LATIN AMERICA: Internationalisation is SME challenge

OxResearch Daily Brief Service. (Nov 06, 2013).

Abstract

SMEs in the region and their insertion in international value chains.

Latin America lags behind other regions in the internationalisation of its small and mid-sized enterprises (SMEs) and their insertion into global value chains.

Full Text

SUBJECT:SMEs in the region and their insertion in international value chains.

SIGNIFICANCE:Latin America lags behind other regions in the internationalisation of its small and mid-sized enterprises (SMEs) and their insertion into global value chains.

ANALYSIS: Impacts.

SMEs, which account for around two in three jobs in LAC, have an important impact on income distribution.

LAC's dependence on commodity exports is a constraint for the development of its SMEs.

Some mining firms in LAC are seeking to alleviate rising production costs through local supplier development.

As foreign investment in Latin America and the Caribbean (LAC) and the region's exports have grown, attention has increasingly turned to its SMEs, including micro-enterprises, as a key vehicle for transforming this growth into increased social as well as economic development and for reducing the region's high level of income inequality. This reflects not only the fact that, according to a 2012 study by the UN Economic Commission for Latin America and the Caribbean (ECLAC) and OECD, SMEs account for some 99% of LAC companies -- very similar to the level seen in many European countries -- but also that there are large differences in their performance and international insertion as compared to SMEs in these latter countries:

Relative productivity. The study found that the productivity of micro-enterprises in the five LAC countries studied (Argentina, Brazil, Chile, Mexico and Peru) ranged from 3% of that of large firms (Chile) to 24% (Argentina) as compared to up to 71% in France. A similar pattern was also seen in SMEs: for example, their productivity in Brazil reached only 40% that of large companies as compared to 83% in Germany.

Wage gap. In line with this, a much wider wage gap was found between SMEs and large companies in LAC than in European countries. In Mexico, for example, wages in micro-enterprises averaged 21% of those in the country's large companies as compared to 69% in Germany and 63% in Spain.

Exports. In LAC countries, virtually no micro-enterprises were exporting while, in France, they accounted for 17% of total exports. Even among mid-sized companies, the highest figure in LAC, at 9.5% for Brazil, was well below the lowest European figure of 15.0% for France.

Obstacles to internationalisation .

Latin American SMEs range from informal micro-enterprises that, in practice, represent self-employment to high-growth or 'gazelle' companies that are extremely innovative, productive and capable of targeting export markets. However, low productivity restricts the vast majority of LAC's SMEs to selling directly on the local market, with the resulting vulnerability to its swings, and they generally do not even export indirectly as part of the supply chains of their country's large exporters.

A recent study -- Policies for the Insertion of Latin American SMEs in Global Value Chains -- by a researcher at ECLAC points out that their level of internationalisation compares negatively with that of SMEs in other regions, with a rate of direct and indirect exports half that of SMEs in Europe and one-third lower than in East Asia. As well as the typical limitations of SMEs in terms of human capital, management expertise and access to finance, this also reflects the region's export structure, dominated by natural resources (minerals and hydrocarbons) which are generally owned by large companies. These activities, moreover, offer fewer opportunities for SMEs since they are less intensive in supply chains than exports with a greater value-added component.

Public policy.

Over the past decade, many LAC countries have introduced measures to support the development of their SME sector, including the creation of special government agencies (although generally with very limited budgets), simplification of procedures for starting a business (partly in a bid to encourage formalisation of existing SMEs and, thereby, facilitate their access to government support programmes) and, in some cases, tax breaks.

However, several policy areas are identified as key for the future development of the region's SMEs:

Access to financing. In LAC's highly segmented financial markets, SMEs have limited access to commercial bank credit and, as a result, are often forced to use more expensive options such as supplier credit or consumer loans taken out by their owners. In many countries, including Brazil, Colombia and Mexico, this obstacle is being addressed by development banks. Similarly, in a bid to counteract another common problem for SMEs -- their inability to provide collateral -- many countries have established government funds for this purpose.

Support for innovation. Due to factors that include limited access to financing, SMEs are at a disadvantage compared to larger companies as regards investment in R&D. The policies for support of innovation that have been introduced in LAC, moreover, have tended not to distinguish by company size -- due partly to aversion to "pick the winner" strategies -- and have, therefore, been used mostly by large companies to their own competitive advantage.

Cluster development. A number of initiatives such as Brazil's Local Production Clusters (APLs) have sought to foster the incorporation of SMEs into value chains. However, in natural resource industries, the development of clusters has been handicapped by the fact that exporters have tended to confine themselves to transmitting the standards they require, rather than actively supporting the improvement and modernisation of suppliers. However, this is showing signs of changing in, for example, Chile and, to a lesser extent, Peru where mining companies have begun to view supplier development programmes as a tool for containing rising production costs, rather than merely as part of corporate social responsibility programmes.

Trade agreement challenges.

As countries seek to secure a larger share of sluggish global trade, a number of mega-regional trade negotiations are underway (see LATIN AMERICA: Trade challenges reduce growth outlook - September 25, 2013). As well as the Transatlantic Trade and Investment Partnership, which would create a free trade area between the United States and EU, and the Regional Comprehensive Economic Partnership, which would bring together the ten members of the Association of Southeast Asian Nations (ASEAN), Australia, China, India, Japan, New Zealand and South Korea, they include the proposed Trans-Pacific Partnership (TPP).

The TPP includes Australia, Brunei, Canada, Japan, Malaysia, New Zealand, Singapore and the United States and, in LAC, Chile, Mexico and Peru; it would facilitate the development of cross-Pacific value chains by establishing cumulative rules of origin. However, LAC governments recognise that their countries' ability to take advantage of the TPP's potential advantages depends significantly on the readiness of their SMEs to form part of these value chains.

CONCLUSION: The heterogeneity of Latin American SMEs implies that a range of public policies are required to foster their internationalisation, without which the region could risk losing international competitiveness to the detriment not only of its growth but also of progress in reducing its high level of income inequality.

Details

Subject	Economic conditions; Politics; Government; Public policy; Small & medium sized enterprises-SME
Location	Latin America, Caribbean area
Classification	9173: Latin America 9520: Small business 1110: Economic conditions & forecasts

Identifier / keyword	Latin America, Caribbean area, Economic conditions, Politics, Corporate, Government, Public policy
Title	LATIN AMERICA: Internationalisation is SME challenge
Publication title	OxResearch Daily Brief Service
Pages	n/a
Publication year	2013
Publication date	Nov 06, 2013
Year	2013
Publisher	Oxford Analytica Ltd
Place of publication	Oxford
Country of publication	United Kingdom
Publication subject	Business And Economics
Source type	Reports
Language of publication	English
Document type	News
ProQuest document ID	1448806314
Document URL	http://libproxy.nps.edu/login?url=http://search.proquest.com/docview/1448806314?accountid=12702
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Last updated	2014-01-16
Database	ProQuest Central