, such as medical devices or hybrid cars. For example, they sought orders related to medical devices, regardless of profit, and bought new machinery to make the processing of larger parts possible. On the basis of such strategies, Company A was finally able to receive an order to process the dye and mould for a hybrid car from a Japanese carmaker.

On the other hand, several famous SMEs went into bankruptcy during 2009. For example, INCs, a famous medium-sized dye and mould maker that had won many prizes from the Japanese government, went bankrupt on February 25, 2009. The chief reason for the failure had been a rapid decrease in orders from the automobile industry. However, they had made excessive investments that were unrelated to their core business, such as a luxurious headquarters located in the city center of Tokyo. In our interviews, we found several similar cases. A small precision dye maker located in Chiba prefecture went bankrupt because of excessive investments in real estate, despite their high level of skills in processing precision dyes.

From these cases, it may be concluded that SMEs that focused on their core business and tried to accumulate cash as the risk averter before the global financial crisis were able to maintain their business. We can also observe from the interviews by ERI-JSPMI that some had entered next-generation industries such as hybrid cars, medical devices, and fuel batteries. On the other hand, SMEs that had made excessive investments in businesses that were not directly related to their core business either failed or headed toward bankruptcy. We can consider that the differences in the attitudes or decisions of SME managers before the global financial crisis were connected to the destinies of their respective companies after the crisis hit.

4. GOVERNMENT SME POLICY IN RESPONSE TO THE FINANCIAL CRISIS

4.1 Monetary Policy

It is generally believed that in order to stabilize the market during and after the financial crisis, the Bank of Japan (BOJ) adopted a policy that was not specifically for SMEs but intended for the entire financial system. For example, the BOJ provided "Special Funds-Supplying Operations to Facilitate Corporate Financing" until the end of March 2010. This policy provided unlimited financing, with a fixed interest rate (around 0.1%), to companies that were required to provide an equivalent value in collateral against the debt. However the policy was limited to large companies because of their lower credit risk.

On the other hand, the Credit Guarantee Corporation and government-affiliated financial institutions such as the Japan Finance Corporation (JFC) provided support to SMEs. For instance, the JFC loaned SMEs operating funds with lower interest than the market rate. The total dispersed under this policy of "Safety Net Loans" was JPY12 trillion in 2009. Other government-affiliated financial institutions, the Development Bank of Japan (DBJ) and Shoko Chukin Bank, also financed SMEs under government policy during the global financial crisis.

To counter any reluctance of banks to lend and to stop forcible withdrawals of money from SMEs, Japan's Ministry of Finance (MOF) conducted special inspections of financial institutions during the crisis. In addition, MOF established the "Act on Special Measures for Strengthening Financial Functions" in December 2008 in a bid to stabilize financing for SMEs.

4.2 Fiscal Policy

During the global financial crisis, the government put into effect several fiscal policies for SMEs. In this section, we focus on two important programs. First, the "Emergency Employment Stability Subsidy System for SMEs" was introduced by the Ministry of Health, Labor and Welfare in December 2008. The purpose was to stabilize the unemployment rate by providing subsidies to proprietors who sought to retain their employees despite faltering business. Under this policy, if employees were asked to take paid leave or undergo training, the government paid part of the salaries or training fees to SMEs.

Second, a "Grants Program for the SMEs in the Manufacturing Industry to Promote Product Development" was established in June 2009 by the Ministry of Economy, Trade and Industry. This policy supported two-thirds of the costs of product development or marketing for SMEs to enter new markets. The total amount of this subsidy was over JPY70 billion. In 2009, over 7,000 SMEs applied for this program, and one of five companies were selected, including Company A.

5. POLICY RECOMMENDATIONS

Considering Japan's situation in the global financial crisis, we can make several policy recommendations for SMEs. First, the government should not be required to provide financial support for the survival of all SMEs. We could see from our case studies that some SMEs failed due to excessive investments that were unrelated to their core business. From the standpoint of market mechanisms, those kinds of companies would, even with government support, become "zombie firms" that harm the morals and efficiency of the market.

Secondly, policies to support SMEs should be more innovative. In Japan, traditional industries such as manufacturing gasoline engine cars are being replaced by next-generation industries such as hybrid cars for a low-carbon society. One way for Japanese SMEs to overcome the recent recession is to enter those new industries. To do that, they must improve their core skills or succeed in the development of new products while upgrading both their equipment and human resources. It is thought that some SMEs need research and development collaboration with universities or public research institutes. Considering the aforementioned, we can suggest that the government help sustain excellent SMEs in adapting to the future for the good of the Japanese economy as a whole.

Finally, we suggest that the government help SMEs deal more effectively with overseas markets and companies, especially in Asia. Japanese SMEs rely heavily on large Japanese companies for orders and sales. Thus, when the global financial crisis hit large Japanese companies, SMEs also faced a crisis in their businesses. Because of the strong yen against the dollar, it is easy to predict that overseas production ratios will become much higher than they currently are. In addition, the Japanese domestic market will shrink in the long run due a decrease in its population. Therefore, Japanese SMEs will gradually be entering Asian markets, collaborating with Asian SMEs to maintain their businesses, and require much support from the government.

Republic of Korea

By Keun Hee Rhee
Korea Productivity Center

1. INTRODUCTION

The ROK's experience with an earlier economic crisis in 1998 allowed the nation to develop an infrastructure of laws, economic systems, and policies to counter instability and market uncertainties. As a result, the nation has been able to recover relatively quickly from the financial meltdown of 2008-09, especially when compared with other OECD countries. Following the latest crisis, macroeconomic indicators of the Korean economy have shown a strong recovery in production, labor market conditions, and monetary stability.

In both crises, Korean GDP followed a V-shaped growth curve, by quickly hitting a low point followed by a rapid rebound. However, SMEs have been especially vulnerable during the latest crisis. The recovery of this sector has been slowed by difficulties in labor flexibility and access to capital markets.

2. COUNTRY SITUATION

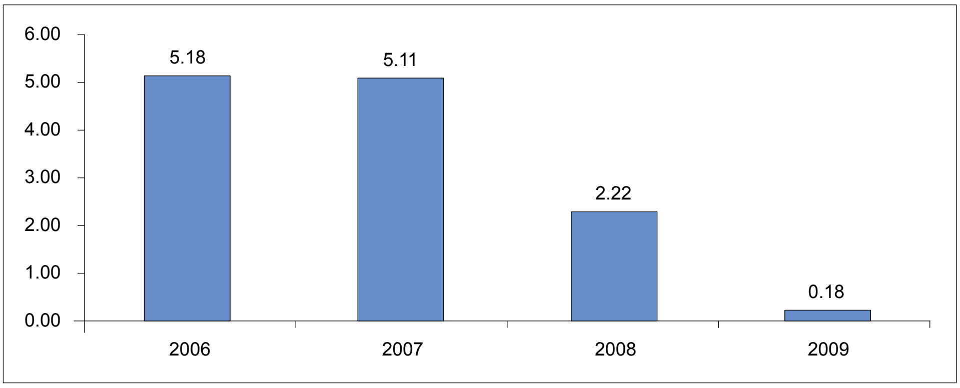
The share of SMEs in terms of the number of establishments and employment is quite high in the Korean economy, so the growth of SMEs is an accepted axis for long-term economic growth. In 2008, the GDP contribution of SMEs was 5.6% in manufacturing and 19.8% in the service sector. By comparison, the GDP contribution of large businesses was 19.7% in manufacturing and 34.4% in services.

It is well known that the overall level of productivity for SMEs is generally lower than that of large business, but this is not always the case with rates of productivity growth. The process of creative destruction can give SMEs an advantage in market entry, survival, and market exit. The labor input coefficient of SMEs—the inverse of labor productivity—was higher than large business in manufacturing and services in 2008. During the global financial crisis, SMEs have experienced limited growth in physical size and monetary factors such as sales, labor demand, liquidity, etc.

2.1 Real GDP Growth

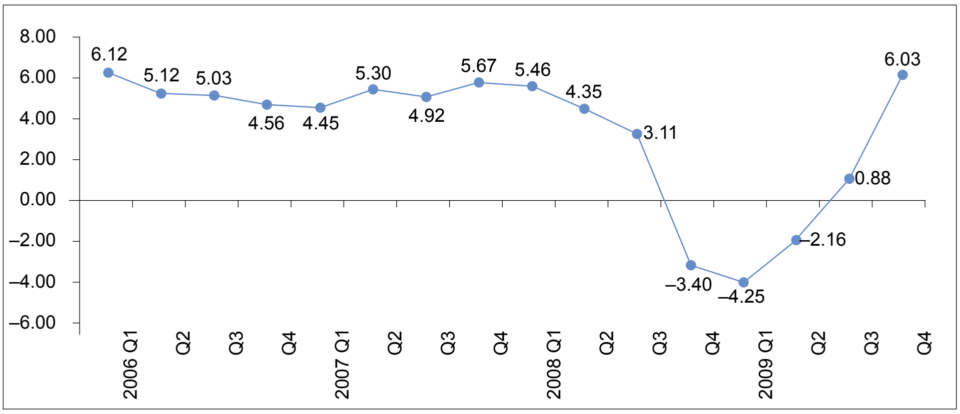
The global financial crisis, triggered by the Lehman shock in August and September 2008, negatively affected not only the monetary but also the physical aspect of the economy of the ROK. GDP growth fell from 5.11% in 2007 to 2.22% in 2008 and 0.18% in 2009 (Figure 1).

The GDP contracted for three consecutive quarters beginning in the fourth quarter of 2008 (Figure 2). In other words, the GDP growth rates were −3.40% in the fourth quarter of 2008, −4.25% in the first quarter of 2009, and −2.16% in the second quarter of 2009. Since the first quarter of 2009 when GDP growth fell to its lowest level, the ROK economy has slowly recovered from the shock, and GDP growth has recently recovered to pre-crisis levels. Thus, it can be said that the crisis had a negative impact on the growth engine of the ROK.



Source: The Bank of Korea, National Accounts, ECOS DB. (http://ecos.bok.or.kr/)

Figure 1. Annual Growth of GDP (%)

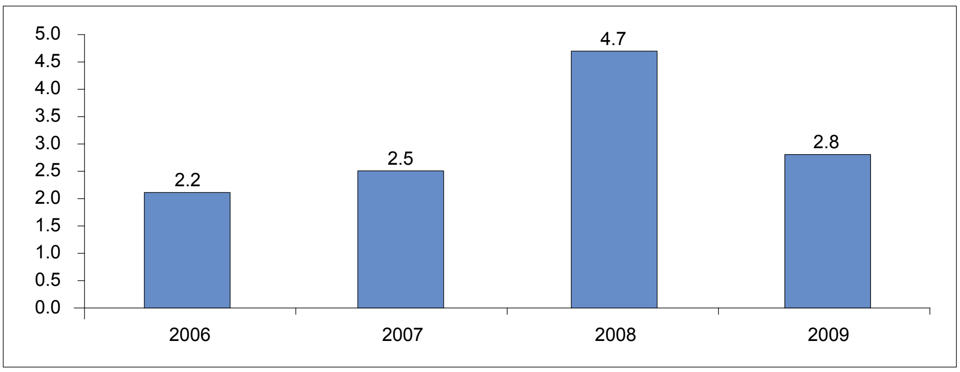


Source: The Bank of Korea, National Accounts, ECOS DB. (http://ecos.bok.or.kr/)

Figure 2. Quarterly Growth Rates of GDP (%)

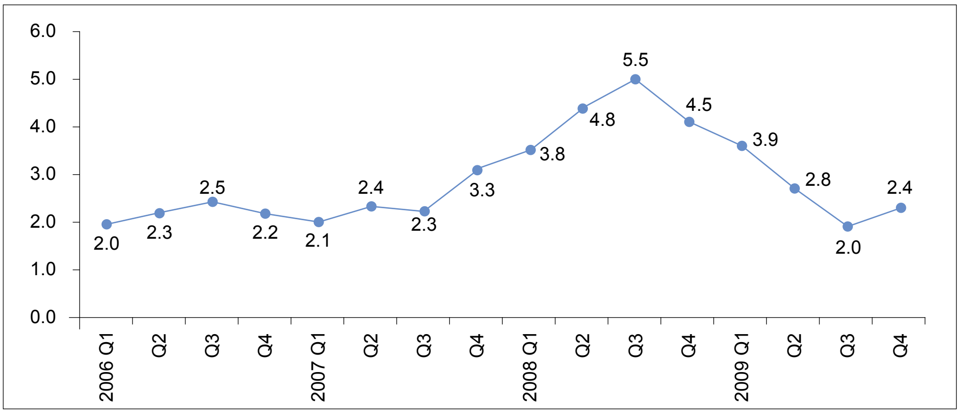
2.2 Inflation Rate

In terms of inflation, the growth of the Consumer Price Index (CPI) increased by 4.7% in 2008 and stabilized at 2.8% in 2009 (Figure 3). The CPI reached its peak of 5.5% in the third quarter of 2008 and then began a downward trend, after which it eventually reached its bottom at 2.0% in the third quarter of 2009 (Figure 4). So we can see that the crisis has had a direct impact on private consumption.



Source: Statistics Korea, Consumer Price Survey. (http://kosis.kr/)

Figure 3. Annual Growth of CPI (%)



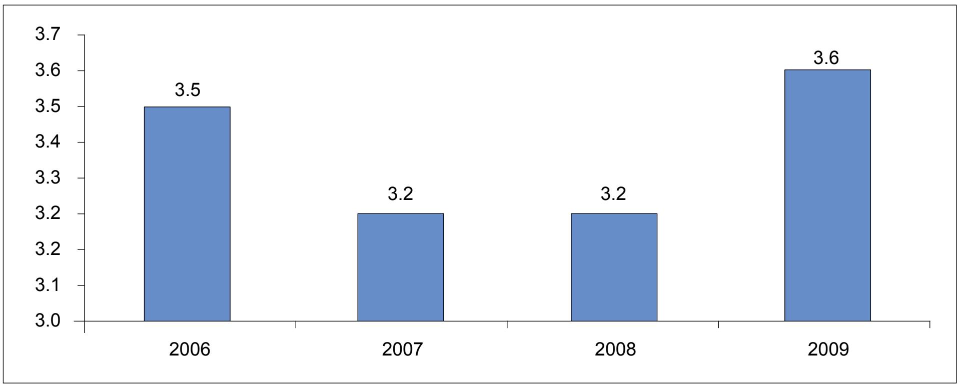
Source: Statistics Korea, Consumer Price Survey. (http://kosis.kr/)

Figure 4. Growth Rates of Quarterly CPI (%)

2.3 Unemployment Rate

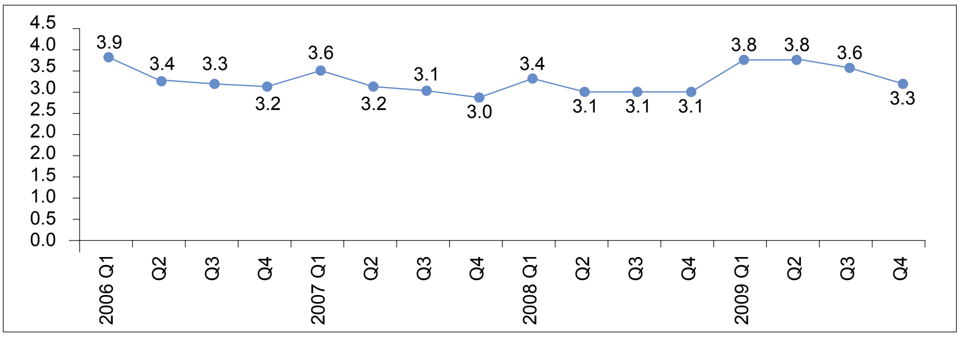
In terms of the labor market, the global financial crisis led to an increase in the unemployment rate, albeit with a slight time lag due to the labor adjustment process. As seen in Figure 5, the unemployment rate went up from 3.2% in 2008 to 3.6% in 2009.

The unemployment rate reached its peak at 3.8% in the first and second quarters of 2009, and stabilized as indicated in Figure 6. So we can see the deterioration of labor market conditions as a result of the crisis.



Source: Statistics Korea, Economically Active Population Survey. (http://kosis.kr/)

Figure 5. Annual Unemployment Rate (%)

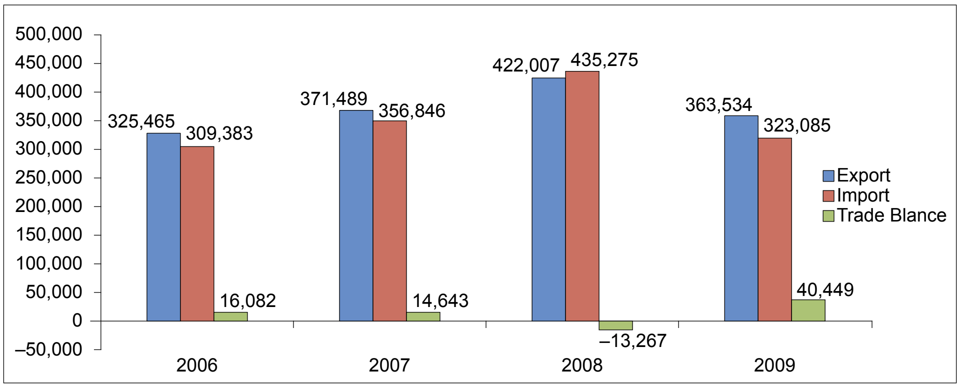


Source: Statistics Korea, Economically Active Population Survey. (http://kosis.kr/)

Figure 6. Quarterly Unemployment Rate (%)

2.4 Trade

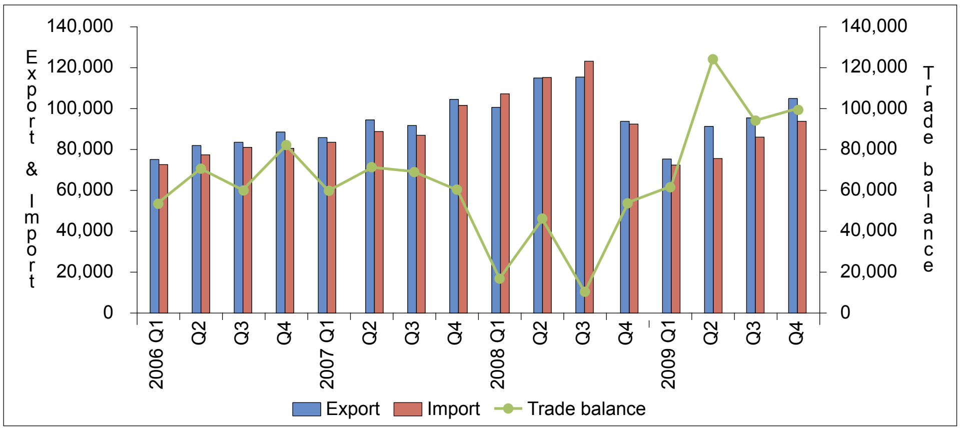
The crisis also pushed the trade balance into deficit. In 2008, imports exceeded exports because of a decrease in foreign demand owing to the global financial crisis, and the ROK had a trade deficit of USD13,267 million (Figure 7). The trade balance returned to a surplus in 2009 as the ROK economy recovered.



Source: The Bank of Korea, ECOS DB. (http://ecos.bok.or.kr/)

Figure 7. Exports, Imports, and Trade Balance by Year (USD million)

The trade balance was at its worst level in the third quarter of 2008, and it has rapidly improved since then (Figure 8). In other words, the trade balance was at –USD7,901 million in the third quarter of 2008 followed by surplus of USD1,543 million in the fourth quarter. The surplus grew to USD3,004 million in the first quarter of 2009 and USD16,390 million in the second quarter (Annex 4). Thus, the crisis had a negative effect on the trade balance because it reduced aggregate demand, especially foreign demand for goods and services.



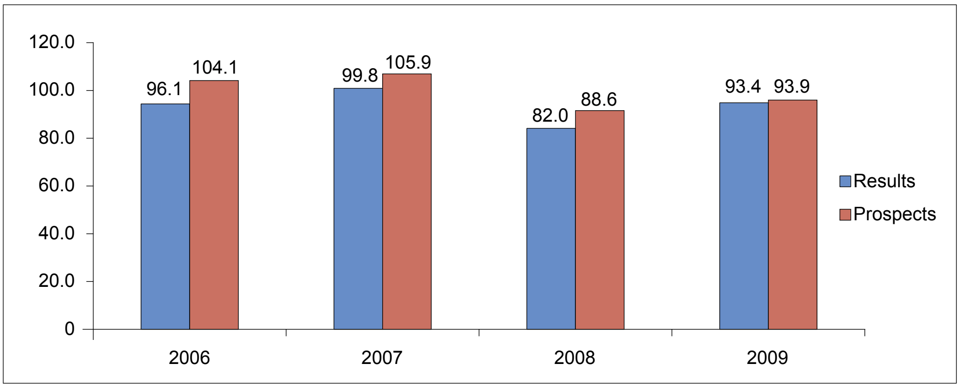
Source: The Bank of Korea, ECOS DB. (http://ecos.bok.or.kr/)

Figure 8. Exports, Imports, and Trade Balance by Quarter (USD million)

2.5 Business Condition Index

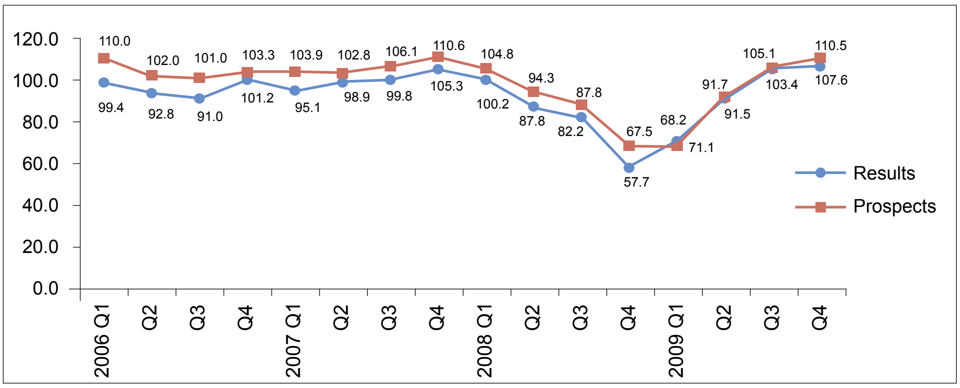
We can further understand economic conditions by taking a look at the views of producers through the Business Survey Index (BSI). The BSI shows the deteriorating economic conditions resulting from the global financial crisis. The index was 82.0 (results) and 88.6 (prospects) in 2008, but recovered in 2009 as seen in Figure 9.

Through the quarterly BSI, we can clearly see that economic conditions were the worst during the fourth quarter of 2008 and that the indexes slowly recovered (Figure 10) as did other macroeconomic indicators.



Source: The Federation of Korean Industries, Monthly Business Survey Index

Figure 9. Business Survey Index by Year



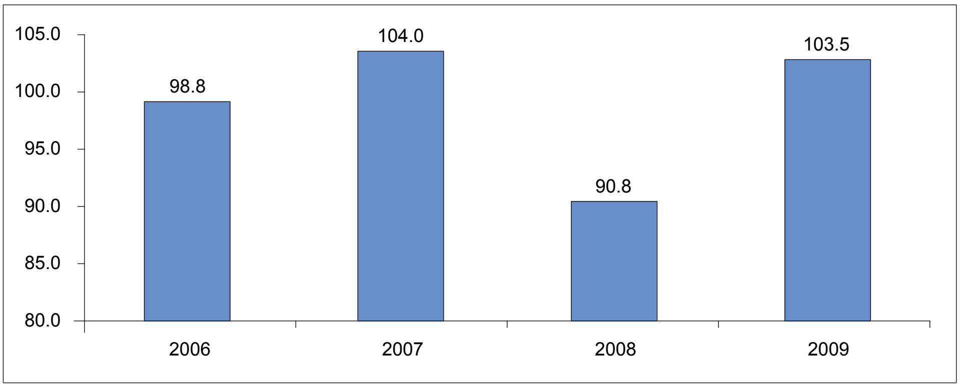
Source: The Federation of Korean Industries, Monthly Business Survey Index

Figure 10. Business Survey Index by Quarter

2.6 Consumer Sentiment Index

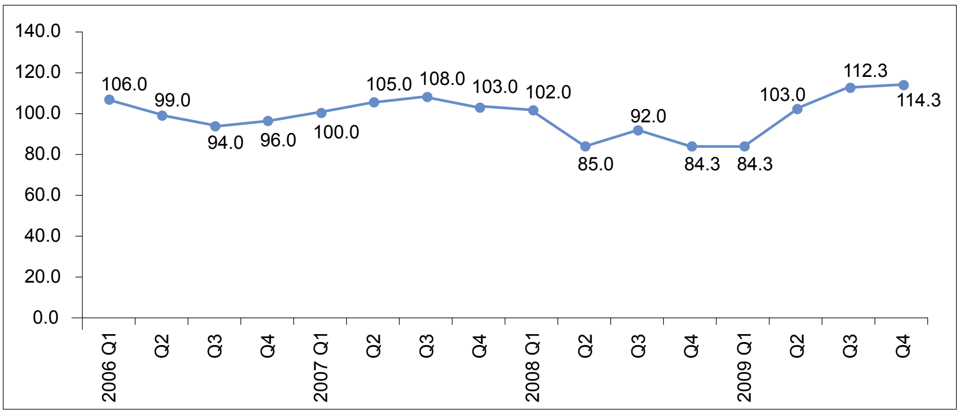
We can assess economic conditions from the views of consumers through the Consumer Sentiment Index (CSI). Many consumers recognized that economic conditions had worsened as a result of the crisis. The CSI was 90.8 for 2008, below the reference level of 100. However, consumer sentiment recovered to 103.5 the following year, climbing back above the reference level (Figure 11).

In the quarterly CSI, the index was lower during the fourth quarter of 2008 (84.3) and in the first quarter of 2009 (84.3) than during any other period going back to the beginning of 2006 (Figure 12).



Source: The Bank of Korea, Consumer Survey Index, ECOS DB. (http://ecos.bok.or.kr/)

Figure 11. Consumer Sentiment Index by Year



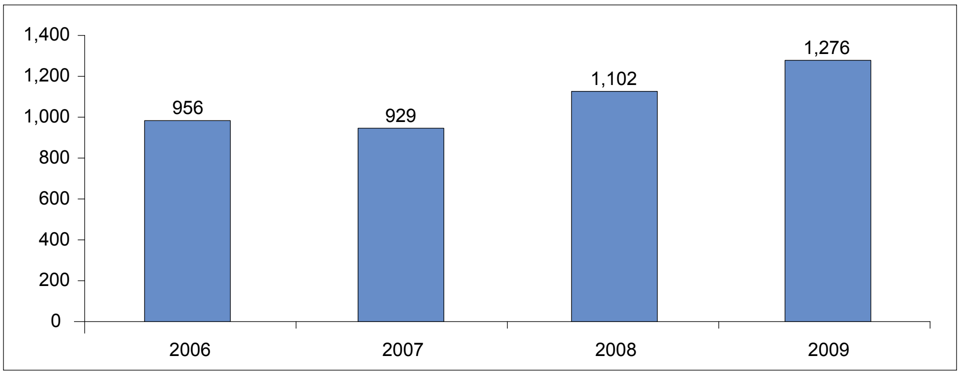
Source: The Bank of Korea, Consumer Survey Index, ECOS DB. (http://ecos.bok.or.kr/)

Figure 12. Consumer Sentiment Index by Quarter

2.7 Exchange Rates

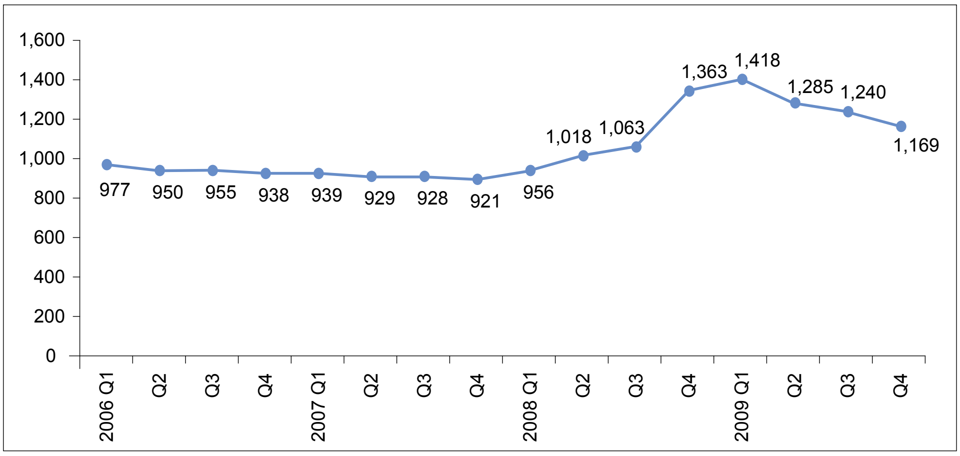
The crisis triggered a rapid depreciation of the KRW against the USD. The exchange rate rose from 1,102 in 2008 to 1,276 in 2009 as seen in Figure 13. This depreciation of the national currency accelerated sharply in the fourth quarter of 2008 and reached its peak in the first quarter of 2009 at KRW1,418 to the USD.

The depreciation contributed temporarily to an improvement in the trade balance by making exports less expensive for foreign customers and raising the domestic costs of imported goods and services.



Source: The Bank of Korea, ECOS DB. (http://ecos.bok.or.kr/)

Figure 13. Exchange Rates by Year (Average Market Rates, KRW/USD)

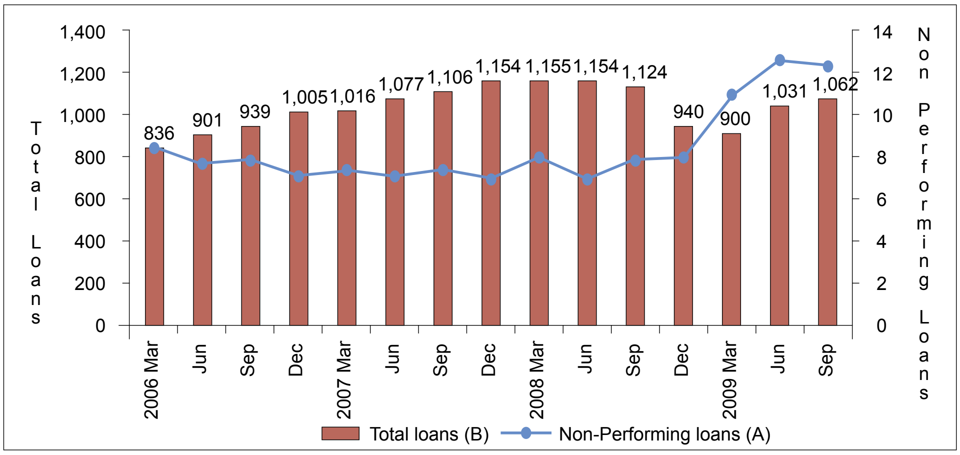


Source: The Bank of Korea, ECOS DB. (http://ecos.bok.or.kr/)

Figure 14. Exchange Rates by Quarter (Average Market Rates, KRW/USD)

2.8 Non-Performing Loans/Total Loans

During the crisis, total loans decreased, while non-performing loans increased due to bankruptcies and legal management of insolvent enterprises (Figure 15). Thus the ratio of non-performing loans to total loans rose above 1% in March 2009 (Annex 5). Total loans were at USD1,124 billion in September 2008 and dropped to USD900 billion by March 2008, when the ratio of non-performing loans to total loans hit 1.21% (Annex 5). This reflected a credit crunch that resulted from the global economic crisis.

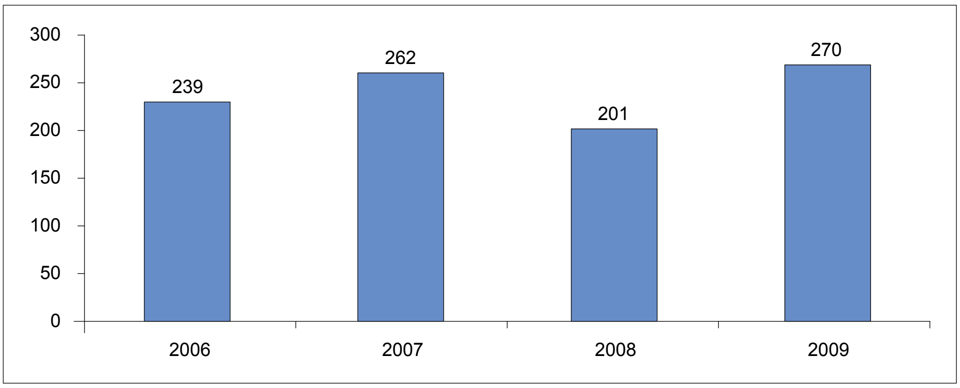


Source: Financial Supervisory Service, Monthly Financial Statistics Bulletin. (http://www.fss.or.kr/)

Figure 15. Non-Performing Loans/Total Loans (USD billion)

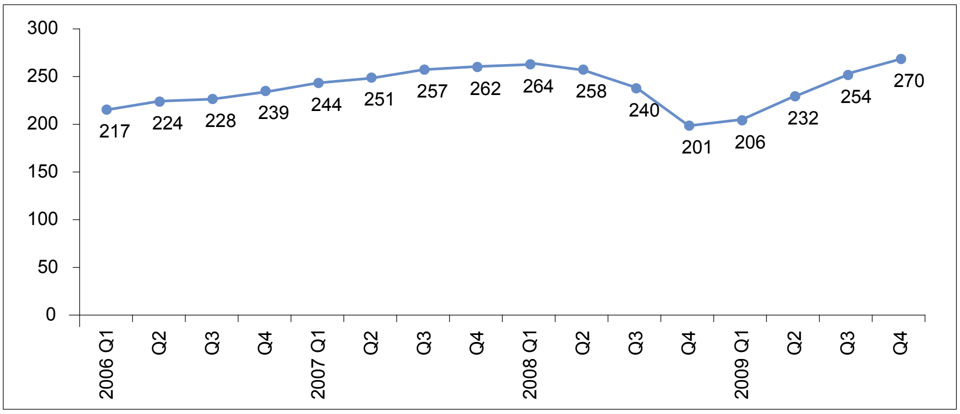
2.9 Foreign Reserves

Figure 16 shows that foreign reserves dropped to USD201 billion in 2008 but recovered to pre-crisis levels the following year at USD270 billion. Foreign reserves bottomed at their lowest level in the fourth quarter of 2008 at USD201 billion as seen in Figure 17. At that point, the government intervened to stabilize the foreign exchange market. The crisis had prompted the use of policy tools, including market intervention, to stabilize the nation's currency.



Source: The Bank of Korea, ECOS DB. (http://ecos.bok.or.kr/)

Figure 16. Foreign Reserves by Year (USD billion)



Source: The Bank of Korea, ECOS DB. (http://ecos.bok.or.kr/)

Figure 17. Foreign Reserves by Quarter (USD billion)

3. CRISIS IMPACT ON SMEs

3.1 Overview of SMEs

3.1.1 Description of SMEs

In general, SMEs in manufacturing are defined as companies that meet one of two conditions: they employ less than 300 regular workers or have less than KRW 8 billion in capital. In the non-manufacturing sector, the criteria for SMEs differ according to the type of business (Table 1).

Table 1. Definition of SMEs by Regular Workers, Capital, and Sales

Industry	Definition
(1) Manufacturing	Less than 300 regular workers or below KRW8 billion in capital
(2) Mining (3) Construction (4) Transportation	Less than 300 regular workers or below KRW3 billion in capital
(5) Information and Communication (6) Business Facilities Management and Business Support Services (7) Human Health and Social Work	Less than 300 regular workers or below KRW30 billion in sales
(8) Agriculture, Forestry, and Fishing (9) Electricity, Gas, Steam, and Water Supply (10) Wholesale and Retail Trade (11) Accommodation and Food Service (12) Financial and Insurance Activities (13) Professional, Scientific, and Technical Activities (14) Arts, Sports, and Recreation Services	Less than 200 regular workers or below KRW20 billion in sales
(15) Sewerage, Waste Management, Material Recovery, and Remediation (16) Education (17) Repair and Other Personal Services	Less than 100 regular workers or below KRW10 billion in sales
(18) Real Estate Activities Including Renting and Leasing	Less than 50 regular workers or below KRW5 billion in sales

Source: Small and Medium Business Administration, Minor Enterprise Basic Law

3.1.2 Number of Companies by Size

In 2008, the number of large businesses with 300 employees or more totaled 2,929, while there were 3,261,853 SMEs with less than 300 employees. Among these SMEs, there were 34,956 medium-sized establishments with 50 to 299 employees, 514,414 small companies with five to 49 people, and 2,712,483 micro-size firms with one to four persons (Table 2). Thus, it can be said that SMEs with one to 299 employees comprise the vast majority of companies in the ROK at 99.9%.

Table 2. Distribution of Companies by Size (Number and % of Establishments)

Size	Establishments		Shares	
	2007	2008	2007	2008
(1) 1–4 Persons	2,711,913	2,712,483	83.1	83.1
(2) 5–9 Persons	310,172	309,810	9.5	9.5
(3) 10–19 Persons	133,321	131,797	4.1	4.0
(4) 20–49 Persons	72,007	72,807	2.2	2.2
(5) 50–99 Persons	22,683	24,208	0.7	0.7
(6) 100–299 Persons	10,135	10,748	0.3	0.3
(7) 300–499 Persons	1,437	1,613	0.0	0.0
(8) 500–999 Persons	850	873	0.0	0.0
(9) over 1000 Persons	407	443	0.0	0.0
5–49 Persons	515,500	514,414	15.8	15.8
50–299 Persons	32,818	34,956	1.0	1.1
1–299 Persons	3,260,231	3,261,853	99.9	99.9
over 300 Persons	2,694	2,929	0.1	0.1
Total	3,262,925	3,264,782	100.0	100.0

Source: Statistics Korea, Census on Establishments. (http://kosis.kr/)

3.1.3 Number of SMEs by Sector

In 2008, there were 3,264,782 business establishments in total. Agriculture accounted for 0.05% of the companies. In manufacturing, there were 319,424 companies, which made up 9.78% of all business establishments. The service sector had 2,837,741 companies, an 86.92% share of all business establishments (Table 3). Thus, in terms of size and sector, we can say that SMEs play a crucial role in the ROK economy, especially SMEs in the service sector.

Table 3. SME Establishments by Sector (Number of Businesses, % of Total)

Sector	SME Establishments		Share of Total	
	2007	2008	2007	2008
Agriculture	1,631	1,561	0.05	0.05
Manufacturing	332,011	319,424	10.18	9.78
Service	2,823,993	2,837,741	86.55	86.92
Others	105,290	106,056	3.23	3.25
Total	3,262,925	3,264,782	100.00	100.00

Source: Statistics Korea, Census on Establishments. (http://kosis.kr/)

Note: 1) The service sector here includes: wholesale and retail trade, restaurants, transportation, finance and real estate, social services, and private services. It does not include: electricity, construction, forestry, fishing, mining and quarrying.

2) An SME here has 299 or fewer employees.

3.1.4 SME Contribution to GDP by Sector

In general, there are no suitable GDP statistics in national accounts with either size or sector categories, so we need an imputation based on other available statistics. Measurements of SME market share by company size and sector are available from the Report on the Survey of Business Activities by Statistics Korea. We have applied these to nominal GDP levels.

Our results indicate that SME contributions to the GDP were 2% for agriculture, 5.6% for manufacturing, and 19.8% for the service sector in 2008 (Table 4). On the other hand, GDP contributions by large businesses were 19.7% for manufacturing and 34.4% in the service sector in 2008. Thus, we can estimate that the contribution of SMEs to nominal GDP is about half that of large businesses.

Table 4. Contribution to Nominal GDP by Size and Sector (USD million, %)

	SME (A)	Large (B)	GDP (C)	A/C*100	B/C*100
	2007				
Agriculture	23,625	–	1,049,236	2.3	–
Manufacturing	58,247	198,528	1,049,236	5.6	18.9
Service	145,640	419,140	1,049,236	13.9	39.9
	2008				
Agriculture	18,300	–	929,264	2.0	–
Manufacturing	51,914	182,811	929,264	5.6	19.7
Service	183,623	320,108	929,264	19.8	34.4

Source: 1) Statistics Korea, Report on the Survey of Business Activities. (http://kosis.kr/)
2) The Bank of Korea, National Accounts, ECOS DB. (http://ecos.bok.or.kr/)

Note: 1) The service sector here includes: wholesale and retail trade, restaurants, transportation, finance and real estate, social services, and private services. It does not include: electricity, construction, forestry, fishing, mining and quarrying.
2) An SME here has 299 or fewer employees.

3.1.5 SME Employment to GDP by Sector

The labor input coefficient, or employment to GDP, is the reverse of labor productivity. The coefficient reflects the workers needed to produce value added units of output. In 2008, the labor input coefficient for SMEs was 864 in agriculture, 51,169 in manufacturing, and 61,295 in the service sector. The coefficient for large businesses was 3,651 for manufacturing and 4,767 in services (Table 5).

Thus, the service sector needs more workers to produce a value added unit than manufacturing. Inversely, this means that of the two, labor productivity in the service sector is lower. In terms of size, SMEs need more workers than large businesses to produce a value added unit, which means that the labor productivity of SMEs is lower.

Table 5. SME Employment to GDP by Sector (Employment/USD thousand)

	2007		2008	
	SME	Large	SME	Large
Agriculture	815	–	864	–
Manufacturing	44,526	3,137	51,169	3,651
Service	73,886	3,189	61,925	4,767

Source: 1) The Bank of Korea, National Accounts, ECOS DB. (http://ecos.bok.or.kr/)
2) Statistics Korea, Census on Establishments. (http://kosis.kr/)

Note: 1) The service sector here includes: wholesale and retail trade, restaurants, transportation, finance and real estate, social services, and private services. Not included are: electricity, construction, forestry, fishing, mining and quarrying.
2) An SME here has 299 or fewer employees.
3) The GDP by sector for labor input coefficient is real GDP.

3.2 Crisis Impact on SMEs by Sector-Level Analysis

3.2.1 Sales

Table 6 shows that for the period 2006–08, SME sales in manufacturing averaged 29.3% of the sales by large manufacturers. In the service sector, SME sales averaged 42.4% of their large business counterparts (Table 6). Thus, the SME share of sales in the service sector was larger than in manufacturing. This is because in some service business areas, small and medium establishments are dominant. Statistics for sales by company size and sector were not yet available for 2009. However, we believe a similar pattern was maintained.[1]

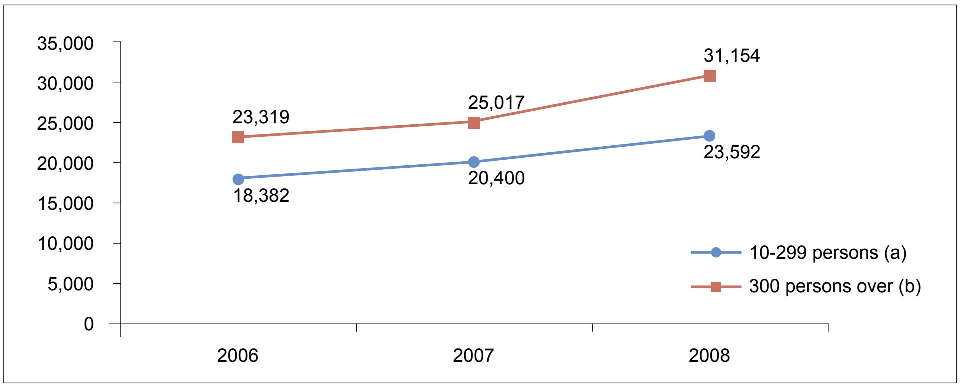
Table 6. Sales by Size and Sectors (KRW billion, %)

		2006	2007	2008	Average
Agriculture	SME (a)	142	146	214	–
	Large Businesses (b)	–	–	–	–
Manufacturing	SME (a)	176,393	189,240	220,522	–
	Large Businesses (b)	584,118	645,007	776,550	–
	Share (a/b*100)	30.2	29.3	28.4	29.3%
Services	SME (a)	157,078	184,891	494,589	–
	Large Businesses (b)	449,348	532,102	862,212	–
	Share (a/b*100)	35.0	34.7	57.4	42.4%

Source: Statistics Korea, Report on the Survey of Business Activities. (http://kosis.kr/)
Note: In the Report on the Survey of Business Activities, the scope of SMEs is 50–299 employees, and 300 or more employees for large businesses.

3.2.2 Inventory

In 2006–08, the manufacturing inventory of SMEs averaged KRW20,791 billion, and that of large businesses KRW26,497 billion (Table 7 and Figure 18). The ratio of inventory was 78.7% on average. The pattern was likely maintained in 2009.[2]



Source: Statistics Korea, Report on Mining and Manufacturing. (http://kosis.kr/)

Figure 18. Inventory in Manufacturing (KRW billion)

[1] The statistics of sales by sizes and sectors in 2009 were not available until 2010.

[2] The statistics of manufacturing inventory by sizes and sectors in 2009 were not available until 2010.

Table 7. Inventory in Manufacturing (KRW billion, %)

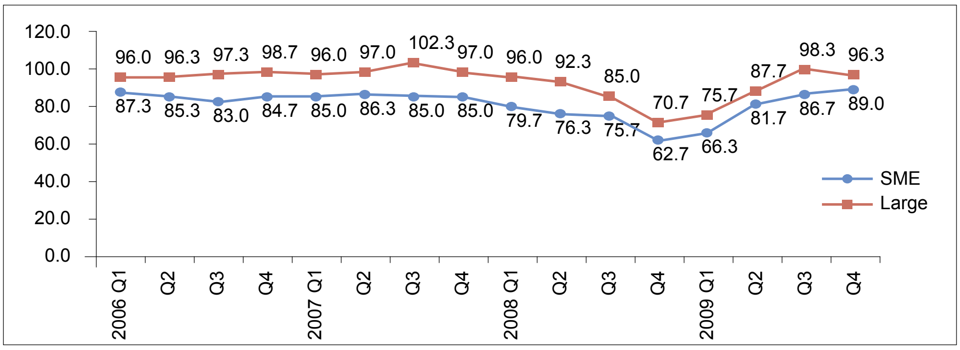
	2006	2007	2008	Average
SMEs (a)	18,382	20,400	23,592	20,791
Large Businesses (b)	23,319	25,017	31,154	26,497
Share (a/b*100)	78.8	81.5	75.7	78.7

Source: Statistics Korea, Report on Mining and Manufacturing. (http://kosis.kr/)
Note: (Figure 18 and Table 7): The Report on Mining and Manufacturing designates SMEs as companies with 10–299 employees, and large businesses 300 or more employees.

3.2.3 Liquidity

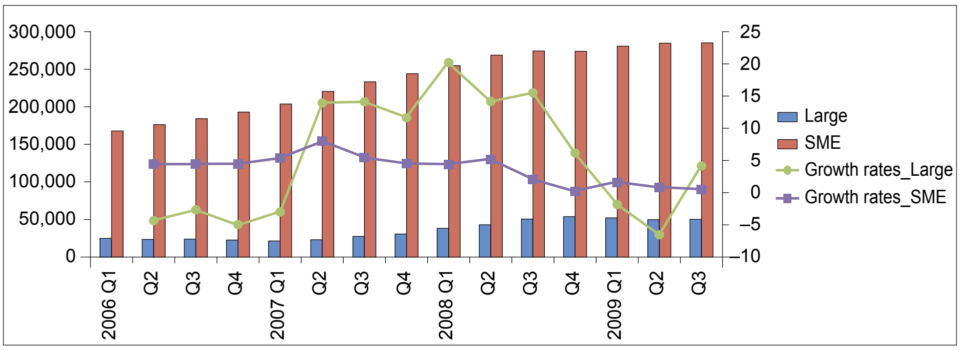
According to the Business Survey Index (BSI) of the financial situation, the indexes were the lowest in the fourth quarter of 2008 (Figure 19). In other words, in manufacturing during the fourth quarter of 2008, the BSI of the financial situation of SMEs was 70.7, and that of large businesses was 62.7. So we can say that both SMEs and large businesses apparently experienced a bottleneck of liquidity.

In practice, the increase in loans from the banking sector to businesses slowed in the fourth quarter of 2008 (Figure 20). Total bank loans for large businesses had dropped since the third quarter of 2008, falling to their lowest levels in the second quarter of 2009. As to SMEs, a slowdown trend in bank lending had become evident in the second quarter of 2008, falling to its lowest levels in the fourth quarter of 2008.



Source: The Bank of Korea, Business Survey Index, ECOS DB. (http://ecos.bok.or.kr/)

Figure 19. BSI of Financial Situation in Manufacturing



Source: Financial Supervisory Service, Monthly Financial Statistics Bulletin. (http://www.fss.or.kr/)
Note: The growth rates are comparisons to the previous quarter.

Figure 20. Bank Lending to Large Businesses and SMEs (Whole Economy) (KRW billion, %)

3.2.4 Layoffs of Workers

In manufacturing, the number of regular workers who were laid off by SMEs, including retired and displaced, was 351,000 in 2006, 271,000 in 2007, and 389,000 in 2008 (Table 8). Among SMEs, layoffs by small size companies (employing five to 49) were greater than at medium size businesses (50–299 employees). In other words, the share of regular SME workers who were laid off at small size companies was 65.4%, and that of medium size firms was 34.6% (Table 8).

Table 8. Regular Workers Retired or Displaced at SMEs (Manufacturing, Persons, %)

Size	Retired or Displaced Workers			Shares			Average
	2006	2007	2008	2006	2007	2008	
5–9 persons	50,747	55,624	81,665	14.4	20.5	21.0	18.7
10–19 persons	73,293	53,813	81,928	20.9	19.9	21.1	20.6
20–49 persons	95,665	73,734	93,215	27.2	27.2	24.0	26.1
50–99 persons	60,596	42,043	58,180	17.2	15.5	15.0	15.9
100–199 persons	46,003	33,309	50,230	13.1	12.3	12.9	12.8
200–299 persons	25,129	12,569	23,273	7.2	4.6	6.0	5.9
Total	351,433	271,092	388,491	100.0	100.0	100.0	100.0
5–49 persons	219,705	183,171	256,808	62.5	67.6	66.1	65.4
50–299 persons	131,728	87,921	131,683	37.5	32.4	33.9	34.6

Source: Korea Federation of Small and Medium Business, Survey on Actual State of SMEs. (http://www.kbiz.or.kr/)

4. GOVERNMENT SME POLICIES IN RESPONSE TO THE CRISIS

Next, we will examine government policies to cope with the crisis in monetary, fiscal, trade, and restructuring terms.

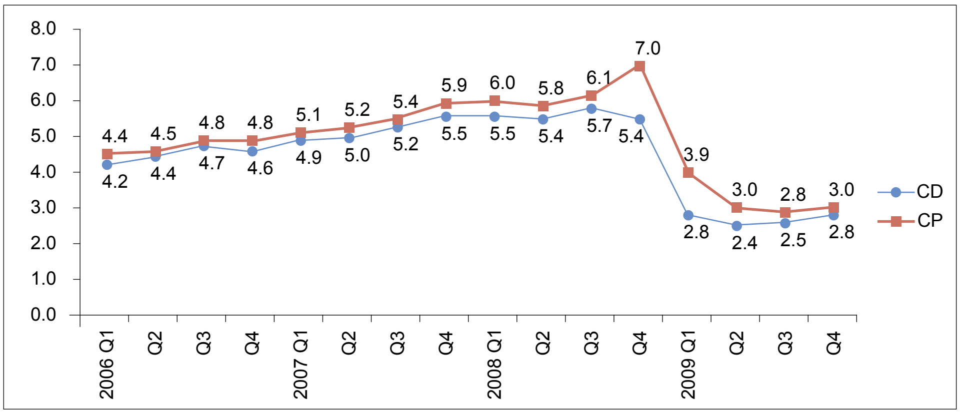
4.1 Monetary Policy

For a period of eight months following the Lehman failure in 2008, the Bank of Korea spent KRW24.6 trillion in its use of monetary tools to settle the instability in financial markets (Table 9). Consequently, interest rates on instruments such as Certificates of Deposit (CDs) and Commercial Paper (CP) stabilized in the first quarter of 2009 (Figure 21). In the case of CP, interest rates peaked at 7.0% in the fourth quarter of 2008 but dropped more than three percentage points in the following quarter. With CDs, the interest rate peaked at 5.7% in the third quarter of the same year, but this also fell by about two percentage points in 2009.

Table 9. Money Supply of the Bank of Korea (12 Sep. 2008 to 7 May 2009) (KRW trillion)

Category	Money Supply
Open Market Operations	18.5
Credit Ceiling Loan of BOK	3.5
Reserve Requirement	0.5
Bond Market Fund	2.1
Total	24.6

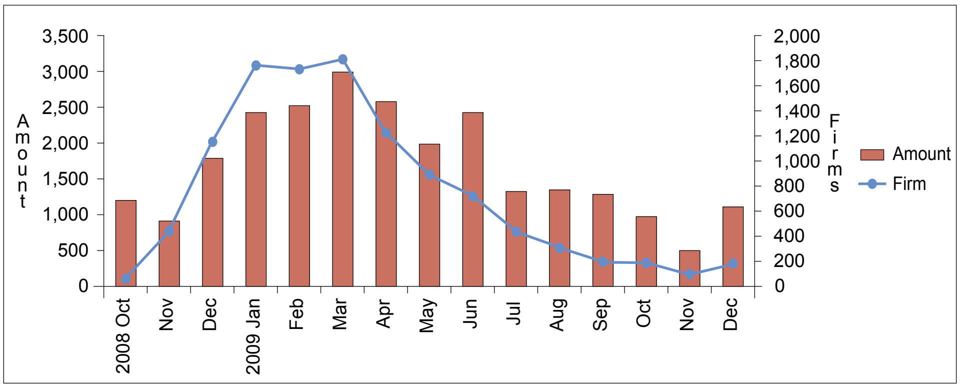
Source: National Assembly Budget Office (2009), Analysis on Financial Policy for Global Financial Crisis (in Korean)



Source: Bank of Korea, ECOS DB. (http://ecos.bok.or.kr/)

Figure. 21 Trend of Market Interest Rates

Also, the ROK government provided economic support to SMEs after the Lehman failure through bank loans involving the Credit Guarantee Fund. In particular, the government provided 11,250 SMEs with liquidity of KRW25,398 billion between October 2008 and December 2009 through a special support effort called the "Fast Track Program."[3] The support peaked in March 2009 (Figure 22 and Table 10). This program was started by the government and the Bank of Korea in October 2008 to remove a bottleneck of liquidity among SMEs. Moreover, this program for SMEs was set to be extended until June 2010.



Source: Financial Supervisory Service. (www.fss.or.kr)

Figure 22. SME Financial Support by the Fast Track Program (KRW billion, number of firms)

Table 10. SME Financial Support by the Fast Track Program (number of firms, KRW billion)

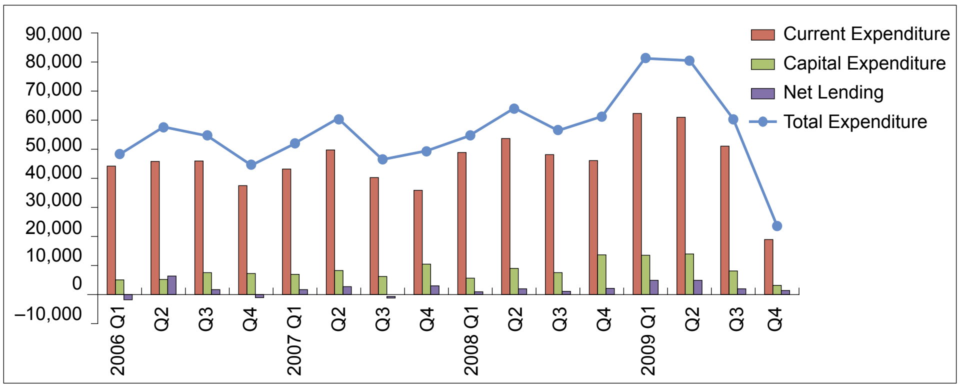
Period	Firms	Amount	Period	Firms	Amount
2008 Oct.	58	1,213	Jun	716	2,417
Nov.	457	916	Jul	431	1,337
Dec.	1,157	1,782	Aug	311	1,357
2009 Jan.	1,755	2,412	Sep	207	1,299
Feb.	1,724	2,522	Oct	202	982
Mar.	1,812	2,971	Nov	102	526
Apr.	1,231	2,569	Dec	194	1,120
May	893	1,975	Total	11,250	25,398

Source: Financial Supervisory Service. (http:ww.fss.or.kr/)

[3] From January to September 2009, the share of loans by the Fast Track Program to nominal GDP is estimated at about 2.4%.

4.2 Fiscal Policy

Fiscal policy provided another effective tool that was used by the Korean government during the crisis. Government expenditures to deal immediately with the crisis peaked in the first quarter of 2009 at KRW81,007 billion (Figure 23 and Table 11).



Source: Ministry of Strategy and Finance, Government Financial Statistics. (www.mosf.go.kr/)

Figure 23. Government Financial Expenditure (KRW billion)

Table 11. Government Financial Expenditure (KRW billion)

	Total Expenditure	Current Expenditure	Capital Expenditure	Net Lending
2006 Q1	48,266	44,328	5,611	−1,673
Q2	58,282	45,994	5,504	6,784
Q3	54,998	45,978	7,876	1,144
Q4	44,382	37,388	7,502	−509
2007 Q1	52,162	43,681	7,134	1,347
Q2	61,268	49,755	8,716	2,797
Q3	46,386	40,292	6,303	−209
Q4	49,994	35,930	10,892	3,172
2008 Q1	55,356	48,947	5,768	641
Q2	64,560	53,823	8,939	1,798
Q3	56,807	48,049	7,900	858
Q4	62,111	46,060	13,868	2,183
2009 Q1	81,007	62,363	13,832	4,812
Q2	80,186	61,207	14,216	4,763
Q3	60,683	51,062	8,225	1,396
Q4	24,095	19,279	3,382	1,435

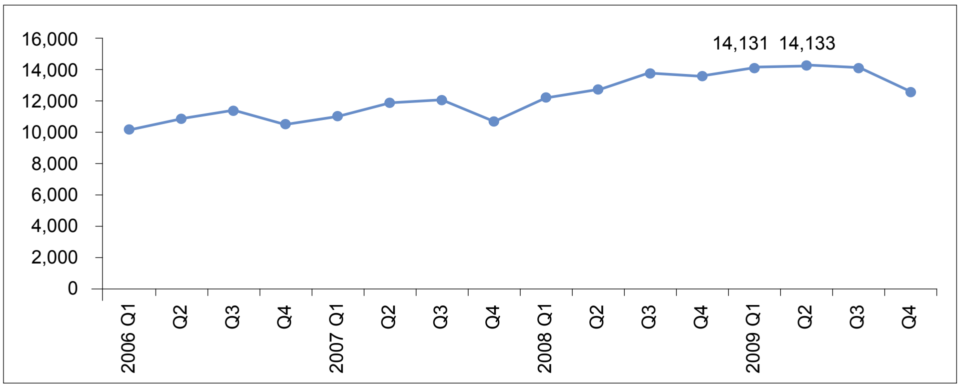
Source: Ministry of Strategy and Finance, Government Financial Statistics. (www.mosf.go.kr/)

In 2008–09, the ROK economy was hit with a drop in both foreign demand and domestic demand due to the crisis. The government boosted its expenditures for SME management, low-income groups, social overhead cost investment, job creation, and so forth.

Moreover, the government also implemented tax policies that reduced income, corporate, and consumption taxes. In addition, it increased R&D tax credits and provided other incentives to help revitalize the economy.

4.3 Trade Policy

To encourage exports, the ROK government expanded financing for trade during the crisis. In the first and second quarter of 2009, the amount of trade financing reached peaks of KRW14,131 billion and KRW14,133 billion, respectively (Figure 24). In addition, the supply of guaranteed insurance was expanded for trade financing in export-intensive industries such as shipbuilding.



Source: The Bank of Korea, ECOS DB. (http://ecos.bok.or.kr/)

Figure 24. Trade Financing (KRW billion)

Table 12. Trade Financing (KRW billion)

	Q1	Q2	Q3	Q4
2006	10,297	10,887	11,374	10,347
2007	10,990	11,879	12,011	10,667
2008	12,363	12,728	13,832	13,459
2009	14,131	14,133	13,971	12,449

Source: Bank of Korea, ECOS DB. (http://ecos.bok.or.kr/)

4.4 Restructuring Policy

The ROK experienced an economic crisis in 1998, during which it developed survival strategies of intensive restructuring. Since then, it has built an infrastructure for restructuring that includes laws, economic systems, and practices. The government has consistently progressed in its efforts to counter instability and market uncertainties.

At present, the basic direction of restructuring policy focuses on providing relief for companies with the potential to survive, while at the same time quickly liquidating those that are unable to endure. Moreover, the government has prepared tools such as the "Restructuring Fund" and the "Financial Stabilization Fund" for efficient restructuring. As a result, 36 firms among 186 SMEs in construction and shipbuilding have been restructured during the global financial crisis.[4]

[4] National Assembly Budget Office (2009), Analysis on Financial Policy for Global Financial Crisis (in Korean), pp 34–38.

5. POLICY RECOMMENDATIONS

The financial crisis was a global economic shock triggered by foreign factors such as the Lehman failure, and it has severely impacted the physical, monetary, and international aspects of the world economy. In particular, the financial instability had a negative effect on SMEs, and we can learn from this experience.

As economic indicators turned around in 2009, it can be said that we have just passed the crisis. The past experience of an economic crisis in 1998 was a key factor in the government's decisions this time. We will now try to address some of the implications of the fiscal, monetary, restructuring, and foreign exchange policies used during this crisis.

5.1 Fiscal Policy

First, it is important to minimize the secondary effects of a crisis on physical sectors such as domestic consumption, exports, and employment. It is therefore necessary to implement immediate fiscal and tax policies. Such policies will help the growth engine recover by creating effective demand and employment. However, an increase in government expenditures can lead to an overflow of liquidity, inflation, and create additional economic instability. Thus another important issue is to decide on a so-called exit strategy and its timing.

5.2 Financial and Restructuring Policy

Secondly, as SMEs are relatively vulnerable during an economic crisis, they are easily affected by any credit crunch. Policies are urgently needed for smoothing the supply of liquidity and reducing interest rates to alleviate any liquidity shortage for SMEs. At the same time, we must implement restructuring strategies with financing for selective SMEs that have good chances for revival. This will help protect the banking sector against insolvencies and improve the competitiveness of SMEs.

5.3 Foreign Exchange Policy

Thirdly, in order to prevent sudden depreciation of the national currency during an economic crisis, it is also important for the government to secure a supply of foreign currencies. The national economy is a kind of system, and it is crucial to maintain an equilibrium. If a foreign market loses its balance, it will have a negative effect on the domestic macroeconomic system. So it is necessary for international authorities to be prepared for currency swaps and other measures.

To summarize, even if we cannot adequately predict global economic crises, it is important to set up a system of crisis management to minimize the economic impact and settle down markets as soon as possible. This means that we must institutionalize effective policy tools in order to respond immediately to a crisis in the physical, monetary, and foreign markets. Moreover, we need to build an international cooperation network to deal with crises as an economic bloc and to minimize instability.

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Annexes

Annex 1. Real GDP and GDP Growth

(KRW billion)

	2006	2007	2008	2009
Yearly	910,049	956,515	977,787	979,508
Q1	212,469	221,931	234,055	224,109
Q2	227,416	239,458	249,865	244,457
Q3	227,901	239,125	246,570	248,728
Q4	242,263	256,000	247,297	262,214
		Growth		<(%)>
Yearly	5.18	5.11	2.22	0.18
Q1	6.12	4.45	5.46	−4.25
Q2	5.12	5.30	4.35	−2.16
Q3	5.03	4.92	3.11	0.88
Q4	4.56	5.67	−3.40	6.03

Source: Bank of Korea, National Accounts, ECOS DB. (http://ecos.bok.or.kr/)

Annex 2. CPI Growth

(2005=100.0%)

	2005	2006	2007	2008	2009
Yearly	100.0	102.2	104.8	109.7	112.8
Q1	99.4	101.4	103.5	107.4	111.6
Q2	99.8	102.1	104.6	109.6	112.7
Q3	100.4	102.9	105.3	111.1	113.3
Q4	100.4	102.6	106.0	110.8	113.5
			Growth		<(%)>
Yearly	–	2.2	2.5	4.7	2.8
Q1	–	2.0	2.1	3.8	3.9
Q2	–	2.3	2.4	4.8	2.8
Q3	–	2.5	2.3	5.5	2.0
Q4	–	2.2	3.3	4.5	2.4

Source: Statistics Korea, Consumer Price Survey. (http://kosis.kr/)

Annex 3. Unemployment Rate

(%)

	2005	2006	2007	2008	2009
Yearly	3.7	3.5	3.2	3.2	3.6
Q1	4.2	3.9	3.6	3.4	3.8
Q2	3.7	3.4	3.2	3.1	3.8
Q3	3.6	3.3	3.1	3.1	3.6
Q4	3.5	3.2	3.0	3.1	3.3

Source: Statistics Korea, Economically Active Population Survey. (http://kosis.kr/)

Annex 4. Trade Balance by Quarter

(USD million)

	Exports	Imports	Trade Balance
2006 Q1	73,885	72,542	1,343
Q2	81,473	76,720	4,754
Q3	82,713	80,216	2,497
Q4	87,394	79,905	7,489
2007 Q1	84,704	82,262	2,442
Q2	92,984	87,962	5,023
Q3	90,529	86,059	4,470
Q4	103,272	100,563	2,709
2008 Q1	99,445	106,053	−6,608
Q2	114,492	114,793	−301
Q3	115,000	122,901	−7,901
Q4	93,071	91,528	1,543
2009 Q1	74,421	71,418	3,004
Q2	90,360	73,970	16,390
Q3	94,781	84,845	9,935
Q4	103,971	92,852	11,120

Source: Bank of Korea, ECOS DB. (http://ecos.bok.or.kr/)

Annex 5. Non-Performing Loans/Total Loans

(USD million)

	Non-Performing Loans (A)	Total Loans (B)	A/B*100
2006 Mar.	8	836	1.00
Jun.	8	901	0.85
Sep.	8	939	0.83
Dec.	7	1,005	0.69
2007 Mar.	7	1,016	0.72
Jun.	7	1,077	0.65
Sep.	7	1,106	0.67
Dec.	7	1,154	0.60
2008 Mar.	8	1,155	0.68
Jun.	7	1,154	0.59
Sep.	8	1,124	0.69
Dec.	8	940	0.86
2009 Mar.	11	900	1.21
Jun.	12	1,031	1.21
Sep.	12	1,062	1.16
Dec.	–	–	–

Source: Financial Supervisory Service, Monthly Financial Statistics Bulletin. (http://www.fss.or.kr/)

Annex 6. Foreign Reserves

(USD million)

	2006	2007	2008	2009
Yearly	238,956	262,224	201,223	269,995
Q1	217,344	243,915	264,246	206,340
Q2	224,357	250,702	258,098	231,735
Q3	228,224	257,294	239,672	254,247
Q4	238,956	262,224	201,223	269,995

Source: The Bank of Korea, Economic Statistics System. (http://ecos.bok.or.kr/)

PHILIPPINES

By Gloria Jumamil-Mercado[1]
Development Academy of the Philippines (DAP)

1. INTRODUCTION

Small and Medium Enterprises (SMEs) are widely considered as the "lifeline" of an economy, rich and poor alike. Worldwide, SMEs account for over 90% of enterprises in almost all economies.[2] In the Asia-Pacific region, SMEs account for the same percentage of known enterprises, and employ as much as 60% of the region's labor force.[3] In the Philippines more specifically, SMEs represent 99.7% of registered businesses in the country over the last five years.[4] They have provided the Philippines, like other countries, with a continuous supply of ideas and innovations which promote competition and efficient allocation of scarce resources, and have contributed to the creation of wealth, employment, and income generation in all sectors of society, thus facilitating a more equitable distribution of income.

However, the occurrence of the Global Financial Crisis in 2008 sent a rather sudden jolt to the world economy, leaving in its wake a huge downturn in many major and growing economies, including the Philippines. While most reports highlight the adverse effects of the crisis only on large enterprises such as real estate, large-scale banking and huge investments, the crisis also struck SMEs hard all over the world, resulting in a myriad of repercussions particularly in the growth of old SMEs and the development of new ones.

This paper looks into the impact of the financial crisis on SMEs in the Philippines, one of the developing nations in the world where SMEs are considered one of the most vulnerable sectors of the economy. The paper also discusses the government's "Economic Resiliency Plan," which is a mix of policy and program interventions aimed at weathering the effects of the crisis on the national economy. The Resiliency Plan also led to the creation of various government programs aimed at promoting the development of SMEs during those trying times.

To date, the Philippine economy managed to withstand the negative impacts of the 2008 Global Financial Crisis through the establishment of a strong foundation of fiscal reforms and sound macroeconomic policies, enabling the government to significantly cushion the impact of the crisis on the lives of the Filipino people.

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[1] Dr. Mercado is currently a Senior Vice President and Dean of the Graduate School of Public and Development Management (GSPDM) of the Development Academy of the Philippines (DAP). She directly supervises the DAP's Institute of Public Management, Institute of Productivity and Quality and the Knowledge Resource Institute. Among her major program portfolio is the development of a comprehensive program for medium and small enterprises, wherein DAP is the integrating venue for training, consultancy/shepherding, policy advocacy, and funding consolidation. She previously worked with the Department of Trade and Industry as Project Analyst of Medium and Small Scale Industries Coordinated Action Program and rose to the rank of Deputy Director General (Assistant Secretary) of the Philippine Economic Zone Authority. She is also currently a Professor of Economics of National Security at various schools of the Armed Forces of the Philippines. She is a lecturer in Modern Chinese Economy at the Ateneo de Manila University, Ricardo Leong Center for Chinese Studies. Dr. Mercado obtained her Master's in National Security Administration (MNSA) from the National Defense College of the Philippines and her PhD in Philosophy from the Institute of Mainland China Studies, Trade and Economy Division of the National Sun Yat-Sen University in the Republic of China.

[2] Source: Small and Medium Enterprises Division, World Intellectual Property Organization (http://www.wipo.int/sme/en/about_sme.html)

[3] Source: Small and Medium Enterprises Working Group (http://www.apec.org)

[4] Source: Department of Trade and Industry data as of 2006 (http://www.dti.gov.ph)

2. COUNTRY SITUATION

The Philippines is the fifth largest state economy in Southeast Asia. In 2007, it was ranked by the International Monetary Fund as the 37th largest economy in the world according to purchasing power parity. With a mixed economic system, it is one of the newly industrialized emerging market economies in the world. The country is also considered one of the fastest-growing economies in Asia, posting a real GDP (gross domestic product) growth rate of 7.1% in 2007. However, economic growth slowed down to 4.6% by the end of 2008 as a result of the global financial crisis.

Significant sectors in the Philippine economy include agriculture and various industries, particularly food processing, textiles and garments, electronics and automobile parts. In recent years, the Philippines has been taking the bitter pill of macroeconomic and fiscal reforms, which provided a firm foundation for the country to pass through a hostile economic environment brought about by the volatility of oil prices, a weakening of the national currency, and the global financial and economic crisis. From 2006 to 2009, the annual economic performance of the country can be best described as follows:

2.1 2006 Economic Performance

On the whole, the Philippine economy enjoyed a relatively good year in 2006. Exports grew robustly and the Philippine peso was one of the best performing Asian currencies against the greenback, appreciating by nearly 7.8%. Net portfolio inflows reached USD2.11 billion in the first 11 months of 2006, which was slightly better than the previous year's total of USD2.08 billion.

Table 1. Summary of Philippine Economic Performance in 2006

Real GDP Growth Rate (%)		5.0%
Inflation Rate (%)		6.4%
Unemployment Rate (%)		7.9%
Trade (USD)	Exports	USD47.4 billion
	Imports	USD51.8 billion
	Trade Balance	USD4.4 billion (deficit)
Exchange Rate (PHP/USD)		USD1=PHP51.314
Gross International Reserves (USD)		USD22.7 billion

However, the economy was still faced with the challenge of generating income internally as it remains heavily dependent on remittances by overseas workers. Overall remittances had already reached USD10.3 billion in the first 10 months of 2006, accounting for around 10% of the country's GDP. Although remittances are excluded from the GDP calculation, consumer spending in the country is fueled to a large extent by such remittances.

Foreign direct investment also grew strongly in 2006 and was expected to continue to increase in the coming years. The fiscal deficit was substantially cut during the first three quarters of 2006.

2.2 2007 Economic Performance

In 2007, the Philippine economy withstood the threat of soaring oil prices, a lackluster US economy, and a host of domestic challenges. A more aggressive infrastructure program and increased spending brought about by a stronger budget in 2007 boosted economic activity during the year. In fact, gross national product (GNP) still grew by 7.8% while the GDP grew by 7.1%, marking the highest economic growth the country had experienced in 31 years. Again, overseas Filipino workers (OFWs) continued to bring in huge contributions to the country's growth, with OFW remittances for 2007 stood at USD14.4 billion.

Despite soaring oil prices, the government contained inflation at a manageable level of 2.7%, down from 6.4% in 2006. Low inflation and prudent financing policies of the government also helped to keep interest rates at low levels. The Philippine peso maintained its strength at an average of PHP46.19 to the dollar in 2007, with appreciation of about 10.1% from the 2006 average of PHP51.31. Meanwhile, gross international reserves at yearend 2007 stood at USD32.36 billion, 42.56% higher than the 2006 level.

However, a strong peso adversely affected the competitiveness of the country's export sector, which decelerated to 6.1% growth from 14.8% growth in 2006.

Table 2. Summary of Philippine Economic Performance in 2007

Real GDP Growth Rate (%)		7.1%
Inflation Rate (%)		2.7%
Unemployment Rate (%)		7.7%
Trade (USD)	Exports	USD50.5 billion
	Imports	USD55.5 billion
	Trade Balance	USD5.0 billion (deficit)
Exchange Rate (PHP/USD)		USD1=PHP46.192
Gross International Reserves (USD)		USD32.36 billion

2.3 2008 Economic Performance

The economy slowed in 2008 but still performed moderately well amid pressures stemming from steep increases in commodity prices, the global economic crisis, and the financial crisis in advanced economies. GDP growth in 2008 slowed to 4.6% while fiscal deficit was at 0.9% of the GDP (versus an initial balanced budget goal) to support growth during the global economic downturn. The Balance of Payments surplus also eroded with weak external demand and intense investor risk aversion.

Although the economy showed some resilience in 2008, it remained vulnerable to a prolonged and more severe global economic downturn. While expansionary fiscal policy would continue to provide support, a key imperative was to strengthen tax revenues on a sustainable basis to ensure adequate fiscal space for higher spending on infrastructure and social services.

Table 3. Summary of Philippine Economic Performance in 2008

Real GDP Growth Rate (%)		4.6%
Inflation Rate (%)		9.4%
Unemployment Rate (%)		7.4%
Trade (USD)	Exports	USD49.1 billion
	Imports	USD56.7 billion
	Trade Balance	USD7.7 billion (deficit)
Exchange Rate (USD/PHP)		USD1=PHP44.471
Gross International Reserves (USD)		USD36.83 billion

2.4 2009 Economic Performance

The Philippines weathered the 2008–09 global recession better than its regional neighbors, due to lower dependence on exports and higher levels of domestic consumption fueled by large remittances from 4 million to 5 million OFWs. Economic growth in the Philippines has averaged 5% per year since 2001, the year when current President Gloria Macapagal-Arroyo took office. The current government averted the fiscal crisis by pushing for new revenue measures and, until recently, tightening expenditures.

Table 4. Summary of Philippine Economic Performance in 2009

Real GDP Growth Rate (%)		0.7%
Inflation Rate (%)		3.2%
Unemployment Rate (%)		7.5%
Trade (USD)	Exports	USD36.2 billion
	Imports	USD46.1 billion
	Trade Balance	USD9.9 billion (deficit)
Exchange Rate (PHP/USD)		USD1=PHP47.604
Gross International Reserves (USD)		USD43.7 billion

In recent years, declining fiscal deficits, tapering debt and debt service ratios, and increased spending on infrastructure and social services have bolstered optimism over Philippine economic prospects. Nevertheless, the economy is still faced with several long-term challenges. One important point to consider is that despite the recorded stable economic growth, poverty has worsened during President Arroyo's term because of a high growth rate in the population and an unequal distribution of income.

3. STATE OF SMEs IN THE PHILIPPINES

SMEs play a vital role in the Philippine economy, not only in the creation of wealth, but also in dispersing new industries to the countryside and stimulating gainful employment. This is particularly important in an economy considered to have a job market that was already in a critical state even before the global economic crisis.[5] To encourage the

[5] Source: "The World Economic Crisis: Its Impact on the Philippine Economy". Benjamin E. Diokno, Ph.D.

development of SMEs, the government has enacted as law the "Magna Carta of Small Enterprises" (Republic Act 6977), which outlines general policies for the development of SMEs. The law mandated the establishment of Small and Medium Enterprise Development Councils throughout the country to promote public-private partnerships in the promotion of SMEs.

For purposes of this country report, SMEs will also include micro enterprises, and will also be referred to as Micro, Small and Medium Enterprises (MSMEs). The legal framework for the establishment of MSMEs is defined primarily by Republic Act 6977 as amended by Republic Act 8289, also known as the "Magna Carta for Small Enterprises." Further legal reference is also found in Republic Act 9178, officially known as "An Act to Promote the Establishment of Barangay Micro Business Enterprises (BMBEs), Providing Incentives and Benefits."

MSMEs, in general, are defined as any business activity or enterprise engaged in industry, agri-business and/or services, whether single proprietorship, cooperative, partnership or corporation, whose total assets, inclusive of those arising from loans but exclusive of the land on which the particular business entity's office, plant and equipment are situated, must meet the following criteria:[6]

Size of Enterprise	Number of Employees	Asset Size
Micro	1–9	Up to PHP3 million
Small	10–99	PHP3 to 15 million
Medium	100–199	PHP15 to 100 million
Large	200 and above	More than PHP100 million

As of the latest national survey in 2006, the MSME sector accounted for about 99.7% of the registered businesses in the country, in which 70% of the country's current labor force are employed. Of all MSMEs, 92% (720,191 companies) are micro enterprises, 7.3% (57,439 companies) are small enterprises, 0.4% (2,839 companies) are medium enterprises, and 0.3% are large enterprises. Around 30% of the total sales and value added in manufacturing come from MSMEs as well.[7]

The contributions made by SMEs in the Philippines cannot be overemphasized. The Department of Trade and Industry's description of MSMEs in the country effectively highlights the indispensable role they play in the economy:[8]

a) MSMEs play a major role in the country's economic development through their contribution to the following: rural industrialization; rural development and decentralization of industries; creation of employment opportunities and more equitable income distribution; use of indigenous resources; earning of foreign exchange resources; creation of backward and forward linkages with existing industries; and entrepreneurial development.

[6] As defined under Small and Medium Enterprise Development (SMED) Council Resolution No. 01 Series of 2003 dated 16 January 2003 (http://www.dti.gov.ph/dti/index.php?p=532)

[7] Source: SME Characteristics and Statistical Needs in the Philippines by Benel P. Laguna

[8] Source: Department of Trade and Industry webpage on MSMEs (http://www.dti.gov.ph/dti/index.php?p=532)

b) MSMEs are vital in dispersing new industries to the countryside and stimulating gainful employment. A country like the Philippines, where labor is abundant, has much to gain from entrepreneurial activities. MSMEs are more likely to be labor intensive, thus, they generate jobs to the locality where they are situated. In this sense, they bring about more balanced economic growth and equity in income distribution.

c) MSMEs are quick in assimilating new design trends, developing contemporary products, and bringing these products to the marketplace ahead of the competition. MSMEs tend to be innovative in developing indigenous or appropriate technology, which may lead to pioneering technological breakthroughs.

d) MSMEs are able to effectively increase the local content or the value added in final goods that are processed and marketed by large manufacturing firms.

e) MSMEs are notably skillful in maximizing the use of scarce capital resources and are able to partner with large firms by supplying locally available raw materials in unprocessed or semi-processed forms.

f) MSMEs can act as the seedbed for the development of entrepreneurial skills and innovation. They play an important part in the provision of services in the community, and they can make an important contribution to regional development programs.

3.2 Sectoral Distribution

The majority of the 780,469 MSMEs in operation in 2006 were: (1) in the wholesale and retail trade industries with 391,215 business establishments; (2) manufacturing with 116,361 businesses; (3) 97,926 hotels and restaurants; (4) 45,293 real estate, renting and leasing establishments; and (5) other community, social and personal services with 44,658 establishments. These industries accounted for about 89.1% of the total number of SME establishments.

The top five subindustries in the manufacturing sector in terms of MSME establishments in 2006 were: (1) food product and beverage manufacturing with 55,007 establishments; (2) 15,623 in wearing apparel; (3) 12,986 in fabricated metal product manufacturing excluding machinery and equipment; (4) manufacture and repair of furniture with 7,188 establishments; and (5) other non-metallic mineral product manufacturing with 5,143 establishments. These sub-industries accounted for 82.4% of the total number of MSMEs in the manufacturing sector.

3.3 Geographical Spread of MSMEs

The majority of MSMEs in operation in 2006 could be found in the National Capital Region (NCR), with 194,549 business establishments accounting for 24.4% of all establishments and 40.1% of all employees; Calabarzon (Region IV-A) with 113,581 establishments; Central Luzon (Region III) with 84,175; Western Visayas (Region VI) with 46,195; and Ilocos Region (Region I) with 44,085. These top five areas hosted about 61.8% of the total number of MSME establishments in the country.

3.4 Employment

MSMEs generated a total of 3,327,855 jobs in 2006 versus 1,657,028 by large enterprises. This indicates that MSMEs contributed almost 70% of the total jobs generated by all types of business establishments in that year. Of these, 33.5%, or 1,667,824 jobs were generated by micro enterprises; 25.7%, or 1,279,018 jobs by small enterprises; and 7.6%, or 381,013 jobs by medium enterprises.

By industry sector, MSMEs in wholesale and retail trade generated the most jobs, 1,181,525 in 2006, followed by MSMEs in manufacturing, 644,927; hotels and restaurants, 427,153 jobs; real estate, renting and related business activities, 242,122 jobs; and education, 180,265 jobs. The majority of the jobs were generated by MSMEs in the NCR, which produced 1,173,464 jobs; followed by MSMEs in Calabarzon (Region IV-A), 452,168 jobs; Central Luzon (Region III), 311,226 jobs; Central Visayas (Region VII), 219,937 jobs; and Western Visayas (Region VI), 184,398 jobs.

3.5 Sales and Export Contribution

The recent trends in value added by SMEs in the country and their sales indicate a steadily expanding share of overall industrial growth. Of late, they have contributed around 30% of the total sales and census value-added. In the manufacturing sector, MSMEs account for 25% of the country's total export revenue. It is also estimated that 60% of all exporters in the country belong to the MSME category. MSMEs are able to contribute to exports through subcontracting arrangements with large firms or as suppliers to exporting companies.[9]

In *Small and Medium Enterprises Across the Globe* (M. Ayyagari et al.), about 31.50% of the average USD1,099.31 GDP per capita income in the Philippines (1990–1999) can be attributed to SMEs.

[9] Source: Bridging the Gap: Philippine SMEs and Globalization, Small Enterprises Research and Development Foundation (SERDEF), Inc., and UP-ISSI, 2001.

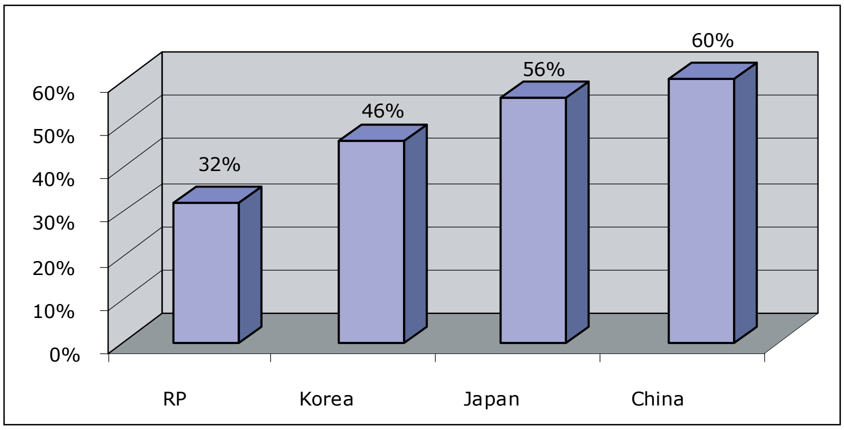
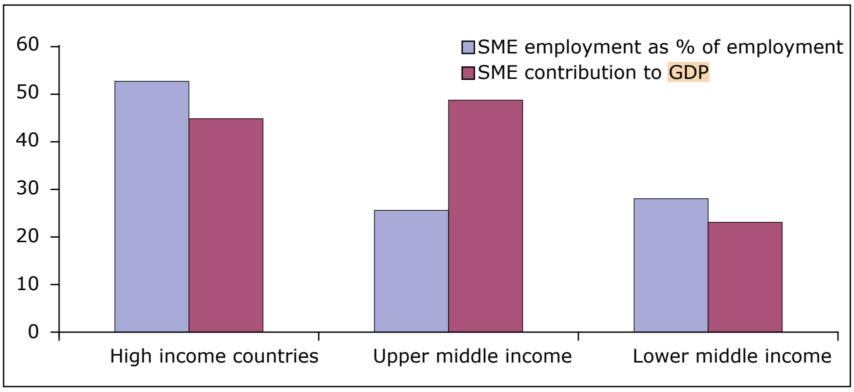


Figure 1. Comparative Value-added



Source: IFC Report MSME 2006

Figure 2. Micro, Small and Medium Enterprises' Contribution to GDP and Employment (130 countries)

3.6 Impact of Crisis on SMEs

The economic recession has emerged as the most significant challenge for SMEs, especially with all its attendant effects like financial issues and dwindling consumer appetites, which lead to lower demand for many of the services and products provided by SMEs. Business confidence is critical to economic growth as it is normally linked to business expansion and capital investment, and with the uncertainties, SMEs in the past have held back on investments and expansions due to dried up demand.

At present, SMEs are facing the main challenge of adapting to an evolving global economic environment, especially since growth opportunities in North American and European markets have become limited. However, more recent studies show that SMEs have been optimistic and ready to be repositioned when an economic upturn occurs.

A 2009 UPS Asia Business Monitor (ABM) study covered 1,200 SME decision makers across 12 countries, including 100 Philippines-based SMEs. The study, conducted in January and February that year, showed that SMEs started to re-evaluate their business practices and strategies as a result of the global economic slowdown.

The ABM findings show that in comparison to SMEs in other Asia-Pacific countries, Philippine SMEs are optimistic about the state of the national economy despite a global credit crunch. In fact, the majority of Philippine SMEs are exploring growth prospects within the Asia-Pacific and the Middle East regions.[10]

Since the negative effects of the economic slowdown were first felt in the North American and European markets, the markets in the Asia-Pacific and the Middle East regions offer relatively more room for Philippine SMEs to grow. Also, shrinking demand in North American and European markets means that Philippine SMEs are looking to do business with companies that are located closer to home. Trade within the Asia-Pacific region remains the strongest possibility.

One change to note is the slight increase in SMEs that are exploring companies in Africa as trade partners. UPS Philippines Managing Director Tim Gohoc noted that strong trade relations, particularly within countries in the Asia-Pacific region, have helped buoy these markets amid the global economic slowdown. The economic downturn has also highlighted the role of government. The ABM study found that while 58% of the respondents worry about the effect of the credit crunch on their businesses, Philippine SMEs are optimistic that the national and global economies will recover and see better days by 2011.

Facing the (economic) survival of the fittest, business owners in the Philippines and the rest of the Asia-Pacific region are learning quickly when it comes to riding out and eventually surviving the global recession. According to the ABM study, Philippine SMEs expected modest economic growth for 2009 and were directing their focus to three key areas for long-term growth: exploring new markets (24%), moving to higher value-added products and services (20%), and strengthening their workforce with good talent (16%). The 2009 ABM study also found that the economic downturn has caused Philippine SMEs to rethink their business efficiencies. For example, results from the study showed that Philippine SMEs planned to reduce their transportation and distribution costs in response to economic conditions.

Certain respondents said that in order to save costs, they intended to move their supply chain operations closer to areas where they often deliver or ship their services. Others were expected to shift to less expensive transportation alternatives, from air freight to ocean freight, to manage increasing costs. "It's only practical for business owners to focus on critical management- and operations-related issues to steer their companies in the right direction. In order to save resources, we see companies switching from premium to other non-premium products and those that previously made use of air freight services are now shifting to ocean freight," said Gohoc, the managing director of UPS in the Philippines.

"Forward-looking SMEs would look to examining their supply chain and seek to increase internal efficiencies, providing long-term solutions which will help them flourish when the economy rebounds. Being the world leader in supply chain and freight services, we at UPS are ready to help the SMEs' transition through this difficult period by providing cost-effective products and value-added tools to help operate a more efficient supply chain. The economic downturn has emphasized the role of globalization in determining a country's progress and policy direction," he added.

[10] Source: Philippine SMEs Adapt Business Strategies To Shifting Global Economy. 2009. (http://www.ups.com/content/ph/en/about/news/press_releases/07172009.html)

A similar study conducted by the International Labor Organization (ILO) showed that SMEs in developing countries like the Philippines had been hit hard by the global financial crisis because of their smaller capitalization and limited access to credit. In a study titled, "The Fallout in Asia: Assessing Labor Market Impacts and National Policy Responses to the Global Financial Crisis," the ILO said workers at SMEs that employ the majority of their workers in developing countries in Asia have already felt the brunt of the global financial crisis. Further, with smaller cash reserves and limited credit support to meet existing debt obligations and sales orders, many SMEs that supply larger firms in national and global production chains have found few alternatives to laying off workers, or suspending or closing their operations altogether.

Sachiko Yamamoto, ILO regional director for Asia and the Pacific, told reporters at a press briefing that factory closures have been reported throughout the region. "Small-and medium-sized firms, which employ the majority of the workers in Asia, are particularly vulnerable." She added that when jobs are cut in the formal sector, the majority of workers simply cannot afford to remain unemployed and many have had to turn to the informal economy where jobs are often precarious and offer little social protection.

Sought for comment, Philippine Labor Secretary Marianito Roque asserted that SMEs in the Philippines have hardly been hit by the crisis, unlike the big export-oriented companies. He said there could be one or two small companies that have been affected. But as far as SMEs are concerned, they are not yet affected because the country is not in a recession. However, Benjamin Diokno, economics professor at the University of the Philippines and the budget secretary during the previous administration of President Joseph Estrada, said the present crisis would surely impact big and small companies.[11]

3.7 Factors Affecting Success of SMEs

Ruben See started making banana chips in a wok in 1996. The One Town, One Product Program (OTOP) provided him with the technical support, funding, branding and packaging design, business skills and access to the market that he needed to succeed. In this example, government policy was able to provide for most of the breaches in skill and resources of the entrepreneur. Creativity, productivity, and a willingness to participate in government programs became the minimum requirements to start a successful business. OTOP fairs that were regularly held in different parts of the country provided an opportunity for him to reach a greater market.

This is one case where comprehensive government intervention proved to be an important factor in an SME's success story. Through the coordination of various government offices, OTOP provides counseling and training, appropriate technology, product design and development, marketing and skills. Today, See employs around 300 workers to produce 50 metric tons of "Gold Chips" per week.

Rommel Juan founded Binalot in 1996, which began as a small food delivery service. But with innovation, it grew into a large food chain that markets traditional Filipino takeaway food. The term "binalot" refers to a traditional method of wrapping and storing food in banana leaves. On its way to success, the Binalot Company encountered mostly product and marketing-related problems. In an open forum organized by the Asian Productivity Organization (APO), Juan shared the following:

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[11] SMEs in Asia Feeling Heat from Crisis by Darwin G. Amolejar, February 19, 2009. (http://www.manilatimes.net/national/2009/feb/19/yehey/top_stories/20090219top5.html)

- Though binalot is a traditional concept, innovation was needed to successfully market the product. They re-introduced binalot as a modern fast-food concept.

- The product has to be well-made, and quality has to be maintained if you want to have a successful franchise. Figures show that 95% of franchises endure. This has something to do with quality control.

- Imitation, a huge possibility given the abundance of banana leaves in the country, was effectively prevented by registration of the product and concept.

- Binalot has failed twice before. But, they tried again. In business, there is a learning curve that one must go through to survive.

- Binalot did not go head to head with the big companies. These companies are better equipped with means and resources.

Aside from the aforementioned, experts attribute Binalot's success in their use of the banana leaf to several factors:

- It provided a unique look.
- Waste was greatly reduced by the leaf's biodegradable quality.
- The company publicized its commitment to help preserve the environment and Filipino culture.

The success of the company was greatly attributed to the use of the banana leaf, but when in huge demand, this same commodity had posed problems in quality and reliability. To counter that, Juan established the Dangal at Hanapbuhay para sa Nayon (DAHON) Program, where banana farmers in Southern Tagalog were paid to provide banana leaves of the quality required by Binalot. Tools and know-how are provided to the farmers to control quality.

In his book *Small Business Management*, Michael Ames gives the following reasons why small businesses tend to fail:

- Lack of experience.
- Insufficient capital (money).
- Poor location.
- Poor inventory management.
- Over-investment in fixed assets.
- Poor credit arrangements.
- Personal use of business funds.
- Unexpected growth.

4. GOVERNMENT SME POLICY IN RESPONSE TO THE FINANCIAL CRISIS

Over the past couple of years, the Philippine government has taken a proactive stand with policy redirection and retrofitting to ensure that the country is able to cope with the global economic crisis, especially in relation to the vulnerable sectors of society that would be most adversely affected by the crises.

This assertive stance was adopted despite high praise from some of the leading economic rating institutions in the world. "Yes, the Philippines are lucky because they have made the necessary adjustments and reforms when times were still good. So they are facing global market problems and the economic slowdown from a considerably improved position compared to what they were in three or four years ago … The Philippines is an island of calm currently, while there is turmoil in the higher-rated and previously stable countries," said Agost Bernard, Associate Director at Standard and Poor's.[12]

A JP Morgan report, "ASEAN Year Ahead 2009: Philippines Well Positioned to Withstand the Downturn," further bolstered that assessment. In the report, Bernard commends the country for being "in a relatively strong position to weather the global downturn with the economy driven by private consumption and services, which are less vulnerable to external shocks."[13]

Just the same, the government devised in January 2009 a PHP330 billion "Economic Resiliency Plan" (ERP) as the Philippines' response to the Global Financial Crisis. Implemented through the National Economic Development Authority (NEDA), it aims[14] "to cushion the impact of the crisis on and jumpstart the economy through a mix of accelerated government spending, tax cuts and public-private sector investments in infrastructure projects. The ERP also seeks to prepare the country for the eventual global upturn."

In essence, the ERP was established with the following objectives:[15]

1. To ensure sustainable growth, attaining the higher end of the growth target.

2. To save and create as many jobs as possible.

3. To protect the most vulnerable sector: the poorest of the poor, returning OFWs, and workers at export companies.

4. To ensure low and stable prices to support consumer spending.

5. To enhance competitiveness in preparation for the global rebound.

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[12] Source: "The Global Economic Crisis and the Philippine Economy". Presentation of the National Economic Development Authority.
(http://www.neda.gov.ph/erp/downloads_/Global%20crisis%20and%20RP%20economy.pdf)

[13] Ibid.

[14] Source: National Economic Development Authority webpage on the ERP.
(http://www.neda.gov.ph/erp/downloads_/Q&A%20on%20ERP.pdf)

[15] Ibid.

According to NEDA,[16] the ERP entails "ensuring resources through better revenue collection; enhancement of cash liquidity, access to credit and low interest rates; and more effective spending. It seeks to ensure stable growth, save and create jobs, provide assistance to the most vulnerable sectors, ensure low and stable prices, and improve competitiveness in preparation for the global economic rebound." It can be noticed in this statement that all efforts of the ERP targets the continued growth of SMEs.

The ERP accelerated lending to SMEs through the Sulong Program as a mechanism to encourage and sustain growth. This was a proactive approach to what some experts predicted would become a common movement among creditors, to prefer lending to large borrowers over SMEs.[17]

The following section is dedicated to the some of the major state policies that proved crucial to the country's capacity to cope with the global economic downturn.[18]

4.1 Fiscal Policies

Income Tax

Fiscal incentives for all registered Barangay Micro Business Enterprises (BMBEs) and SMEs provided exemptions from payment of income tax on income arising from the operations of the enterprise. Local governments were also encouraged to reduce the amount of local taxes, fees and charges imposed, or to exempt the BMBEs from local taxes, fees and charges.

Additional fiscal incentives to direct and indirect exporters, including export traders, included:

1. Exemption from advance payment of customs duties and taxes.

2. Duty-free importation of machinery and equipment, raw material inputs and packages.

3. Tax credit for imported inputs and raw materials that are used primarily in the production and packaging of export goods and which are not readily available locally.

4. A tax credit of 25% of the duties paid on raw materials and capital equipment and/or spare parts. The credit is available to exporters of nontraditional products who use or substitute similar locally produced inputs.

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[16] Ibid.

[17] Can Philippine Economy Withstand Crisis in 2009? by the IBON Foundation. January 2, 2009

[18] The succeeding paragraphs were taken directly from the ASEAN article on "Policy Incentives Granted to Local SMEs in the Philippines."
(http://www.aseansec.org/pdf/sme_7.pdf)

Also, export-oriented enterprises were made eligible to apply for incentives when locating in the Philippine Economic Zone Authority, Clark Special Economic Zone Authority and the Subic Special Economic and Freeport Zone. Examples of incentives include:

1. Corporate income tax exemption for four to eight years.
2. Exemption from duties and taxes on imported capital equipment, spare parts, materials and supplies.
3. Exemption from national and local taxes.
4. Tax credit for import substitution.
5. Tax credit on domestic capital equipment.
6. Tax-free and duty-free importation of breeding stock and genetic materials.
7. Tax credit for domestic breeding stock and genetic materials.
8. Exemption from value-added tax for certain exporting industries.

Indirect Taxes

Investors were made eligible for certain benefits and incentives provided they invest in preferred areas designated in the Investment Priorities Plan:

1. Exemption from wharfage dues and export taxes, import duties and fees.
2. Additional deductions for labor expenses.
3. Additional deductions for necessary and major infrastructure work (mining- and forestry-related projects excluded).

Excise taxes on exported goods that are locally produced or manufactured were made eligible for credit or refunds upon submission of proof of actual exportation and upon receipt of the corresponding foreign exchange payment. Excise taxes on distilled spirits were lowered for products made from materials that are indigenously available (e.g., coconut, palm, sugarcane).

4.2 Non-Tax Policies

Wholesale and Retail Lending Facilities: Development Bank of the Philippines

The Development Bank of the Philippines (DBP) currently implements the Industrial Support Services Expansion Program (ISSEP) and Industrial Guarantee and Loan Fund (IGLF) to promote wholesale capital lending to MSMEs despite the risky environment brought about by the Global Financial Crisis. Also, the DBP promotes retail lending to smaller enterprises through its Window III program.

The ISSEP promotes the construction, expansion, or modernization of plants and related services, including relevant land improvements. It finances the acquisition of raw materials, equipment and parts, and environment-related projects on a standalone basis, as part of plant construction or expansion. The target sectors are manufacturing, such as food, textiles, wood, industrial machinery, and chemicals, as well as the non-manufacturing sector as in computer software, transport services and communication.

On the other hand, the IGLF may be availed by enterprises that are engaged in the manufacture or processing of products on a commercial scale, as well as the delivery of services which support manufacturing activities. It also provides credit supplementation support through the extension of guarantee schemes to stimulate the flow of credit to SMEs. The facility may be used for the purchase of factory sites for new expansion projects, factory building construction, equipment purchases, and also for permanent working capital.

Lastly, Window III is the centerpiece of DBP's retail lending operations. It finances innovative and socially desirable projects with high developmental impact. Some of the programs assisted under the program include: Agricultural Production and Food Security Financing; Damayan Pangkabuhayan Program; and Women Entrepreneur Financing Program.

Funds were made available to non-government organizations (NGOs) for relending to eligible micro enterprises set up by a private sector-led export financing institution that focuses on the unique needs of the export sector.

Mandatory Allocation of Credit Resources

All financing institutions were required to set aside at least 6% and 2% of their loan portfolios respectively for small and medium enterprises. The Bangko Sentral Ng Pilipinas (BSP) is mandated by law to monitor compliance.

SME Centers

SME Centers are "one-stop shops" that are located in various parts of the country. They provide information, advisory, and consulting services in the following areas: productivity improvement, technology upgrading, market information, product and market development, trade promotion, credit, financing, and entrepreneurial development, simplifying and streamlining administrative procedures to shorten the process of exporting. These services include:

1. The Electronic Data Interchange project, which automates the processing of export declarations and applications to the authorities for loading.

2. Faster turnaround time in the processing of export documents (from one week to a half-day) with the removal of duplicating functions and agencies.

3. Establishment of Philippine trade centers to house the trade promotion offices and serve as permanent exhibit sites of the country's export products.

4. Development, expansion and strengthening of trade linkages among and between the local manufacturing and trade sectors.

5. Development of SME databases to provide easy access for buyers and suppliers.

6. Availability of information on the basics of importing, customs and tariff rates, import liberalization programs, and import monitoring of sensitive and liberalized commodities.

4.3 Incentives for Given Locations or Regions

Registered Economic Zones

Incentives were made available in the form of export tax exemptions and income tax deductions for operational losses, including loans and other financial credit assistance. Registered zone enterprises are likewise entitled to prior allocation of foreign currencies by the BSP or by any of its authorized agent banks.

Income tax holidays, tax credits for exporters with increased revenues, additional tax credits for exporters of non-traditional products, additional deductions for necessary and major infrastructure work were made available under RA 7844, or the Export Development Act. The legislation provides these incentives to exporters by making additional deductions from taxable incomes of 100% of the wages corresponding to the increment in the number of direct labor for skilled and unskilled workers in the year available as against the previous year. Likewise, Local Government Units (LGUs), under the LGU Code, may also provide fiscal and non-fiscal incentives to SMEs.

4.4 Others

Other incentives promoted by the government: (a) SMEs are entitled to a share of at least 10% of the total procurement value of goods and services paid to all government offices; (b) Exemption from the coverage of the minimum wage law to all registered BMBEs inventors; (c) RA 7459 provides tax/duty exemptions assistance, the Loan Assistance Program, testing analyses, travel assistance, and accreditation of inventor organizations. (d) On research and development, the Department of Science and Technology (DOST) assists SMEs in the manufacturing sector to attain higher productivity. Through the Technology Application and Promotions Institute, DOST fields consultancy teams comprised of industrial engineers and experts to provide productivity consultancy services to various firms throughout the country.

5. POLICY RECOMMENDATIONS

The Philippine government has done an exceptional job in keeping the economy afloat with existing policies and programs for SMEs, but its efforts focus mainly on providing financial help and incentives. Both local and foreign experts find that support to and facilitation of the exchange of information is a primary gap in existing policy.

In a presentation entitled, "ICT Usage in the Philippines, Indonesia, and Thailand," the Asia Foundation recommended policies that would provide incentives to encourage wider use of ICT among SMEs. In their research, they have also found that the Philippines does not have a nationwide database on SMEs. Though ICT usage has in the past two or three years reached a wider margin among SMEs, about 70% now have access to the Internet, ICT infrastructure needs to be further improved. A better ICT infrastructure, combined with a broad awareness campaign on useful ICT functions and practices (such as advertising through Web sites and the use of Internet banking) will improve the productivity and global competitiveness of local SMEs. And in the wake of increased ICT use for commerce, government will need to develop a nationwide database to monitor the activity. This will require both an empowered e-government and improved partnerships with the private sector.[19] Raul Sabularse of the Philippine Council for Industry and Energy Research and Development recommended the same in his presentation at a productivity workshop in Beijing, People's Republic of China, in October 2006. Similar to the Asia Foundation, he emphasized the value of easy access to information by way of an SME database.

In their discussion paper entitled, "Small and Medium Enterprise Development Experience and Policy in Japan and the Philippines: Lessons and Policy Implications," Ronald Tamangan, Frances Josef, and Cielito Habito have laid out some additional areas of concern that require further attention from the government: Access to markets; Simplified and standardized customs procedures; Human resource development; Swift resolution of disputes; Trade finance and credit guarantees; Trade facilitators; Export promotion and assistance; and Tariffs and non-tariff restrictions.

The effects of the economic downturn must be countered by stimulating the economy through expansionary and, importantly, equity-building policies. These include: Providing immediate emergency food, income, and work relief; Increasing public spending on health care, basic education, and housing for people and restoring real per capita social services spending to at least 1997 levels; and Increasing public spending on labor-intensive and rural infrastructure projects that will directly improve people's livelihoods.

To further facilitate fiscal spending, many of the available public resources can be freed by: suspending debt payments (this can begin with, but not be restricted to, debt to foreign creditors receiving bailouts from their governments); drastically reducing military spending; cracking down on corruption (especially critical to prevent leakages into politicians' electoral war chests); giving priority to Filipino producers in government procurement and aid-funded projects; implementing an across the board nationwide wage hike and a PHP3,000 increase in government salaries; removing the VAT on oil products and increasing taxation of wealth, luxury goods and services, and on unproductive assets and transactions; and reducing interest rates while ensuring that credit remains available.

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[19] ICT in SMEs of Three Asian Countries by Digital Philippines. March 17, 2010 (www.aijc.com.ph)

There is also a need to immediately stabilize capital flows with capital controls, especially against outflows, and to support the exchange rate. Capital controls must be used to defend against speculative attacks or financial transactions that are not related to trade and production.

6. CONCLUSION

The 2008 Global Financial Crisis significantly affected the overall economic performance of the Philippines. More important however, was its effects on the performance and continuous development of SMEs, which comprise almost all of the known enterprises of the country. The effects of the economic crisis are critical because SMEs contribute to the creation of wealth, employment, and income generation in all sectors of society.

The government's ERP was devised as the country's firm stand in response to the effects of the crisis on the national economy. The ERP introduced a PHP330 billion stimulus fund that facilitated the creation of various government programs aimed at promoting the development of SMEs during those trying times.

However, the studies and programs mentioned above show that SMEs are still facing significant challenges in the aftermath of the global financial crisis. These challenges include:

1. Credit crunches caused by the reluctance of financial institutions to provide financing for both working and investment capital.

2. Accumulation of inventory due to shrinking domestic and export markets.

3. Excess fixed costs derived from the downsizing of firms.

4. Readjustment of supply chains caused by reduced demand from large enterprises.

Can the Philippine economy continually withstand the crisis? Currently, the most important part is to arrest the slowdown in economic activity and the corresponding worsening in unemployment, incomes, and poverty. This is critical especially since the country has already been suffering record unemployment, falling incomes, and rising poverty in the last few years.

Thailand

By Ketmanee Ausadamongkol
Thailand Productivity Institute (FTPI)

1. INTRODUCTION

Globalization has been a major driver of socioeconomic growth, stimulating better access across borders. Socioeconomic integration through globalization has enabled the free flow of information, ideas, technologies, goods and services, capital, finance, and people. In order to cope with global challenges, Thailand's socioeconomic development, especially that of Thai SMEs, has undergone significant changes. The increasing globalization of economic activities has influenced the way in which SMEs operate. In this current situation, SMEs need to accelerate their development for long-term survival and competition.

This study deals with an analysis of Thai SMEs in the global financial crisis. It is an attempt to analyze the impact of globalization on the development of local SMEs, and also give recommendations for their further development. This study is based on reviews and analytical data and information on the impact of the global financial crisis onon SMEs. The opportunity to conduct the review was made possible through various stakeholders who deal with the development of SMEs.

2. COUNTRY SITUATION

In the past, the world has experienced many economic crises. During the last three decades, we have seen the Latin American debt meltdown in the early 1980s, USA stock market crash in 1987, and late 1980s savings and loans collapse in the USA that led to the creation of the Resolution Trust Corporation. In the 1990s, the insolvency of many housing loan companies led to the decade-long Japanese economic slowdown and ultimately, Asian financial crisis.

The current financial crisis will be the worst since the Great Depression in the 1930s. It is truly a "global crisis" because it affects all global banking and financial markets, as well as overall economy of not only the USA and Europe but also the emerging markets of Asia and Latin America. This is the result of the world that has evolved into the global community linked by a chain of international trade and investment, stock and financial markets.

Even though the world has faced several crises in the past, they did not involve innovative and complex subprime mortgage-backed securities that were ultimately dispersed globally by huge mortgage lenders, global investment banks, big hedge funds and other giant multinational financial institutions. The Bank for International Settlements indicates that the value of all outstanding global derivative contracts at the end of 2007 reached USD600 trillion. Worldwide losses on debt originating in the USA will reach USD1.4 trillion, according to the IMF.

This current crisis has left many large global financial institutions facing huge losses and severe illiquidity. Two large mortgage companies in the USA that provided loans and guaranteed lending for home mortgages by members of the general public, Fannie Mae and Freddie Mac, as well as AIG, the world's largest insurance company, were faced with acute financial difficulties. However, they were rescued by the US Treasury and the Federal Reserve, as well as several European banks which had been bailed out with public funds. Meanwhile, many other financial institutions throughout the globe have also become increasingly troubled or insolvent.

The severe overall impact and consequences of the crisis have been very deep, wide, and globally dispersed. It will inevitably hurt many economies and will result in a global recession that may take many years to fully recover from. While we should hope for the best, we should also prepare for a possible worsening situation in the future and not become the victims of "optimistic or pessimistic errors."

2.1 Thailand Economic Outlook in 2006–2008

The Thai economy enjoyed continued growth in 2006–2007, owing to the economic performance of its major trading partners as well as a downward trend in inflation and a pickup in domestic demand from improved private consumption and increased government expenditure. Thailand's internal stability remained sound, with positive signs following an ease in inflation pressures and a secure state of full employment. Although the political situation inevitably affected the economy in 2007, Thailand's growth has still been on par with the previous year because of the strong and sound socioeconomic fundamentals following the drop in oil prices and interest rates. In addition, its total investment has grown steadily, resulting from improvements in real private investment and a stable interest rate. The disbursement of capital expenditure has also helped restore investor confidence and enhanced private investment.

Regarding external stability, the current account in 2006–2008 was strong from a surplus, mainly contributed by higher income from the tourism sector. However, in 2008, exports of goods and services were affected by a slowdown in global demand, while imports accelerated in line with improved domestic demand. Therefore, net exports, which had been the key economic driver in 2006–2007, played a less significant role in driving the Thai economy in 2008. Thailand's internal stability has thus remained sound and robust, with decreased pressures of inflation resulting from lower costs of production due to stable crude oil prices and a currency appreciation trend, as well as a secure situation of full employment.

Although the Thai economy has had to face various local and global shocks such as the tsunami, avian flu, drought, flooding, spiraling oil prices, rising interest rates, southern unrest, and political uncertainty, its economic fundamentals and stability were strong enough to withstand fluctuations caused by these internal and external factors. In addition, fiscal and financial positions have proved to be stable and maintained within the sustainability framework.

Table 1. Economic Projections for 2009 and 2010 (as of Sep 2009)

Projections		2008	2009f	2010f	
				Average	Range
(1)	Economic Growth Rate 1/	2.6	–3.0	3.3	2.5–4.1
(2)	Consumption Growth 1/	2.2	–0.2	4.3	3.7–4.9
	- Private Consumption	2.5	–1.0	4.2	3.7–4.7
	- Public Consumption	0.4	6.4	4.8	4.0–5.7
(3)	Investment Growth 1/	1.1	–9.1	7.0	3.4–9.6
	- Private Investment	3.2	–13.7	6.6	2.7–9.0
	- Public Investment	–4.8	5.3	8.2	5.2–11.3
(4)	Export Volume of Goods and Services 1/	5.4	–14.8	5.6	4.8–6.7
(5)	Import Volume of Goods and Services 1/	7.5	–22.2	12.4	10.6–14.2
(6)	Trade Balance 2/	0.2	20.5	9.7	8.7–11.1
	- Export Value of Goods 1/	16.8	–17.2	10.0	9.0–11.4
	- Import Value of Goods 1/	26.4	–28.8	19.5	17.0–21.9
(7)	Current Account 2/	–0.2	22.7	11.5	10.5–13.0
	- Percentage of GDP	–0.1	8.7	4.0	3.7–4.6
(8)	Headline Inflation 1/	5.5	–0.8	2.5	2.0–3.0
	- Core Inflation 1/	2.3	0.4	1.5	1.0–2.0
(9)	Unemployment Rate 3/	1.4	1.8	1.3	1.0–1.5

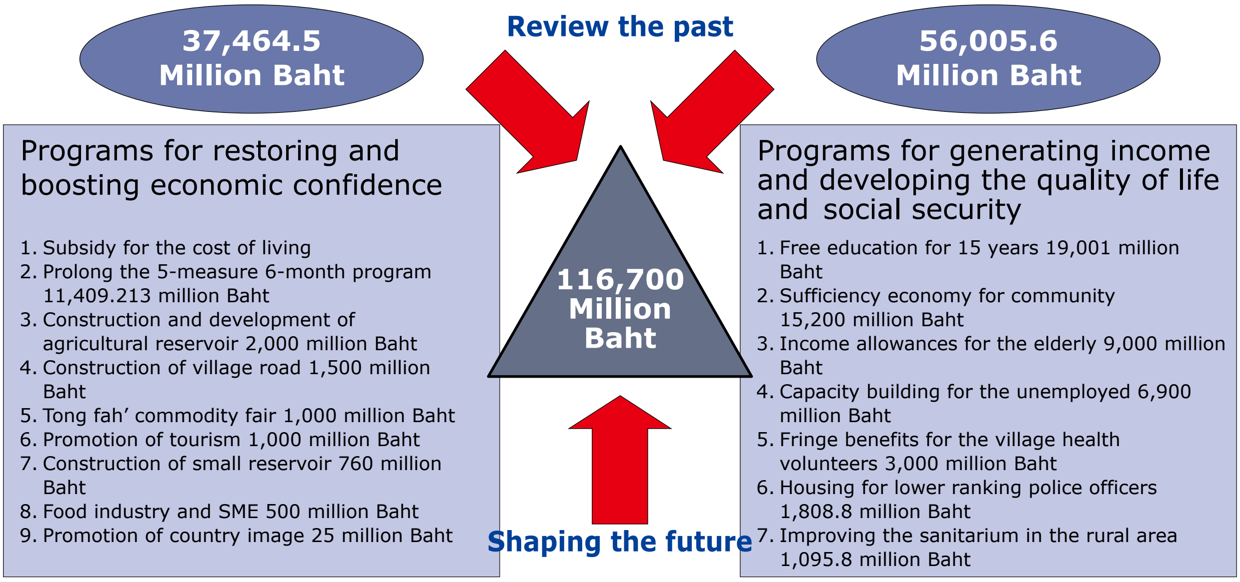
Note: f=forecast, 1/=percent y–o–y, 2/=USD billion, 3/=percentage of total labor force.
Source: Fiscal Policy Office, Ministry of Finance, Thailand.

2.2 Thailand Economic Situation in 2009

According to the Fiscal Policy Office (FPO), the Ministry of Finance, the Thai economy in 2009 had been forecasted to contract by 3.0% as the result of the global economic crisis that adversely affected the export volume of goods and services (see Table 1). Although there would be positive signs of recovery of the global economy in the second half of the year, export volume was projected to contract by 14.8%. The import volume of goods and services, on the other hand, had been projected to decline by 22.2% following declines in demand for export-oriented production and contraction in domestic demand. In particular, private investment had been projected to contract by 13.7% as investors delayed their investment plans. Despite improved private consumption that resulted from the government's Stimulus Package 1 (SP1) that helped support income and reduce household expenses, the sharp contraction in private spending caused private consumption in 2009 to shrink by 1.0%.

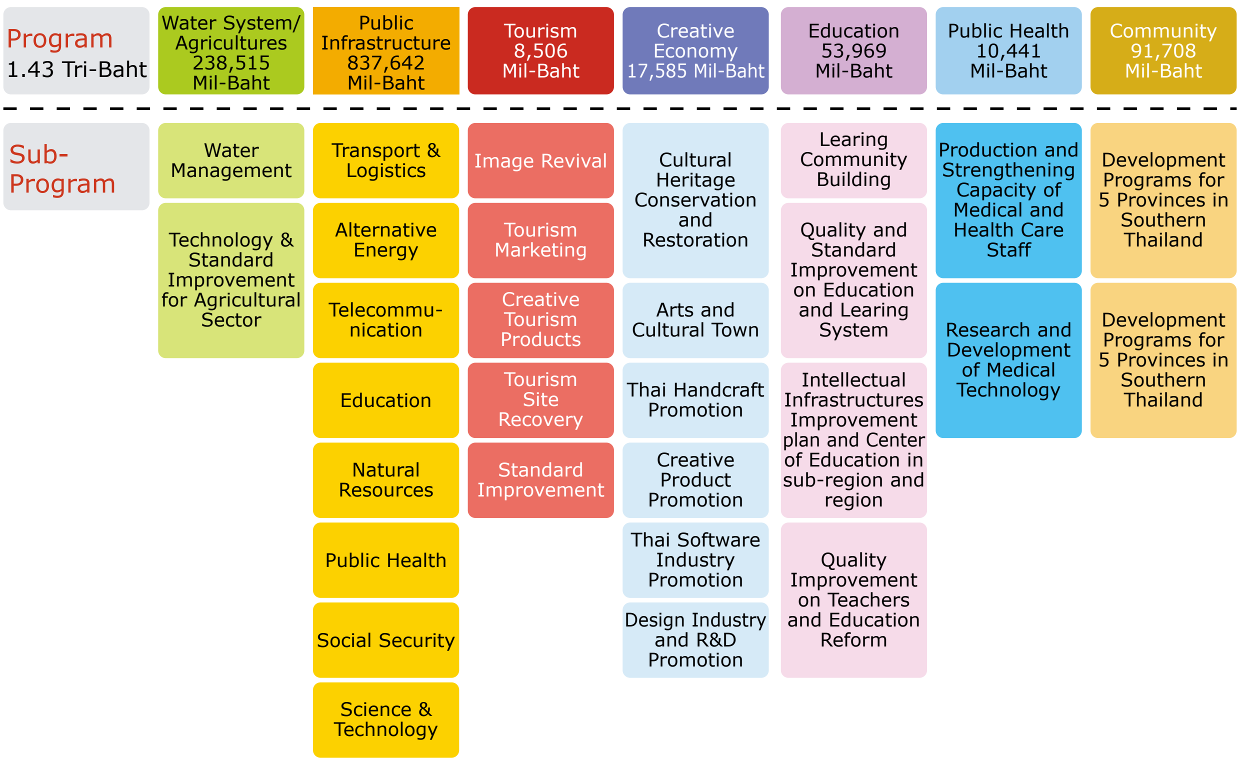
Despite the sharp contraction during the first half of the year, projections indicated that the Thai economy would start to recover in the second half of 2009 along with the global recovery trend, and show positive growth in the last quarter of the year. A major contributing factor for Thailand's economic recovery had been increased public expenditure, especially investment expenditure under "Strong Thailand 2012," or Thai Khem Kaeng program, along with the revival of economies of major trading partners, particularly those in Asia. In this connection, public consumption growth in 2009 had been projected to accelerate to 6.4%, while public investment growth was projected to increase to 5.3%.

Nonetheless, the Thai economy still faced some risks from slow recovery of private expenditures in both consumption and investment. Internal economic stability was expected to improve, with headline inflation in 2009 forecasted to decline by –0.8% following falls in oil prices compared to the previous year, as well as an appreciating trend of the Thai Baht. Core inflation, which excludes energy and raw food prices, had been projected at 0.4% due to an extension of the government's measures to help lower costs of living. The unemployment rate had been projected at 1.8% of the total labor force as the employment situation improved following overall economic recovery in the second half of the year. As for external economic stability, the current account in 2009 had been projected to record a large surplus of 8.0% of GDP, as import value shrank more than export value. Import value had been forecasted to contract by 28.8%, while projections for export value were down by 17.2%.



Note: USD1=THB32
Source: Suwanne Khamam, 2009.

Figure 1. The Structure of Stimulus Package I (SP1)



Note: USD1=THB32
Source: Suwanne Khamam, 2009.

Figure 2. The Structure of Stimulus Package II (SP2)

2.3 Thailand Economic Projection in 2010

In 2010, Thai economy had been forecasted to expand at 3.3% subject to the following conditions: magnitude of the global economic recovery, consistency and efficiency of government economic stimulation, and Thailand's ability to maintain economic confidence and facilitate private investment. However, a major supporting factor for Thailand's economic recovery is continued public expenditures under the "Strong Thailand 2012" program. In this connection, private consumption is forecasted to accelerate to 4.2% following economic recovery, with the employment situation returning to its normal level. Private investment is projected to grow at 6.6%, partly due to public investment under the Strong Thailand program. Meanwhile, the export goods and services in 2012 are forecasted to grow at 5.6% as the result of global economic recovery, which has mainly been attributed to the economic stimulus measures taken by several major trading partners. The import volume of goods and services is projected to accelerate to 12.4% as the result of domestic spending and a recovery in exports.

Despite the sluggish economy and political unrest in Thailand, internal economic stability has continued to improve, and headline inflation in 2010 is projected to increase to 2.5% per year as global oil and agricultural prices are expected to rise in line with recovery of the global economy. The unemployment rate is expected to further decline to its normal level, at 1.3% of the total labor force. As for external stability, the current account is projected to decline from the previous year but still record a surplus of 4.0% of GDP due to lower trade surplus, as the value of import grows at a faster pace than that of exports. Meanwhile, export value is projected to grow by 10.0% following the global economic recovery. Import value is forecasted to grow by 19.5%, as a result of domestic demand picking up and rises in import orders.

Despite the projected expansion of Thailand's economy in 2010, economic management to support the economic recovery should concentrate on the following areas: 1) ensuring continuity in government policy to support private-sector investment in order to maintain the momentum of growth, which includes continued investment in public infrastructure and resolving the Map Ta Phut case so as to regain investor confidence; 2) encouraging the private sector to utilize the tax reduction scheme under AFTA and speeding up regional economic cooperation with neighboring economies in transport and logistics infrastructure in order to open up new opportunities for trade and investment; and 3) ensuring the coordination of monetary and fiscal policy in order to support continued economic recovery and reviving public confidence.

3. PROFILES OF SMEs IN THAILAND

3.1 Definition of SMEs

On 11 September 2002, the Ministry of Industry introduced a definition of Thai small and medium-sized enterprises (SMEs). It is based on the number of salaried workers and fixed capital. An enterprise is categorized as an SME if it has less than 200 employees and fixed capital of less than THB200 million, excluding land and property. SMEs in Thailand are classified into three sectors: production, service, and trading (see Table 2).

Table 2. The Definition of an SME

Type	Small		Medium	
	Employees	Capital (million Baht)	Employees	Capital (million Baht)
Production	Not more than 50	Not more than 50	50–200	50–200
Service	Not more than 50	Not more than 50	51–200	50–200
Wholesale	Not more than 50	Not more than 50	26–50	50–100
Retail	Not more than 50	Not more than 50	16–30	30–60

Note: USD1=THB32
Source: OSMEP, Ministry of Industry, Thailand.

In business practices, the definition of SMEs can be extended to include the number of shared holdings of parent companies, enterprise structures, and independence. The principle criterion for an SME is the independence of enterprise. This characteristic indicates that not more than 25% of SME capital should be owned by one large or many large companies. At present, there are many multinational companies in the form of franchise companies and joint ventures between Thai and overseas companies. Some of these companies should not be classified as Thai SMEs.

3.2 Profiles of SMEs

According to the Office of Small and Medium Enterprises Promotion (OSMEP), there were 2.4 million SMEs in Thailand as of April 2009, accounting for 99.6% of all business enterprises across the country (see Table 3). In terms of geographical concentration, SMEs are mostly located in the Greater Bangkok Metropolitan Area (BMA), Northeast, and Northern region.

Thai SMEs have created about 8.9 million jobs, accounting for 76.7% of total employment in the country. Approximately 40% of those jobs are in manufacturing (see Table 4). In terms of efficiency, there are many factors that influence the performance of SMEs. The labor productivity of SMEs declined 5.7% in 2009 following decreases in income and profit (see Table 5). However, as a firm becomes larger in terms of production, it also tends to become more efficient.

SMEs generated USD180.7 billion, or 37.2% of the overall Thai GDP in 2009 (see Table 6). As a breakdown of SME products, about 47.9% came from SMEs in manufacturing, with 29.5% from the service sector and 22.7% from SMEs in trade and maintenance. Thai SMEs can be seen as being roughly equally divided in manufacturing, service, and trade.

Table 3. SME Enterprises, 2006–2009f (as of April 2009)

Industry/Business	Enterprises											
	2006			2007			2008f			2009f		
	SMEs	L.E.	Total	SMEs	L.E.	Total	SMEs	L.E.	Total	SMEs	L.E.	Total
Manufacturing	661,055	1,817	662,872	668,185	1,828	670,013	668,001	1,845	669,846	653,561	1,838	655,399
- Agriculture, Hunting and Forestry	3,765	35	3,800	4,527	30	4,557	4,686	29	4,715	4,810	29	4,839
- Fishery	428	3	431	431	1	432	405	1	406	399	1	400
- Mining	4,332	16	4,348	4,841	15	4,856	5,081	16	5,097	5,281	16	5,297
- Industry	651,728	1,750	653,478	657,082	1,775	658,857	656,461	1,799	658,260	641,682	1,792	643,474
- Electricity, Gas and Waterworks	802	13	815	1,304	7	1,311	1,368	n.a.	1,368	1,389	n.a.	1,389
Services	673,120	1,192	674,312	708,841	1,223	710,064	728,349	1,247	729,596	719,408	1,253	720,661
Trade (Wholesale and Retail)	938,057	1,211	939,268	973,248	1,266	974,514	993,199	1,283	994,482	1,015,049	1,301	1,016,350
Other	17,564	12	17,576	15,953	7	15,960	13,922	6	13,928	14,073	6	14,079
Total	2,289,796	4,232	2,294,028	2,366,227	4,324	2,370,551	2,403,471	4,381	2,407,852	2,402,091	4,398	2,406,489

Note: f=forecast, L.E.=Large Enterprises.
Source: Office of Social Security Fund, National Statistics Office, compiled by SMEs Sectors Analysis and Warning Project (SAW), OSMEP, Thailand, April 2009

Table 4. SME Employment, 2006–2009f (as of April 2009)

Industry/Business	Employment											
	2006			2007			2008f			2009f		
	SMEs	L.E.	Total	SMEs	L.E.	Total	SMEs	L.E.	Total	SMEs	L.E.	Total
Manufacturing	3,402,699	1,726,494	5,129,193	3,460,967	1,776,884	5,237,851	3,452,092	1,777,766	5,229,858	3,305,969	1,666,374	4,972,343
- Agriculture, Hunting and Forestry	37,437	26,634	64,071	44,355	26,380	70,735	46,371	22,528	68,899	46,818	22,641	69,459
- Fishery	3,007	n.a.	3,007	2,712	n.a.	2,712	2,833	n.a.	2,833	2,741	n.a.	2,741
- Mining	36,861	3,051	39,912	36,097	3,548	39,645	39,110	3,134	42,244	40,140	3,196	43,336
- Industry	3,318,850	1,696,809	5,015,659	3,367,034	1,744,124	5,111,158	3,351,767	1,752,104	5,103,871	3,203,027	1,640,537	4,843,564
- Electricity, Gas and Waterworks	6,544	n.a.	6,544	10,769	2,832	13,601	12,011	n.a.	12,011	13,243	n.a.	13,243
Services	2,857,284	536,783	3,394,067	3,007,968	632,213	3,640,181	3,177,846	664,103	3,841,949	2,976,811	633,449	3,610,260
Trade (Wholesale and Retail)	2,376,968	379,808	2,756,776	2,431,432	401,670	2,833,102	2,532,093	404,843	2,936,936	2,627,859	406,992	3,034,851
Other	175	443	618	200	n.a.	200	601	n.a.	601	628	n.a.	628
Total	8,637,126	2,643,528	11,280,654	8,900,567	2,810,767	11,711,334	9,162,632	2,846,712	12,009,344	8,911,267	2,706,815	11,618,082

Note: f=forecast, L.E.=Large Enterprises.
Source: Office of Social Security Fund, National Statistics Office, compiled by SMEs Sectors Analysis and Warning Project (SAW), OSMEP, Thailand, April 2009

Table 5. SME Labor Productivity, 2006–2009f (as of April 2009)

Industry/Business	Labour productivity (USD per person)											
	2006			2007			2008f			2009f		
	SMEs	L.E.	Total	SMEs	L.E.	Total	SMEs	L.E.	Total	SMEs	L.E.	Total
Manufacturing	157,549.68	2,572,452.30	2,730,001.98	201,924.80	2,363,871.65	2,565,796.45	88,322.19	1,923,281.54	2,011,603.73	74,604.32	2,003,529.51	2,078,133.83
- Agriculture, Hunting and Forestry	951.75	26,680.49	27,632.24	30.38	39,742.08	39,772.46	353.62	42,195.17	42,548.79	317.73	48,283.47	48,601.20
- Fishery	n.a.	n.a.	n.a.	n.a.	n.a	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Mining	51,157.29	2,527,175.22	2,578,332.51	37,424.76	2,306,505.09	2,343,929.85	29,049.27	1,866,641.23	1,895,690.50	31,788.50	1,941,551.32	1,973,339.82
- Industry	2,365.56	18,596.59	20,962.15	2,663.87	17,624.48	20,288.35	2,264.04	14,445.14	16,709.18	2,157.77	13,694.72	15,852.49
- Electricity, Gas and Waterworks	103,075.08	n.a.	103,075.08	161,805.79	n.a.	161,805.79	56,655.26	n.a.	56,655.26	40,340.32	n.a.	40,340.32
Services	3,278.95	18,495.92	21,774.87	3,298.99	18,033.41	21,332.40	2,774.28	12,980.58	15,754.86	2,726.26	12,485.46	15,211.72
Trade (Wholesale and Retail)	2,137.31	9,036.36	11,173.67	2,014.26	9,257.02	11,271.28	1,563.27	8,231.62	9,794.89	1,400.95	8,161.42	9,562.37
Total	162,965.94	2,599,984.58	2,762,950.52	207,238.05	2,391,162.08	2,598,400.13	92,659.74	1,944,493.74	2,037,153.48	78,731.53	2,024,176.39	2,102,907.92

Note: f=forecast, L.E.=Large Enterprises. Labour productivity data have been converted from Thai Baht, at USD1=THB32.
Source: Business Development Department, Customs Department, Industrial Works Department, Office of Social Security Fund, National Statistics Office, compiled by SMEs Sectors Analysis and Warning Project (SAW), OSMEP, Thailand, April 2009

Table 6. SME Revenue, 2006–2009f (as of April 2009)

Industry/Business	Revenue (USD million)											
	2006			2007			2008f			2009f		
	SMEs	L.E.	Total	SMEs	L.E.	Total	SMEs	L.E.	Total	SMEs	L.E.	Total
Manufacturing	81,634.46	261,441.02	343,075.48	88,374.73	280,221.14	368,595.87	90,121.82	276,681.51	366,803.33	86,477.58	258,087.90	344,565.48
- Agriculture, Hunting and Forestry	5,072.17	3,428.12	8,500.29	4,430.92	3,908.77	8,339.69	4,563.14	4,615.43	9,178.57	4,423.23	4,935.00	9,358.23
- Fishery	193.32	78.90	272.22	202.70	138.67	341.37	163.37	20.19	183.56	156.51	17.72	174.23
- Mining	4,379.01	19,471.63	23,850.64	3,490.19	18,564.61	22,054.80	3,948.13	17,728.83	21,676.96	3,962.15	17,308.34	21,270.49
- Industry	70,177.49	233,163.59	303,341.08	77,309.93	252,232.11	329,542.04	79,228.41	248,257.68	327,486.09	75,750.05	230,115.66	305,865.71
- Electricity, Gas and Waterworks	1,812.47	5,298.78	7,111.25	2,940.99	5,376.98	8,317.97	2,218.77	6,059.38	8,278.15	2,185.64	5,711.18	7,896.82
Services	56,511.15	27,497.99	84,009.14	55,930.18	26,153.31	82,083.49	54,964.26	25,492.07	80,456.33	53,257.11	24,712.23	77,969.34
Trade (Wholesale and Retail)	40,846.36	19,615.47	60,461.83	38,935.75	21,918.87	60,854.62	39,930.45	22,536.81	62,467.26	40,978.59	22,762.17	63,740.76
Total	178,991.97	308,554.48	487,546.45	183,240.66	328,293.32	511,533.98	185,016.53	324,710.39	509,726.92	180,713.28	305,562.30	486,275.58

Note: f=forecast, L.E.=Large Enterprises. Revenue data have been converted from Thai Baht, at 1 USD=32 Baht.
Source: Business Development Department, Customs Department, Industrial Works Department, Office of Social Security Fund, National Statistics Office, compiled by SMEs Sectors Analysis and Warning Project (SAW), OSMEP, Thailand, April 2009

Thai SMEs are not confined to the domestic market. They are increasingly active and successful in international trade. In Q2 2009, SMEs accounted for 30.4% of Thailand's total exports of USD163.5 billion, down 6.4% from the previous year (see Table 7). Regarding imports, SMEs played a slightly larger role, bringing in 30.8% of total imports worth nearly USD163.0 billion, down 9.3% from the preceding year (see Table 8).

Despite this strong international involvement, only 27.5% of SME revenue came from exports. As might be expected, smaller companies are relatively more focused on the domestic market than are the larger companies, although not by a wide margin, and the net profit of SMEs was down 8.4% from the previous year (see Table 9). Nonetheless, Thai SMEs are already competing successfully in regional and global markets, and can expect to do even more in the future.

In terms of technology development, most activities are run on the SMEs' own initiatives. These activities range from product licensing, training, technical consultancy, modern machine support, and quality control. However, some SMEs produce according to customer needs, and some machinery providers for SMEs have influence in the areas of technical consultancy and modern machinery support.

In general, the sector does not have strong technical support from abroad. Only a small percentage of SMEs are assisted by joint venture firms. Bigger size firms can get more technical support from overseas, thus being able to be subcontractors for overseas counterparts. Hence, they would need the foreign market to support production as well. In terms of sales and distribution methods of SMEs, subcontracting is by far the most important approach used, except for the small-sized firms which try to set up their own stores to facilitate their product distribution.

As for SME sources of funds, the sector depends mainly on commercial loans and self-financed support. Demand for such funding stems chiefly from needs for revolving funds to acquire machinery and parts and for the construction of new plants. These firms face financial problems that are often related to high interest rates, insufficient capital, difficulties in getting loans, and scarcity of sources of funds. It is, however, thought by financial institutions that SMEs are often incapable of fulfilling the requirements for standards in accounting and budgeting systems, especially in their provision of supplementary financial data in order to meet the loan requirements of financial institutions. As a result, it becomes more difficult for them to get loan approval from banks.

Table 7. SME Exports, 2006–2009f (as of April 2009)

Industry/Business	Export (USD million)											
	2006			2007			2008f			2009f		
	SMEs	L.E.	Total	SMEs	L.E.	Total	SMEs	L.E.	Total	SMEs	L.E.	Total
Manufacturing	42,898.59	105,513.22	148,411.81	47,657.38	113,017.58	160,674.96	52,222.36	122,613.10	174,835.46	48,786.29	110,309.88	159,096.17
- Agriculture, Hunting and Forestry	4,622.07	3,253.79	7,875.86	3,884.76	3,805.83	7,690.59	4,093.68	4,442.63	8,536.31	3,956.95	4,756.87	8,713.82
- Fishery	156.76	78.90	235.66	166.15	138.67	304.82	127.28	20.19	147.47	119.67	17.72	137.39
- Mining	1,547.33	732.94	2,280.27	947.25	932.73	1,879.98	1,236.24	1,105.70	2,341.94	1,264.05	1,148.38	2,412.43
- Industry	36,571.80	101,431.81	138,003.61	42,656.88	108,140.35	150,797.23	46,762.24	117,044.57	163,806.81	43,442.24	104,386.91	147,829.15
- Electricity, Gas and Waterworks	0.63	15.78	16.41	2.34	0.00	2.34	2.92	0.01	2.93	3.38	0.00	3.38
Services	16.00	0.18	16.18	16.98	4.66	21.64	23.49	2.53	26.02	26.84	2.01	28.85
Trade (Wholesale and Retail)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other	2,031.67	757.42	2,789.09	1,804.08	730.47	2,534.55	782.30	370.54	1,152.84	816.35	212.14	1,028.49
Total	44,946.26	106,270.82	151,217.08	49,478.44	113,752.71	163,231.15	53,028.15	122,986.17	176,014.32	49,629.48	110,524.03	160,153.51

Note: f=forecast, L.E.=Large Enterprise. Export data have been converted from Thai Baht, at USD1=THB32.
Source: Customs Department, compiled by SMEs Sectors Analysis and Warning Project (SAW), OSMEP, Thailand, April 2009

Table 8. SME Imports, 2006–2009f (as of April 2009)

Industry/Business	Import (USD million)											
	2006			2007			2008f			2009f		
	SMEs	L.E.	Total	SMEs	L.E.	Total	SMEs	L.E.	Total	SMEs	L.E.	Total
Manufacturing	48,571.27	97,293.84	145,865.11	44,253.79	102,820.17	147,073.96	53,388.93	120,867.65	174,256.58	48,080.02	103,777.44	151,857.46
- Agriculture, Hunting and Forestry	913.14	1,108.11	2,021.25	882.62	1,208.51	2,091.13	1,121.89	1,698.84	2,820.73	1,130.83	1,738.66	2,869.49
- Fishery	102.55	6.44	108.99	97.39	6.46	103.85	123.70	7.09	130.79	113.25	6.35	119.60
- Mining	5,708.53	22,240.60	27,949.13	1,488.96	24,809.34	26,298.30	1,724.27	34,854.75	36,579.02	1,454.33	28,382.93	29,837.26
- Industry	41,846.89	73,823.14	115,670.03	41,784.63	76,795.73	118,580.36	50,418.96	84,306.89	134,725.85	45,381.53	73,649.44	119,030.97
- Electricity, Gas and Waterworks	0.16	115.55	115.71	0.19	0.13	0.32	0.11	0.08	0.19	0.08	0.06	0.14
Services	7.50	7.02	14.52	12.76	22.24	35.00	11.60	49.95	61.55	10.52	56.71	67.23
Trade (Wholesale and Retail)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other	1,222.00	847.17	2,069.17	1,145.17	1,308.89	2,454.06	1,965.59	3,775.30	5,740.89	2,121.39	3,890.99	6,012.38
Total	49,800.77	98,148.03	147,948.80	45,411.72	104,151.30	149,563.02	55,366.12	124,692.90	180,059.02	50,211.93	107,725.14	157,937.07

Note: f=forecast, L.E.=Large Enterprise. Import data have been converted from Thai Baht, at USD1=THB32.
Source: Customs Department, compiled by SMEs Sectors Analysis and Warning Project (SAW), OSMEP, Thailand, April 2009

Table 9. SME Net Profit, 2006–2009f (as of April 2009)

Industry/Business	Net Profit (USD million)											
	2006			2007			2008f			2009f		
	SMEs	L.E.	Total	SMEs	L.E.	Total	SMEs	L.E.	Total	SMEs	L.E.	Total
Manufacturing	5,688.63	26,463.18	32,151.81	6,464.71	27,302.93	33,767.64	4,139.92	19,094.78	23,234.70	3,791.38	16,666.65	20,458.03
- Agriculture, Hunting and Forestry	63.14	501.47	564.61	40.10	799.95	840.05	42.92	784.64	827.56	45.40	766.94	812.34
- Fishery	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Mining	1,239.79	5,576.64	6,816.43	842.02	5,967.09	6,809.11	662.59	3,261.31	3,923.90	762.43	3,586.86	4,349.29
- Industry	3,921.54	19,627.80	23,549.34	4,748.65	20,089.09	24,837.74	3,122.84	14,635.47	17,758.31	2,693.74	11,935.67	14,629.41
- Electricity, Gas and Waterworks	464.16	757.27	1,221.43	833.94	446.80	1,280.74	311.57	413.36	724.93	289.81	377.18	666.99
Services	3,347.62	4,853.81	8,201.43	3,968.69	4,670.35	8,639.04	2,755.91	3,617.67	6,373.58	2,420.82	2,938.64	5,359.46
Trade (Wholesale and Retail)	1,494.00	1,307.40	2,801.40	1,368.87	1,301.13	2,670.00	957.51	1,205.60	2,163.11	973.16	1,428.95	2,402.11
Total	10,530.25	32,624.39	43,154.64	11,802.27	33,274.41	45,076.68	7,853.34	23,918.05	31,771.39	7,185.36	21,034.24	28,219.60

Note: f=forecast, L.E.=Large Enterprises. Net profit data have been converted from Thai Baht, at USD1=THB32.
Source: Business Development Department, Customs Department, Industrial Works Department, Office of Social Security Fund, National Statistics Office, compiled by SMEs Sectors Analysis and Warning Project (SAW), OSMEP, Thailand, April 2009

4. IMPACT OF CRISIS ON THAI ECONOMY

Since 2003, Thailand's economy has expanded on private and external demand despite turbulence such as problems in the Middle East, oil prices, and so forth. In 2007, the main driver of the economy was its expansion in exports, even though domestic demand had decelerated. This was due to the fact that higher oil prices and high inflation rates contributed to more cautious consumer spending. The overall economic growth of Thailand in 2008 still accelerated slightly from the previous year (see Table 10). In 2009, the Thai economy had been expected to decelerate following the global financial crisis. This had not only been due to external problems related to the global financial turmoil and the slowdown in public and private consumption and investments, but also the internal problems of political uncertainty and the issue of the three southern provinces.

Table 10. Major Thai Industrial Experts (unit: USD million)

Industry	2004	2005	2006	2007	2008
Computers & Parts	11,528	14,826	17,681	18,658	18,916
Automotive	6,900	9,697	11,324	13,972	16,036
Electronics	6,139	7,452	8,362	9,073	7,437
Rubber	4,296	4,646	6,421	6,073	6,988
Plastic products	3,900	5,247	5,356	5,610	5,661
Jewelry	3,321	4,042	4,371	5,786	8,565
Refined fuel	2,221	2,969	4,337	4,397	8,117
Iron	3,112	3,613	4,189	4,928	5,527
Electric appliances	4,048	3,923	4,117	4,031	3,870
Chemical products	2,589	3,305	4,077	4,221	4,428
Others	73,034	79,009	84,100	69,743	74,543
Total	121,088	138,729	154,335	146,492	160,088

Source: Ministry of Commerce, 2009

This financial crisis has brought crucial consequences for both the Thai economy and its society. Even if its direct impact may not be so great, the indirect consequences are quite substantial. Hence for the country's economy, the crisis is likely to directly affect Thai exporters who rely heavily on traditional markets such as garments, furniture, modified starch, rubber products, air conditioners, and plastic products. Meanwhile, Thai exporters of raw materials such as fabrics and yarn, automotive parts, computer accessories, and circuit boards would also be indirectly affected as they constitute part of the global supply chain. However, direct consequences for the Thai economy are likely to be characterized in the following areas.

1) Impact on the Export Sector

Recently, the USA, the European Union, and Japanese markets have accounted for approximately 35% of Thailand's export market. With its impact on market demand, the crisis has resulted in a substantial decline in demand for Thai products in these major export markets. Entrepreneurs in various kinds of Thai industrial exports have seen declines in product delivery volume by about 20 to 30%. The industries that have been most adversely affected include those that produce garments, computer parts and components, electric products, vehicles, leather and footwear, steel products, furniture, ceramics, plasticware, seafood, and jewelry. With exports of goods and services serving as a crucial sector contributing to more than 70% of Thailand's GDP, a decline in this sector will inevitably affect its economic growth.

2) Impact on Tourism

Following the Tom Yum Kung crisis of 1997, Thailand has attracted an annual average of 10.5 million foreign tourists. With steadily increasing numbers of foreign tourists during this period, tourism has contributed annual earnings of USD16–19 billion to the country's revenues, or about 10% of the total value of exports of Thai goods and services. In 2007, the number of foreign tourists rose to 14.5 million, and in 2008, 11.3 million tourists had entered the country by September. However, even before the financial crisis, tourism had been affected by political turmoil. The current crisis is in this respect a negative factor contributing to the decline that Thai tourism had already been experiencing.

3) Impact on Credit and Investment

The financial crisis has already resulted in a credit crunch in the global financial system. As a consequence of this, the costs of dollar loans will become far higher, and businesses that once benefited from foreign loans will have to look for domestic credit, and this will lead to a rapid shortage of domestic credit. The situation, in turn, will cause a rise in interest rates. Therefore, it will become more difficult and costly to obtain credit from local financial institutions. This state of affairs will have a severe impact on SMEs in Thailand, because their chances of acquiring credit, which are actually limited, will become even more squeezed.

4) Impact on Employment

The Federation of Thai Industries has estimated that in view of a 30% decrease in foreign orders for the first quarter of 2009, the country's employment in 2009 had been adversely affected. With the drop in foreign orders, entrepreneurs in this sector would have to make 10 to 15% reductions in their work force. In addition, given the economic recession, a large number of Thai workers abroad will be laid off and return to Thailand. The country's unemployment situation has been severely worsened by the influx of new graduates into the labor market.

5) Impact on the Prices of Certain Agricultural Products

This crisis has had the important effect of reducing global purchasing power. In turn, this has led to falls in agricultural product output, especially such that supply has exceeded demand. During the past several years, a number of Thai agricultural products, particularly natural rubber and tapioca products, have benefited from the tremendous economic growth of the People's Republic of China (PRC). Both the volume and value of Thai agricultural exports have thus remained high all through this period. Now that Chinese exports, which had heavily depended on the US market, have experienced a slump, the prices of certain agricultural products have precipitously tumbled. This drop in the prices of agricultural products will have a severe impact on the income of farmers in rural areas, who still represent the majority of the Thai population.

4.1 Impact of the Crisis on SMEs

The overall impact produced by the crisis could be felt differently, depending on the type of industry, orientation of production (export and domestic market), share of equity held by foreign affiliates, and so forth. The crisis prompted the suggestion that there would be a sharp decrease in production, trade, and employment, and for certain industries a collapse of overall activities which could have a strong impact on the management and organization of firms. As most SMEs are still domestically oriented, subcontracting activities as practiced by the majority of firms could hardly be felt. These have held true for products such as textiles and leather products, plastic and chemical products, jewelry, automobiles, and electronic and electrical products.

At the moment, SMEs are still suffering from the credit crunch. They are in a less favorable situation than the big firms, which get their loans extended and interest rates reduced while they negotiate with financial institutions. The SME sector, mostly small firms, is trying to service debts, struggling to avoid non-performing loans (NPLs). Meanwhile, they are badly affected by high interest rates when they ask for debt restructuring.

The government has started to recognize that SMEs are integral and important part of economic recovery. If the crisis is prolonged and adversely affects the sector for too long, the path to recovery could be longer for the overall economy. Hence, a campaign to support SMEs gained momentum by the second half of 2009 when the government announced measures to guarantee financial needs for the sector. Various public and private financial institutions then followed suit by extending funds to SMEs with a combined injection of over several billion USD.

Addressing immediate concerns for financial assistance could be part of the recovery process, as SMEs need not only loans but also support in the areas of production, technology, marketing, and management. Subcontracting and its links to foreign firms can play important roles in mitigating the impact of the crisis in the long run. In this Thai case, only a small number of firms are joint ventures with foreign affiliates. However, they practice strong subcontracting within the country and possibly with other countries. This suggests that if well developed, local SMEs that have relationships with foreign affiliates could be less seriously affected by the crisis.

4.2 Challenges in the Development of Thai SMEs

According to a study by the International Institute for Management Development (IMD) on economic competitiveness, Thailand's competitiveness had, to date, fallen since 2005. The Human Development Report, or the HDI index, is another indicator for measuring human development, which also indicated that current development has slowed down compared to the previous year. Data from the National Economic and Social Development Board showed that total factor productivity (TFP) in Thailand still needs improvement. TFP is explained as the change in output after taking into account growth in physical capital and changes in the quantity and quality of labor input. The TFP index, which shows Thailand's overall economic growth, decreased from 2003 to 2007.

Even though Thailand had recovered remarkably from the Asian financial crisis of 1997, the country still faces economic development challenges that are common to many developing countries. Global uncertainties have remained as a key risk for Thailand, such as how long the hamburger crisis would continue to hurt the global economy. Policymakers needed to focus on improving the Thai economy's flexibility and efficiency by strengthening the resiliency of households and the overall competitiveness of the country's business environment. They also need to balance short- and long-term development goals. Currently, the government is taking the following actions, both direct and indirect measures, to support SMEs:

- A stimulus package of around USD3,646.8 million as a supplement to the FY2009 budget
- Measures in an urgent economic recovery plan
- A medium- and long-term public investment scheme through government-financed projects under proactive fiscal policy
- Acceleration of disbursement of FY2009 and FY2010 government budgets
- More accommodative monetary policy, together with credit expansion and guarantee scheme provisions for SMEs
- Stimulation of domestic consumption in the short run, through supportive monetary policy
- Provide a relief and cushion to those affected by the economic turmoil through subsidies for elderly persons, training for the unemployed, a soft loan and credit guarantee scheme for SMEs in return for an agreement to refrain from laying off workers, and extension of tax allowances to reduce the tax burden
- Price guarantee scheme to stabilize agricultural prices

To compete in the global economy in the long run, Thailand must raise the competitiveness of SMEs through innovation and productivity. On this point, the government can continue to lay down a crucial foundation through related plans, including, for example, the National Strategic Productivity Plan. In addition, to achieve sustainable and quality growth, the country needs to constantly develop the quality of human capital, physical capital, and technology, particularly where SMEs are concerned, and find better ways to combine them to produce goods and services and develop new ones. This will definitely require a better innovation system to nurture new ideas, and in particular, a vision for the nation will require strong building blocks for economic resilience through increased productivity to enhance competitiveness.

5. CASE STUDY

For a long time, Thai SMEs have made the most significant contributions to national economic development. In 2009, the deterioration of global economic and financial conditions had been a key risk factor for the growth of SMEs. The crisis hit SMEs severely, because their ability to export had become crucial for their long-term survival and growth. This means that Thai SMEs are currently in a critical stage of their development. SMEs in developed countries can provide their products and services with high quality and low prices. However, Thai SMEs have been faced with a challenging situation to provide higher quality with a lesser price compared to competitors. A case study of a Thai SME in the automotive industry will provide a successful model of the characteristics for survival in the economic downturn.

Company A was established in 1976 and employs more than 60 persons. It is a wholly-owned Thai company. The company has continued to make improvements in producing automotive parts as a first-tier supplier, for example, the bracket compressor, idle pulley, pulley crank shaft, pulley water pump, and so forth. In 2001, the company received two awards: the Prime Minister's Award and the Leadership Award.

The company focuses its vision on improving the quality of products at lower cost, offering a high quality of service, and providing prompt delivery to customers. It is also concerned about the environment. This means that quality products and services and customer satisfaction are at the heart of the business. The financial crisis has affected the company and slowed sales. Company revenue, which had been more than THB60 million before the crisis, had shrunk during this period. Since all customers are car manufacturers, company income is based on contracts with major customers. Fulfillment of each contract requires use of a major part of the company's high-capacity production facilities. In order to survive the crisis and maintain its market share, the company has developed the following strategies.

1) Management

In a period of serious decline, the company focuses on cost reduction rather than reducing production capacity. The market trend is always to demand new products with high technological content. For this reason, the management team must be aware of the importance of R&D for long-term company growth. The team has continued its strategy to carry out R&D projects both within company and with outside partners.

2) Customer and Market Focus

The company divides target customers into two categories: Firstly, the existing customers. The company focuses on tightening relationships with existing customers to maintain its market share, while at the same time looking for new customers for existing products. Secondly, the company develops new customers for new product lines created from its innovation, for example, products for car service centers.

The company focuses on customer satisfaction and maintains good relationships with them. The prime activities are listening to suggestions, opinions, and complaints from customers and supporting their needs. Customer analysis is carried out to understand the perceptions and expectations of customers with regard to the company's products and services. The results from this analysis are released to relevant staff within the company. Moreover, the company also initiates strategy for building long-term networks with customers and suppliers. The results from this process assist the company in getting information about new opportunities for further growth and development.

3) Production Plan and Control

The company has a periodic plan to invest in modern machinery, such as a CNC, CAD, and CAM in order to produce high-quality products while at the same time increasing productivity. This always improves the production process, such as in failure mode and effect analysis), and helps to develop value creation out of existing products. The production plan is synchronized with the marketing plan. The company is able to deliver the products on time, as well as quickly solve any problems that are encountered by customers.

4) Improvement through Productivity

Since the previous crisis, the company has maintained its staff policy rather than laying off part of production staff for cost reduction. The company maintains its competitiveness by making improvements in its productivity through the management and production process, for example, in cost reductions, product quality and delivery times through a minimum stock system, kanban, zero defect, reductions in indirect cost, 5S, 7 QC tools, ISO 9000 and kaizen.

5) Human Resource Development

There are several training programs, both in-house and outside the company. In addition to the technicians, the sales people also learn about the different types of machines, tools, and production techniques to allow them to communicate precisely with their customers. Every year, relevant staff are sent to seminars and training courses outside the company. Moreover, the company emphasizes the importance of effective internal communication by announcing relevant information to all staff at all levels. Working conditions are key concerns for the company. Light, air ventilation, and dust reduction measures are employed to help protect employee health.

In summary, the company has maintained its competitiveness, even during the two crises. The company has kept its position through five viewpoints: governance, innovativeness, market expansion, competitiveness, and networking. Governance is considered by the management team for maintaining all staff, rather than laying off workers to decrease unit costs, which, at the same time, creates a good environment and working system. Innovativeness is carried out for new lines of business. Market expansion covers maintaining existing customers, but also expanding new customers, both domestic and international. Competitiveness is pushed forward with the productivity concept, taking into account costs, quality, prices, and delivery time. Networking is done all the way through the supply chain, including subcontracting between large companies and among SMEs, as well as links with the government and other supporting agencies.

6. GOVERNMENT SME POLICY IN RESPONSE TO THE FINANCIAL CRISIS

In order to assist SMEs in the present economic downturn, the government and SME-related agencies in the public sector have launched a number of projects and measures in an effort to help SMEs to sustain themselves.

6.1 Fiscal Policy

1. To assist unemployed workers and small businesses, the SME Bank and the Social Security Fund (SSF) have set up a program to provide financial aid to workers and business entrepreneurs. Under the program, the SSF will deposit USD187.5 million at the SME Bank to help finance soft loans for entrepreneurs at interest rates of no more than 5% for up to five years. Companies may apply for loans from USD1,562.50 to USD3.1 million. However, borrowers must pledge not to lay off their staff, or they will have penalty rates charged to their loans.

2. To maintain employment, Minister of Labor has proposed to the SSF a one-year special reduction of mandatory contributions to the fund at 1.5% of salaries for employees, down from the current 5% rate. Cutting contribution rates would reduce the cash flow to the fund by USD593.7 million per year, but it would directly assist workers and companies and potentially offer employers sufficient cost savings to make further layoffs unnecessary. Then, reducing contribution rates would be worth it if it reduces unemployment.

3. To boost private spending, the SSF has offered USD62.5, or THB2,000 per fund member per year as a measure to help ease workers' pressures from the cost of living, a policy that would cost the fund some USD625 million per year, and offer grants of USD156.20, or THB5,000 per month to support job retraining programs for unemployed workers.

4. To stimulate the overall economy, the cabinet approved a public investment program worth USD40.5 billion to finance investment projects from 2009 through 2012, under Stimulated Package 2 (SP2), or the "Thai Khem Khaeng" Scheme. At the end of September 2009, the disbursement for projects under SP2 amounted to USD453.1 million for the recapitalization of Specialized Financial Institutions (SFIs) under "Community Level Investment Sector" Program. The disbursement of the supplementary budget amounted to USD2,961.8 million under the major programs, namely: "15-year free education" (USD594 million); "Income Support Measure for Low Income Earners" or "2,000 baht cash handout," or USD62.5 (USD559.9 million); "6-month, 5 measures" package (USD352.9 million); and "replenishment treasury account" (USD598 million).

6.2 Monetary Policy

1. To boost the cash flow of SMEs, the government has placed considerable importance on supporting the credit needs of small businesses. Six state banks, including Government Savings Bank, Government Housing Bank, and Export-Import Bank, have a target of lending USD28.7 billion in 2009, an increase of 50% from targets set earlier this year.

2. To support SMEs and the grassroots economy, the government provides soft loans to SMEs through SME Bank, while other agencies have been assisting in the way of technical services, such as knowledge of product design, packaging, and other value creation aspects. The Bank of Thailand will channel the loans for this purpose through financial institutions, totaling USD1.2 billion for a period of three years.

3. To enhance competitiveness, the Export and Import Bank Thailand (EXIM Bank) launched a new facility called "EXIM 4 SMEs" for SME exporters with annual export values of up to USD3.1 million while reducing their worries about non-payment from overseas buyers. Under this new facility, EXIM Thailand will help examine the credit information of buyers and assess their payment ability. The bank will also recommend competitive payment terms to exporters and pay compensation in case of non-payment after goods are shipped. Moreover, the EXIM 4 SMEs policy can be used as collateral for loans from financial institutions as claim payment rights are transferable to the lending bank.

4. The Small Business Credit Guarantee Corporation (SBCG) was established to facilitate access to credit for small businesses by sharing credit risks with local lenders. Under a government program, the agency has increased its activities aimed at ensuring access to credit for businesses, even as local financial institutions cut back on new lending. Guarantee approvals under the portfolio guarantee scheme total USD937.5 million. A total of 5,694 projects have benefited from the program to date, indirectly assisting 177,000 workers nationwide and also helping create an estimated 22,700 new jobs.

5. To help SMEs to cope with debt, the Cabinet approved the Ministry of Finance's portfolio guarantee scheme for SMEs on 28 April, with the SBCG guaranteeing debts incurred by SMEs in paying their corporate income tax due to the economic downturn. At present, SBCG has the ability to guarantee debts of USD343.7 million for SMEs, which account for the largest portion of corporate income payers. Corporate income tax for SMEs in 2008 was projected at around USD4.1 billion. The portfolio guarantee scheme is expected to assist SMEs that have difficulty in paying their corporate income tax, as well as increase government tax revenue and boost liquidity of financial institutions.

6. To encourage the tourism sector, the SME Bank offers loans totaling USD156.2 million to smaller tourism operators. Under the plan to boost cash flow of tourism operators, the money is loaned to operators whose business size does not exceed USD6.2 million, with each operator entitled to no more than USD156,250. The maximum lending period is five years, with the first year as a grace period. The interest rate for the second year is the minimum lending rate, while rates from the third year onward will be fixed by SME Bank.

6.3 Investment Policy

1. To facilitate investment and enhance investor confidence, the Board of Investment (BOI) has opened the One Start One Stop Investment Center (OSOS) to create a positive environment for investors, whether they are big or small, Thai or foreign, and regardless of whether or not they are promoted by the BOI. At the OSOS offices, investors will be able to accomplish under one roof all government interaction required for their businesses. The center offers business consultation and guidance on a wide range of applications. Some examples are business license applications, social security registrations, investment incentive applications, tax ID applications, value added tax registrations, and applications for environmental impact assessments. It also provides information and services for certain types of businesses such as food, energy, and logistics.

2. To promote investment in SMEs, the BOI has eased its conditions for promoting SMEs, regardless of whether they are under OTOP or approved by the Thai Community Product Standard or the Office of Small and Medium Sized Enterprises. This step is being taken to enhance SME competitiveness and also to improve their ability to meet international standards. In the past five years, less than 150 SME projects have been approved. The majority of them were in the manufacture or preservation of food, grading and packaging, or storing plants, vegetables, fruits, and flowers.

3. To support government policy in pushing tourism, the BOI entitles SME hotel projects to receive special promotion incentives, easing conditions from 100 rooms for standard projects to less than 40 rooms for SME projects. However, their location must be in Zone 3, not including the districts of Had Yai, Hua Hin, Cha-am, or Samui, or the provinces of Pang-Nga and Krabi.

7. POLICY RECOMMENDATIONS

The new economy is built on ICT, and innovation is the significant elevating factor for competitiveness. The competitive advantage will be with SMEs that have the capacity to finance, complete, and deliver fast and innovative forms of new products and working systems that raise their productivity. With such conditions, SMEs will have tremendous opportunities, including access to world markets, low-cost entry to new markets, and the ability to gain efficiency in their business processes. Competition has become increasingly fierce, not only in global economies but also among SMEs. There are numerous producers competing for both existing and new markets. Consumer preferences and market standards have become more sophisticated. Competitive advantage for SMEs is determined by the factors mentioned above. Moreover, market demand is constantly changing, a trend facilitated by rapid advances in ICT and innovative technology. In this situation, there are more frequent introductions of new products and services, shortened product life cycles, higher quality, greater mass customization, more "just in time" sourcing, and greater punctuality in delivery. In this regard, SMEs are required to boost their productivity through a restructuring of their value chain, not only through investments in human resources, infrastructure, and innovation, but also through the creation of an effective management system.

For Thai SMEs to achieve international competitiveness, policies should be constructed with consideration for the initiatives of SMEs and improvements in the business environment, rather than directing them to meet specific targets as defined by the government. The following government policies are required:

1) SME Development and Promotion

- Supporting and encouraging SMEs to develop product standards, brands, and patents;
- Providing convenient public services, for example one-stop services that meet the needs of SMEs;
- Support in the latest quality data and information for SMEs and transmiting them to awider group of SMEs.

2) Funding, Incentives, and Grants for SMEs

- Assisting SMEs in accessing loans and developing a financial environment to facilitate business and financial transactions;
- Providing funding opportunities for SMEs with good governance who encounter financial difficulties or bankruptcies, to help them recover as soon as possible.

3) Assistance in Upgrading Capabilities of SMEs

- Supporting productivity improvement of SMEs that cover the whole value chain from production and management, to enhance product and process quality;
- Supporting technology and innovation skills of SMEs in order to create capabilities among Thai SMEs in technology and innovation application;
- Supporting knowledge and training skills for SME workforce;
- Promoting subcontracting system among SMEs which require effective clustering and networking;
- Supporting SMEs in reaching international markets;
- Encouraging and supporting SMEs on workforce security and welfare.

4) Reducing Regulatory Burdens on SMEs

- Creating a friendly environment that facilitates SMEs to grow and succeed, with special attention to those with potential to grow;
- Initiating rules and regulations under the principle of 'Think Small First,' which takes into account the characteristics of SMEs without adding burden;
- Applying public policy instruments, such as the public procurement framework, to facilitate SME needs;
- Supporting SMEs to go green, for example, producing environmentally friendly products. This could also turn SMEs to new business opportunities.

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List of Contributors

Chief Expert

Mr. Setsuya Sato
Executive Director
Public Policy and Regulatory Affairs
UBS Securities Japan Ltd.
East Tower, Otemachi First Square Bldg.
5-1, Otemachi 1-chome, Chiyoda-ku
Tokyo 100-0004, Japan

National Experts

Mr. Anil Bhardwaj
Secretary General
Federation of Indian Micro and
Small & Medium Enterprises (FISME)
7A, First Floor, Humanyu Pur
Safdarjung Enclave
New Delhi 110029, India

Mr. Satoshi Yamamoto
Researcher
The Economic Research Institute (ERI)
Japan Society for the Promotion of
Machine Industry (JSPMI)
Kikai Shinko Bldg.
3-5-8, Shibakoen, Minato-ku
Tokyo 105-0011, Japan

Dr. Keun Hee Rhee
Senior Researcher
Korea Productivity Center
57-1 Sajik-ro, Jongno-gu
Seoul, 110-751, Republic of Korea

Dr. Gloria Jumamil Mercado
Senior Fellow/Consultant
Development Academy of the Philippines
DAP Bldg., San Miguel Avenue
Ortigas Center, Pasig City, Philippines

Dr. Ketmanee Ausadamongkol
Director of Research Division
Thailand Productivity Institute (FTPI)
12-15F Yakult Building
1025 Pahonyothin Road, Phayathai
Bangkok 10400, Thailand

(as of August 2009 coordination meeting)

Asian Productivity Organization

Leaf Square Hongo Building, 2F
1-24-1 Hongo, Bunkyo-ku
Tokyo 113-0033, Japan

Phone: (81-3)3830-0411
Fax: (81-3)5840-5322
e-Mail: apo@apo-tokyo.org
URL: www.apo-tokyo.org