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Social Enterprises and Employment: Mainstreaming SMEs and Employment Creation

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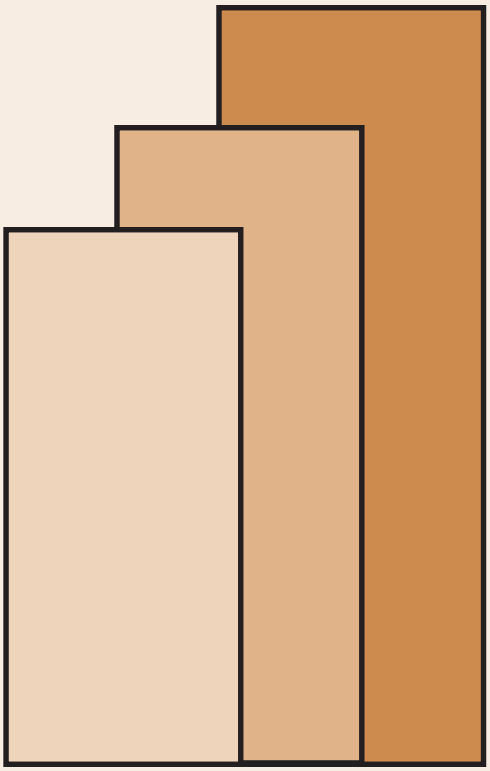

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Social Enterprises and Employment:
Mainstreaming SMEs and Employment Creation

Leonardo A. Lanzona, Jr.*

This paper argues that mainstreaming SMEs and SE into various international treaties will require the assumption of positive externalities which markets cannot fully evaluate. To show this, the possible influence that SEs may have on SME development and eventually on employment will be discussed. SEs are small and medium-sized commercial businesses providing valuable social service to customers and sustainable jobs and training for up to about 200 people. Their goal is to provide public goods to the communities, in the form of increased productivity and employment. What separates SEs from SMEs is that it addresses the social issues at the forefront. Through this paper, the importance of providing such public goods to SME development will be highlighted. This study shall provide inputs to the analytical framework for the Philippines' engagement in APEC under the priority theme of "Mainstreaming Small and Medium Enterprises (SMEs) and Employment Creation" and shall make concrete recommendations on how employment can be created through the formation of social enterprises or socially inclusive companies.

Key Words: Social Enterprises, Small and Medium Scale Enterprises, Poverty, APEC

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Social Enterprises and Employment:
Mainstreaming SMEs and Employment Creation (Final)

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I. Introduction

The Philippines will chair APEC for the second time in 2015, amid a global economic climate that presents both opportunities for greater prosperity and recipes for further economic stagnation and even decline. While the Philippine substantive agenda for APEC 2015 should be driven by its basic development goals provided for in the Philippine Development Plan 2011-2016, it should not ignore global realities. In addition to domestic goals, the Philippine substantive agenda must also take into account socio-economic and geopolitical trends in the region even beyond 2015 and, more importantly, the Philippines' role and how it can maximize the benefits through cooperation with other member-economies.

As host of APEC in 2015, the Philippines will set the theme for all APEC and APEC-related meetings to be held during the year. The host is also expected to set the substantive agenda for all APEC fora and subfora during the hosting year through the listing of APEC host economy priorities. These priorities will guide and inform the direction of all APEC meetings, activities, and projects, taking into account APEC's core principles of trade and investment liberalization, business facilitation, and economic and technical cooperation, but with greater flexibility to tackle issues of importance to developing economies.

In particular, this study shall provide inputs to the analytical framework for the Philippines' engagement in APEC 2015 under the priority theme of "Mainstreaming Small and Medium Enterprises (SMEs) and Employment Creation" and shall make concrete recommendations on how employment can be created through the formation of social enterprises or socially inclusive companies. In the Philippines, an increasing number of social enterprises (SEs) have been recently established and has been hailed as "innovative business model".

SMEs are seen as the key players for sustaining growth for two main reasons. First, growth is often initiated by large firms but over time, as the economy expands, much depends on increasing the scale of new firms to make them more efficient. Second, growth presupposes structural transformation: new firms making new goods in new ways and old inefficient ones innovating and reorganizing or being dissolved.

The paper aims to provide a rationale for state intervention for SMEs and SEs in particular. Pro-SME policy is based on three core arguments (World Bank, 1994, 2002, 2004). First, SME advocates argue that SMEs enhance competition and entrepreneurship and hence have external benefits on economy-wide efficiency, innovation, and aggregate productivity growth. From this perspective, direct government support of SMEs will help countries exploit the social benefits from greater competition and entrepreneurship. Second, SME proponents frequently claim that SMEs are more productive than large

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firms but financial market and other institutional failures impede SME development. Thus, pending financial and institutional improvements, direct government financial support to SMEs can boost economic growth and development. Finally, some argue that SME expansion boosts employment more than large firm growth because SMEs are more labor intensive. From this perspective, subsidizing SMEs may represent a poverty alleviation tool.

However, there are two main arguments why intervention is unnecessary and inefficient. First, skeptical views question the validity of considering firm size as an exogenous determinant of economic growth. From the industrial organization literature, natural resource endowments, technology, policies, and institutions help determine a nation's industrial composition and optimal firm size. Hence, conditioning on firm size will not necessarily make these firms more efficient, and policy on SMEs can result in inefficiency.

A second skeptical view regarding the efficacy of SME policies considers the business environment view, and casts doubts on the crucial role of SMEs. Instead, this stresses the importance of the conditions facing all firms, whether big or small. The cost of doing business, including low entry and exit barriers, well-defined property rights, and effective contract enforcement, characterizes a business environment that is conducive to competition and private commercial transactions. While these factors may encourage SMEs, the focus of the business environment view is not on SMEs per se; it is on the environment facing all businesses

This paper argues mainstreaming SMEs and SE into various international treaties will require the assumption of positive externalities which markets cannot fully evaluate. To show this, the possible influence that SEs may have in SME development and eventually on employment will be crucial. SEs are small and medium-sized commercial businesses providing valuable social service to customers and sustainable jobs and training for up to about 200 people. Their goal is to provide public goods to the communities. What separates SEs from SMEs is that it addresses the social issues at the forefront.

Hence, the argument of this paper is the SEs can help provide the needed stimulus for the development of SMEs. Each SE employs a blended workforce, consisting of on-Government Organizations (NGOs) and other community institutions working with production units comprised of qualified tradespeople, cooperatives, apprentices and industry experienced staff work.[1] These social enterprises are organized to work with production units, often households, from disadvantaged backgrounds, often struggling to maintain work in the competitive labor market due to their disability, mental illness, age, cultural background, housing status or other barriers.

By improving their access to loans and technology, SEs are believed to enrich the community and thus provide necessary public goods for the whole community. When it can be given an opportunity to realize its potential and be empowered, it viewed to increase the employment in their respective areas.

[1] Given the diverse nature of SEs, there are other ways in which SEs may have different purposes in social development, aside from employment creation. These other roles, including the creation of sustainable and resilient communities, however go beyond the scope of this paper (see Dacanay, 2012, for a survey of Philippine Social Enterprises).

Social enterprises may be seen as an emergent and important segment of the SME sector. The study will thus consider and identify the key policy variables that can be utilized to achieve these employment goals. In particular, the study will examine closely the extent to which international trade arrangements such as the APEC can support SE and SME development.

The empirical investigation done in this paper indicate that before these SEs can realize their full potential, other forms of assistance will be necessary aside from improving the business environment. This stresses the importance of addressing poverty directly, and not simply to improve their business environment.

The rest of the paper is organized as follows: Section II provides a review of literature, particular in terms of how SMEs and SEs can contribute to employment creation. Section III discusses a conceptual framework that can be tested to justify the government intervention in developing SEs. The point is that various macroeconomic, community and household constraints prevent the SEs from increasing their scale of production, resulting in a vicious cycle of poverty. In which case, even assuming an improvement in the business cycle, poverty will have to be addressed directly if these enterprises are to move out of this cycle. Section IV provides an empirical test of the conceptual framework. This will attempt to show the key factors affecting the revenues and income of the enterprises which will ultimately affect its demand for labor. More importantly, it will also indicate that for the particular sample of SEs, poverty is a major constraint, and hence public goods will be needed to transform their conditions. The final section provides policy alternatives which can be considered in APEC.

II. Review of Literature and Stylized Facts on SMEs

Small and medium enterprises (SMEs) are viewed to have an important role in developing the Philippine economy. The Philippine government for instance has instituted a number of laws intended to improve the SMEs. These laws include:

- R.A. 7459 (1992): Investors and Invention Incentives Act (providing Incentives for inventions and commercialization and Inventions Development Assistance Fund)
- R.A. 6977 (1991) amended by R.A. 8289 (1997): Carta for Small Enterprises (a policy to promote, support, strengthen and Magna encourage SMEs and Created SBGFC, SMED Council)
- R.A. 9178: Barangay Micro Business Enterprises (BMBEs) Act of 2002
- E.O. 176 (2003): Institutionalizing the “Isang Bayan, Isang Produkto, Isang Milyong Piso” Program

In addition, SME development has been highlighted in various government strategies, including the Philippine SME Development Strategy, the Philippine Export Plan and the Philippine Development Plan.

These programs for SME development stem from the widely accepted belief that SMEs are crucial to the economy in several specific ways. First, they help reduce poverty by creating jobs for the country’s growing labor force. They stimulate economic development in rural and far-flung areas. Second, they serve as valuable partners to large enterprises as suppliers and providers of support services. They serve

as breeding ground for new entrepreneurs and large corporations. Third, a vibrant SME sector is an indication of a thriving and growing economy and the key to sustaining economic growth.

However, despite these policies that aim to provide an enabling environment for SME development, the sector still faces various constraints that prevent it from realizing its full growth and potential (Aldaba, 2009). The evidence showing how SMEs are able to reduce poverty and sustaining growth has largely been inconclusive. The problem with using firm size as basis for policy can be tied to the false notion that firm size is an exogenous determinant of economic growth. From the industrial organization literature, natural resource endowments, technology, policies, and institutions help determine a nation's industrial composition and optimal firm size (Kumar, et al., 2001)

In particular, given certain endowments, the country can have a comparative advantage in the production of goods that are produced efficiently in large firms while other countries will have a comparative advantage in goods produced most economically in small firms (You, 1995). Similarly, countries that are open and well-integrated to international trade may have a larger optimal firm size than countries that are less integrated internationally (Caves et al., 1980). As a specific example, institutional theories suggest that firm size will reflect the margin between intra-firm transactions costs and market transactions costs, such that as market transaction costs fall relative to intra-firm transactions costs the optimal firm size falls (Coase, 1937). This margin will vary across industries and countries for various institutional and technological reasons. Thus, SME subsidization policies could actually distort firm size and potentially hurt economic efficiency.

Another issue is the fact that government is unable to identify the productive SMEs, thereby leading to government failure. It is argued that a more targeted SME program will ensure that the gains from state subsidies are maximized. Programs need to be implemented differently for different firms since what can be effective for some enterprises may lead to inefficiency or limited if not zero benefits on others. By targeting the type of SME that will address the issue of poverty will result in higher social welfare as long as other firms are not going to be adversely affected by the measure.

SEs are believed to enrich the community when it can be given an opportunity to realize its potential and be empowered to increase the employment in their respective areas. SEs may be seen as an emergent and important segment of the small and medium scale enterprise (SME) sector. The study will thus consider and identify the key policy variables that can be utilized to achieve these employment goals, without affecting the productivity of other firms. In particular, the study will examine closely the extent to which international trade arrangements such as the APEC can support SE and SME development.

Contribution of SMEs to the Economy

The size of the SME sector itself has been used as a justification for subsidizing it. An SME in the Philippines is defined as any business activity or enterprise engaged in industry, agri-business and/or services that has: (1) an asset size (less land) of up to PhP100 million; and (2) an employment size with less than 200 employees. Based on these categories, it is classified as micro, small or medium (Table 1)

regardless of the type of business ownership (i.e., single proprietorship, cooperative, partnership or corporation).

As of 2010, there were a total of 777,687 business enterprises in the Philippines. The small industries have been divided into two: the Micro enterprises (1-9 employees) and the Small enterprises (10-99 employees). Of this figure, SMEs represented 99.6 percent with 774,664 establishments while large enterprises represented 0.4 percent with 3,023 establishments. Micro enterprises comprised 91.6 percent (709,899) of the total number of SMEs while small and medium enterprises accounted for 8 percent (61,979) and 0.4 percent (2,786), respectively.

In terms of employment generation, SMEs provided a total of 3,532,935 jobs[2] in 2010 or 62.3% of the total jobs generated by all types of business establishments. Large enterprises generated 2,136,362 jobs. Among SMEs, micro enterprises created 1,729,100 (30.5%) jobs while small and medium enterprises generated 1,417,672 (25%) and 386,163 (6.8%) jobs, respectively. SME employment by industry generally follows the same structure as the number of establishments per industry, with SMEs engaged in the wholesale and retail trade generating 1,237,917 jobs in 2010 followed by 617,634 jobs in manufacturing, and 479,668 jobs in hotels and restaurants.

Two main points are noteworthy. First, despite the fact that MSMEs contribute the majority of jobs recorded in the survey, these firms actually comprise roughly 99 percent of the total enterprises in the country. Hence, at the firm level, these enterprises do not generate as much employment as the larger firms. Second, the largest proportion of the jobs in the MSME sector is found in the wholesale/retail trade and repair services. These jobs are mainly of low quality, characterized by limited skills and low productivity.

Table 1. Number of Employees by Industry and Firm Size

	Micro	Small	Medium	MSMEs	Large	Total
Agriculture, Hunting and Forestry	9,855	31,213	16,515	57,583	81,594	139,177
Fishing	3,408	5,705	4,377	13,490	14,227	27,717
Mining and Quarrying	930	3,878	1,960	6,768	21,201	27,969
Manufacturing	259,204	244,156	114,274	617,634	685,410	1,303,044
Electricity, Gas and Water	2,608	20,924	17,086	40,618	56,397	97,015
Construction	5,305	27,781	17,391	50,477	92,819	143,296
Wholesale/Retail Trade; Repair Services	816,095	364,164	57,658	1,237,917	139,032	1,376,949
Hotels and Restaurants	233,525	224,963	21,180	479,668	22,883	502,551
Transport Storage and Communications	26,161	49,399	16,671	92,231	106,331	198,562
Financial Intermediation	80,706	85,395	12,377	178,478	152,970	331,448

Real Estate, Renting and Business Activities	109,214	122,428	46,104	277,746	578,239	855,985
Education	31,516	154,515	37,695	223,726	98,770	322,496
Health and Social Work	51,006	35,240	15,615	101,861	57,000	158,861
Other Community Social and Personal Service Activities	99,567	47,911	7,260	154,738	29,489	184,227
Total	1,729,100	1,417,672	386,163	3,532,935	2,136,362	5,669,297

Source: 2010 List of Establishments, NSO

Apart from employment generation, SMEs are expected to drive economic growth by: (1) stimulating innovation; (2) Acting as a competitive spur to existing businesses to increase their productivity; (3) Making a disproportionately large contribution to job creation. However, there is inconclusive data concerning its

Stimulating innovation: Through the established empirical relationship between innovation and firm growth, the contribution of SMEs to innovation is seen to be important to the economy. The idea is that the potential for greater innovation is greater in smaller firms. Examining U.S. firms, Acs and Audretsch (1987) find that small firms have higher innovation rates in "high technology" skill-intensive industries and larger firms have the innovative edge in "lower technology," capital–intensive industries. In developing countries, however, researchers find that large exporting firms are typically the primary mechanism through which technologies are adapted from abroad to local circumstances (See Biggs, Shah, and Srivastava, 1996 for Sub-Saharan Africa; Pack, 1992, and Pack and Westphal, 1986 for Asia). Thus, from a developing country perspective, the firm level evidence does not favor SME subsidization as a mechanism for boosting innovation and productivity growth. In the Philippines, Aldaba (2009) finds that the deepening of high-technology industries has remained weak due to limited backward linkages and low value added of high technology export products.

Spurring competition: SMEs spur competition which raises productivity and in turn stimulates economic growth. The concept of 'creative destruction' is a widely recognized principle, first proposed by the economist Schumpeter, whereby new innovative entrepreneurs challenge incumbent businesses. As competition increases, there is 'churn' in the market; the least productive firms exit and the most productive firms grow, resulting in an increase in aggregate productivity.

However, in the Philippines, while some notable improvements in the number of enterprises, value added and employment were registered, the overall economic performance of SMEs in the last decade has remained weak. Thus, they have not substantially generated sufficient value added and employment to increase competition, improve industrial structure and increase the country's overall manufacturing growth (see Aldaba and Aldaba, 2014). Despite the substantial trade and investment liberalization in the country along with increasing regional integration, penetrating the export market has not been easy for SMEs. Making small and medium manufacturers internationally competitive

remains a major challenge that the Philippines faces especially in the light of rising globalization trend and increasing economic integration not only in the ASEAN but also with the East Asian region.

Job creation: The evidence shows that small firms make a disproportionately large contribution to job creation, given the percentage of the workforce they employ. Despite In aggregate they make a rather static contribution to the economy and although they employ a significant proportion of people (Tecson, 2004), they do not contribute a lot to employment growth. Many only have a relatively short life expectancy, perhaps of 3 - 5 years, although this depends on the economy. Most of these SMEs are presently in the 'at risk' or 'insulated' categories, and the main issue that they face is how to best adapt to the increasing competitive pressures occasioned by open regionalism.

Structural and Productivity Limitations of SMEs

Based on the Department of Trade and Industry Small and Medium Enterprises Development (SMED) Plan, 2004-2010, the Philippines does not perform as well as the other countries as shown in Table 2.

Table 2. SME Contributions of Selected ASIAN Economies (in Percentage)

	Philippines	South Korea	Japan	China	Malaysia	Thailand	Indonesia
No. of Establishments	99.7	99	99	99	94	98	99.99
Employment	69.1	78.7	88.6	75	40	55.8	99.4
Value Added	32	47	56.7	68	26	Not Reported	63.11

Source: SMED Plan, 2004-2010

This to some extent indicates the incapacity of the SMEs to meet their expectations. The plan noted that a number of limitations that SMEs face are productivity performance and structural weaknesses of services and the business environment, which include:

- Outmoded or less productive operational assets/methods
- Insufficient use of technology.
- Limited room for efficient operational levels
- Insufficient management and professional know-how
- Insufficient and inaccessible funding sources
- Unappreciated and inadequate professional services
- Insufficient incentives and inability to meet regulatory procedures
- Insufficient access to information

All these seem to relate to the fact that a subset of SMEs given their initial conditions may have limited potential to profit and possibly expand its production. In most cases, SMEs have a tendency to be poor, engaging in multiple occupations and affected by limited access to financial markets. There is a valid reason why so many of the poor end up as entrepreneurs. If individuals have few skills and little but

sufficient capital to start business, and especially if you are a woman, being an entrepreneur is often easier than finding an employer with a job to offer.

There is no measurement of how much of the SMES are actually poor. However, data on poverty shown in Table 3 feature the employed as having a larger poverty incidence than the unemployed and the self-employed contributing a greater proportion of the employed who are poor. If the self-employed and unpaid workers include owners and employees of SMEs, it may be inferred then that a certain proportion of these SMEs are actually poor.

Table 3. Poverty Incidence by Employment Status

Sector	2006	2009	2012	Increase/ Decrease	
				2006-2009	2009-2012
Philippines	26.6	26.3	25.2	-0.3	-1.1
Employed Population	22.9	22.8	21.9	-0.1	-0.9
Unemployed Population	16.5	16.8	18.7	0.3	1.9
Self-Employed and Unpaid Workers	**30.6**	**29.9**	**29.0**	-0.8	-0.9

Source: Philippine Statistics Authority

This does not mean however that SMEs are inefficient. Despite their poor skills and limited technology, poor SMEs perform the same function as any other SME in the sense of creating some value in the chain of productive businesses or reducing the transaction costs in production process. However, poverty itself constrains these SMEs from achieving their full potential in terms of their access to better technology and quality of inputs. In this case, direct interventions of poverty reduction in the form of public goods are expected to support SMEs and to raise growth.

The Key Role of Social Enterprises (SE)

In the Philippines, the definition of social enterprises is linked to social entrepreneurship as a process of creating spaces and transforming markets to serve the goal of poverty reduction and sustainable development. This tradition continues to be pursued by Asian scholars and practitioners, and was the inspiration behind the setting up of the Institute for Social Entrepreneurship in Asia (ISEA) based in the Philippines in 2008 (Dacanay, 2004; 2009b). Some scholars have appreciated this perspective of social enterprise and social entrepreneurship as context-specific to Asia, a region where poverty and social inequity are stark realities. Robinson, et al., (2009) have noted that context matters in social entrepreneurship research, citing how the phenomenon has unfolded in different ways outside of Europe and the United States, not only in Asia but also in Latin America and the Middle East.

Fundamentally, a social enterprise (SE) is an enterprise aims in some way to increase "social value," i.e. to contribute to the welfare or well-being in a given human community. SEs are expected to influence the local conditions primarily in improving economic conditions. Disagreement however exists over the importance of social value in the purposes of the enterprise. In particular, the main issue is the value of creating wealth which can be contrary to its social welfare goals. If wealth creation then is noted to be the main goal of the program, and in the process this task fails to address the social concerns and more

importantly the needs of these production units, mainly households, that can comprise these enterprises, then it is likely that the SE was not able to achieve its purpose.

The idea is that the SEs performs a function different from the other SMEs. Given its social orientation, SEs can be viewed as producing public goods that are accessible to all workers of a community. The publicness of the good produced by SEs indicates its potential for collective consumption. The goal is to achieve a more inclusive development by allowing the benefits, including greater employment for other businesses, to be accessible to everyone that is part of the enterprise, including their consumers and other members of the community.

The provision of public goods such as social protection, business opportunities, education, electricity, health, sanitation, and water are crucial to the transformation of society. These used to be regarded as primarily the responsibility of governments, but privatization of such services spread and reliance on market mechanisms instead of governments became common in many parts of the world, including developing countries. The record of the past twenty-five years of market-led development, however, has not been encouraging. Not only has it failed to improve public services significantly, but it has also undermined democratic institutions and processes, reproduced authoritarian relations of power, and suppressed alternatives made possible by an increasing global acceptance of the importance of economic and social rights.

In this case, the development of the SE can be a solution to the failed provision of public goods. Social enterprises operate in markets in order to address social needs and reduce inequality, recognizing that this has value. They do so often trading using financial prices from existing markets which do not recognize this value in the same way. By so doing, they can put themselves at a disadvantage to their competitors, who may not use the same measure of value, especially the values that take into account wider and longer term impacts. In the short term, and within prevailing sets of relative prices, it can cost more to create social value. This is not to say that it always will cost more and that innovative businesses cannot bring new products to market that reduce inequality (for example mobile phones which allow farmers to get accurate information on market prices before taking their goods to markets) but that these outcomes are not necessarily the primary business objective as they are in a social enterprise.

Technology Innovation and SEs

SEs are expected to introduce new technology that not only increases productivity but also address other social concerns, including protecting the environment. The introduction of a better technology is a crucial element in the sense that offsets the initial conditions faced by the enterprise and provides the enterprise its comparative advantage over other firms.

The SE can be simply defined as running a business that drives social innovation rather than being focused only on obtaining financial goals. Business-minded entrepreneurs with a social agenda seize opportunities by creating innovative processes that can help solve major social issues. They relentlessly focus on producing practical results that can change the world for the better.

The ability of the SE to create new innovations can be used to link their production activities to the Global Value Chain (GVC). The developments of recent years have shown that, increasingly, firms are globalizing their production with the help of international suppliers. Thus, the value-creation process is also being internationalized. These collaborations between firms play an important role for the individual firms in order for them to generate entrepreneurial growth, and to create and expand competitive advantages (upgrading) and synergy effects. Thus, transnational and situation- and cooperation-specific norms, which govern the conduct of the value-chain actors, come into existence. If legal independence is retained, firms are independent actors and are able to negotiate these norms with each other. The parameters of the norm-generating process are determined by various factors. Contractual weaknesses, the degree of asymmetry between value-chain partners, and the environment in which the value chain is integrated play a defining role.

Just like lead firms and local suppliers, value chains are also embedded in civil society networks which, as a contextual factor, constitute a certain framework for norm-building processes within a value chain. For instance, relevant civil society actors—such as trade unions, nongovernmental organizations, associations, the epistemic communities, and credit or consumer organizations—play an important role in the value chain's internal negotiation and norm-building processes, even though they are located outside of the value chain. Here, a distinction is made between local (national) and international (global) actors and (norm-building) networks.

Organizational Structure of the SEs

Systematic studies and surveys in the Philippines are unable to establish a comprehensive profile of social enterprises. A rapid appraisal using secondary data and interviews with key informants from national networks of social enterprises, social entrepreneurship resource institutions and regulatory government agencies was however conducted in 2007. The rapid appraisal defined social enterprises as social mission-driven wealth creating organizations that serve the poor or marginalized as primary stakeholders and have a distributive enterprise philosophy (Dacanay, 2007). The rapid appraisal came up with an informed estimate of 30,000 with the following categories:

- Cooperatives;
- Microfinance institutions;
- Fair trade organizations;
- NGO-initiated income enterprises;
- Sector or area-based enterprises serving specific poverty groups; and
- Small entrepreneur-initiated enterprises with a clear social agenda.

The biggest share of this is the group of cooperatives that are registered with the Cooperative Development Authority. Most cooperatives involve poor households as majority members are savings and credit cooperatives engaged in microfinance operations; agricultural or farmers' cooperatives, including cooperatives of agrarian reform beneficiaries or small holders who acquired lands under the government's land to the tiller program; and cooperatives providing various forms of social protection schemes such as micro health insurance.

A number of social entrepreneurs have successfully built 'hybrid' organizational structures using a number of innovative approaches to tap into the strengths of both; non-profits with wholly owned business subsidiaries, donated equity models and emerging for benefit business structures are all good examples of this type of thinking. Others have developed hybridized investment structures that achieve similar goals from the investor side like Calvert Foundation's GiftShare program. In addition, there has also been research done by groups like the Aspen Institute into the frameworks that surround these structures and how to begin moving public policy to embrace the for benefit business structure initially pioneered in the UK.

Given the hybrid nature and resource mix mobilized by social enterprises, they are unable to adequately operate exclusively as stock, for profit corporations or as a non-stock, nonprofit corporations. For this reason, a number of the more mature social enterprises have become multi-organizational systems where they have a stock, for profit corporation handling their market-oriented or transactional activities while they have a non-stock, non-profit corporation or foundation handling their transformational services directed at the capacity development of the poor and advocacy activities to effect changes in the broader context within which the social enterprise operates.

A significant differentiating factor therefore between the SMEs and the SEs is the concept of social technology. As such, SEs are operating not as independent enterprises but a collection of various production and services units working under a single organization or entity. This means that social capital is a crucial element in the operations of the SE. Social capital is defined as the confluence of organizational operations such as networks, norms and trust that facilitate co-ordination and cooperation with mutual benefit (Putnam, 1995). These presumably are factors of production that can be mobilized to improve its production. For one, social capital is expected to reduce transaction and production costs.

The difference between SE and the Civil Society Organization like the NGOs is the production activity intended to sustain the main social objectives of the SE. The concept of 'social enterprise' was introduced in Italy to designate those pioneering initiatives that were created due to the institutional imagination of its promoters. Three distinctive features of these innovations are worth mentioning: (i) the search for direct participation by stakeholders through new democratic forms of management (multi-stakeholder), (ii) the widespread use of the cooperative form in activities which in other the enterprises are generally managed by associations and foundations, and (iii) the production process is expected to meet certain social standards, resulting to a difference in its technology. Through various forms of institutional arrangements, the associations and NGOs are able to determine the socially efficient level of such goods to the household enterprises that perform the production activities of the SE.

More importantly, to the extent that household enterprises are the direct beneficiaries of these associations and the NGOs, any support given to the SEs will also promote the SMEs sector as well. Furthermore, targeting these SEs would not only lead to efficiency but also to greater equity and lower poverty in the communities, as more the products of the SEs are presumably in the nature of public goods. Hence, this will not affect the SMEs but the community in general.

In the framework, the foundation or the association often with its non-government organization (NGO) partner acts as principals whose main objective is to achieve community social gains by assigning household agents or firm, who will undertake the main tasks of achieving the association's objectives. This creates a number of problems in the absence of complete information on the household's capacity to manage and sustain a business enterprise. For one, information asymmetries can lead to adverse selection where poor targeting results in the wrong choice of households who can manage the enterprises. Moreover, the association and the NGOs as principals act jointly as a leader that design the key decision rules and provides enough penalties for inefficient performance. However, at the same time, the association and the NGO, in the absence of complete community information, should provide the adequate incentives that will allow the household agents to work as a "self-managed" enterprise, instead of merely a follower. In effect, the problem is how to define the right incentives in the face of a continuum of unknown agent characteristics.

The success of the SE then depends on the incentives that are offered by the NGOs to the household production units. The association between the NGOs and the production units of the SE is also involved in providing a wide range of incentives with its NGO partners such as cooperatives who will in turn transfer them to the household enterprises. These are in the form of assistance in business and strategic planning, market studies, capability building and development financing. Capacity building and technical assistance are also key forms of intervention that the association offers to these households. The main challenge is to identify a sufficient package of incentives and interventions that will lead to the ultimate goal of reducing poverty in the communities. Moreover, these incentives are fundamentally business in nature and production-oriented. In the process, these may not be enough in addressing the consumption needs of the household enterprises.

Fowler (2000) points out two possible ways in which foundations and NGOs can support social enterprises. The first is an integrated approach whereby NGOs select and introduce enterprises to commercial practices which can potentially create reinforcing horizontal, vertical, backward and/or forward linkages to produce additional development and economic benefits for both existing and a wider array of people. The second is called a re-interpretative approach where the association builds on and creatively applies NGO's existing activities in ways that reduce costs and/or increase and diversify incomes. The idea in the second approach is to encourage greater self-management for the enterprise, but the first approach attempts to build up the enterprise at the stage when its scale of production is not sufficient enough to earn substantial profits. Essentially, the first approach is centered on the association and NGO objectives towards greater clustering, while the second approach focuses on the goals of the household towards self-management. Both approaches should reinforce one another.

III. Empirical Model for Social Enterprises

In the Philippines, social enterprises refer to organizations that provide support to poor household firms by means of loans and other forms of assistance. Given the absence of complete markets in the rural areas and in poorer urban communities, an integrated approach where production and consumption are non-separable can work best in the case when the SEs consist of poor households that are still struggling to establish themselves. An approach where production is separable from consumption is best suited to

SMEs that are already profitably operating. For the projects to succeed, both approaches should be applied at the proper stage. For many poor households, however, an integrative approach will be necessary. For the NGOs, that are expected to support SEs, it is important to understand the decisions that household enterprises make. The point of Fowler's thesis then is that it is crucial for NGOs and the government to understand at least the distribution of households for those that are struggling to establish their business and those that are already thriving. The assumption is that SE projects are supposed to be development-focused, market-based, business-oriented and value-chained driven. This presupposes that the households are already prepared to engage in a productive and profitable operation. Clearly, this particular here needs to be reviewed and tested. The SME approach of already thriving NGOs may not be applicable if the households are starting in a position of weakness and are incapable of achieving these goals.

The rationale for an integrated approach is best seen by looking at a model of coordinated household. This is shown in Figure 1. This framework was the basis of the questionnaire designed for the data that will be used for this empirical investigation later. The model indicates that the poverty intervention cannot be limited to a particular aspect of the households as most decisions are tied to one another. The key then is to deliver a package of programs responding to the needs of the household. The model has the following important specific points.

First, coordination of the household decisions exists. Consumption decisions are linked to production decisions, and vice versa. Household conditions regarding health and education can affect the decisions for production. In particular, the genetic variability exposes certain households to poor health and varied forms of diseases. Inversely, improved production can help improve health. Nevertheless, for the inverse to occur, other measures, such as vaccinations and other types of preventive care are needed to relieve the household of its poor health constraint. This then constitutes the integrative approach, that is, one that considers both consumption and production simultaneously.

Second, short-term outcomes are linked to long-term outcomes. The framework shows the potential of SEs in influencing local and national conditions (as shown with the blue broken lines). Nevertheless If SEs are expected to spur community development, the pressing needs of the household will have to be addressed first. [2] Programs that aim to achieve greater productivity are often long-term in nature as certain factors of production are not available in the short-term. PEF are supposed to leave these tasks, such as water systems, to their partner cooperatives. While the programs are expected to achieve growth in the future, such constraints should be addressed in the present.

Third, the household is affected by initial conditions, such as its genetic feature and its family of origin. While the external factors, including national and local government policies, may affect the conditions of the households in the long-run, these initial conditions may constrain the households from expanding its

[2] The general policy of NGOs is to delegate the needs of the households, such as the water system, to the cooperatives. This can be problematic if baseline data will show that such needs are still unmet. This shows that the importance of a "principal-agent" model. Part of the task of the cooperatives is to address these needs and show that a more integrative approach will be required, indicating that additional programs and incentives will be required for the success of the program.

production capability. Unless the project is able to address these pressing needs that affect the household's capacity, the enterprise may be limited to a smaller scale of production.

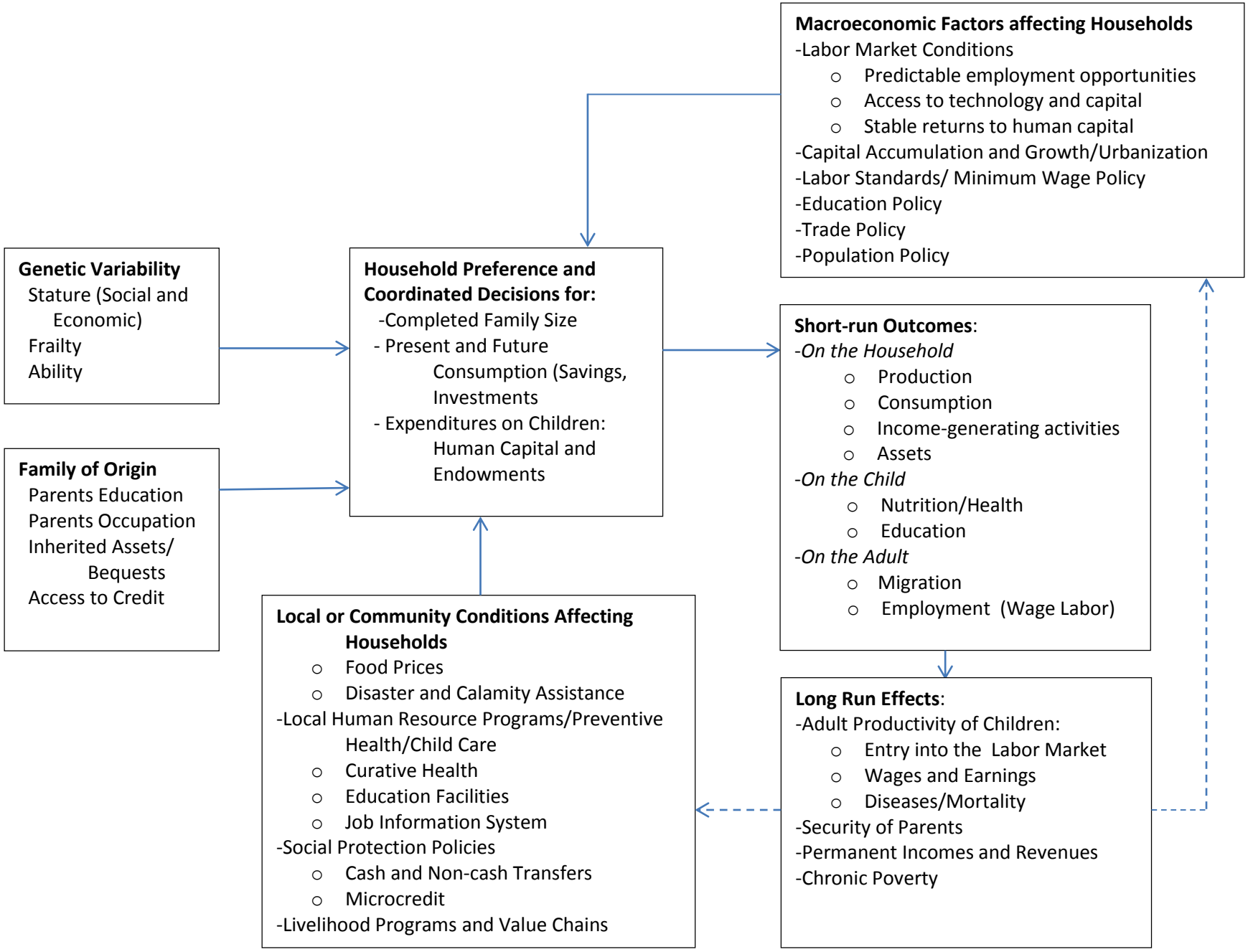
Fourth, the households' preference for a larger or a smaller family size and subsequently its preference for future or present consumption and for expenditures for consumption (such as children's education and health) or production resources may also affect the status of the household. Given limited resources, households may be forced to trade-off one need or goal or activity for another. In certain cases, the ability to household to manage its resources in adjusting to its preferred goals may be crucial in determining how much of its resources for production in the enterprise. In this case, the persons making the decisions regarding the allocation of resources can affect household outcomes. In particular, gender issues may be significant in the sense that if mothers make decisions the household enterprise may be more successful.

Fifth, households respond to incentives. Commodities or activities that are seen to be more expensive are substituted for the less expensive ones. However, unless consumption needs are also addressed, the sustainability of the projects becomes an issue. For instance, even though loans may be available, but if the family members are not healthy, production can be limited. Loans can be used for consumption instead of production. This can mean that the loans will not result in long-term benefits.

Sixth, macroeconomic and local communities need to be controlled in order to assess the impact of the project on the household's production and consumption. The efforts of the NGOs and the government may not be effective if the economic, social and environmental conditions offset such gains. At the same time, there are programs available from both the national and local governments that can be useful in improving the outcomes that the SEs hope to accomplish. Coordination between local and national governments and NGO programs will be crucial in achieving full impact.

The program design of the NGOs should account for these coordinated decisions if they are to make any headway in the social development of the communities. There are particular initial conditions that can constrain the households from achieving greater production and creating a lucrative business. Such pressing needs have ultimate consequences in the long-run, and unless programs and incentives are offered to offset these initial conditions, or the provision of public goods is adequate, the SEs may be faced with difficulties in achieving its goals.

Figure 1. A Model of Coordinated Household Decisions



Source: The Author

IV. Empirical Analyses of SEs

The data used for this analysis come from a 2012-2013 baseline survey that was conducted by the Ateneo Center for Economic Research and Development (ACERD) for several of its partner NGOs. The objective of the survey was to collect baseline data for SEs in 13 projects being implemented by the NGO. The sample consisted of control (beneficiaries) and treatment groups consisting of MSMEs and SEs, the latter being the industries being supported by the said NGOs[3]. These NGOs include one of the largest SEs in the country.

Table 4 shows the sample of SEs surveyed. Several points are important here. First, these enterprises are household based with most of the workers, especially those that are agriculture based. While there are enterprises that are in manufacturing and services, these have remained small hiring at most 20 workers. The objective is to increase the scale of production over time and to distribute the benefits to the community. Second, the SEs identified here are distributed across different locations creating a wide network of activities. The main inputs of the capital infusion mainly as a form of investment that will help rural households gain better incomes and move out of poverty. It utilizes social enterprise models and builds capacity to become ready for growth and investment. These capital infusion come in the form of credit or loans, ranging from Php 300,000 to 7 million.

Table 4. Sample of SEs Surveyed by Location and Enterprise

NGO	**Location**	**Enterprise**	**Number of Target Household Firm /Enterprise Beneficiaries**	**No. of Beneficiaries Surveyed**	**No. of Non-Beneficiaries Surveyed**
1	Rizal	Business Development Services and Financing	4000	40	40
	Laguna			50	31
	Antique			50	30
2	Puerto Princesa, Palawan	Wild honey expansion & lighting project	350	253	108
4	Quezon, Palawan	Enhancement of Alternative Tourism	541	175	67
5	Antique	Financing of Purchase Order	500	172	121
6	Ilog, Negros Occidental	Expansion and Improvement of Potable Water Supply System	1450	172	176
7	Calatrava, Negros Occidental	Hi-Breed Goat Farming Enterprise	400	99	101
14	Laua-an, Antique	Muscovado Sugar Production	150	43	41
8	Northern Samar	Climate Adaptable Palay Seed	700	162	188

[3] For confidentiality reasons, the NGOs will be left unmentioned.

9	Cebu City	Building Market Access for Fair trade Products	264	175	175
10	Zamboanga del Sur	Land Redemption Program	135	50	68
11	North Cotabato	Banana chips production	400	127	73
12	Agusan del Sur	Integrated Rice Duck Farming System (Duck Center for IRDFS)	1800	161	181
13	Davao City	Cacao production	120	67	52
Total			6,810	1,656	1,351

The objective of the empirical analysis is to identify key factors that are correlated with revenues, incomes, and poverty. Data on labor employment is missing, and if ever these exist, seem to be affected by measurement errors. Hence, the dependent factors here are used to proxy for employment creation since labor demand is derived from the firm's profit maximization and its income status. Revenues and incomes and poverty incidence are the key indicators of welfare and income that determine the potential of the firm to increase its scale of production

Using the framework of coordinated household decisions presented in the previous section, these variables include:

- Factors of production: loans and costs. Costs are supposed to proxy for scale of production.
- Household composition: Percentage with high school and college education and age distribution
- Household Assets: working phone, electricity, walls constructed with strong materials
- Water and hygiene: water delivered or piped to their own houses, and sealed water toilet
- Health: whether the household has visited a medical practitioner and whether the household
- Geographical Factors: Access to roads for the whole year, conditions in Visayas and Luzon relative to Mindanao, calamities
- Preferences: Whether the Wife make the decision in the family; Whether there is an Overseas Filipino Worker (OFW)
- Unmeasured NGO characteristics: whether the household is a beneficiary or not

Another factor of production we also included as a variable is if the source of the loan is from an NGO, a microfinance institution or a cooperative.[4] This is intended to control for loans that are production loans as opposed to loans for consumption.

[4] In certain cases, these three categories can overlap.

Table 5 shows the means and standard deviation of these variables by type of household enterprise. Note that all of these are SMEs but the beneficiaries are SEs. The data indicate no significant difference in these two groups, except for the amount of loans they already have. This means that the beneficiaries were chosen randomly and were not self-selected for the evaluation that will follow from this baseline data.

Table 5. Means and Standard Deviation of Variables

	Non-Beneficiary		Beneficiary	
	Mean	Std. Dev.	Mean	Std. Dev.
Incomes	6,007.98	17,920.11	6,737.93	16,129.89
Revenues	4,610.83	17,026.56	4,711.11	24,010.25
Poverty	0.59	0.49	0.59	0.49
Loans	1,202.77	8,278.70	946.38	2,958.52
Received Production Loans	0.12	0.32	0.13	0.33
Costs of Household Production	1,157.29	6,771.34	1,323.80	19,988.89
Proportion of Adults with College Education	0.06	0.15	0.07	0.17
Proportion of Adults with High School Education	0.32	0.35	0.29	0.35
Proportion Aged 15 to 20 years old	0.12	0.16	0.12	0.15
Proportion Aged 61 and above	0.06	0.16	0.07	0.18
Proportion Aged 6 to 14 years	0.19	0.19	0.18	0.18
Proportion Aged 30 to 60 years old	0.31	0.22	0.33	0.23
Proportion Aged 5 years and below	0.13	0.16	0.11	0.16
Electricity	0.63	0.48	0.61	0.49
Working Phone	0.61	0.49	0.60	0.49
Road Accessible for the whole Year	0.66	0.47	0.65	0.48
Strong Wall	0.21	0.41	0.21	0.41
Owned Water	0.18	0.39	0.23	0.42
Sealed Toilet	0.44	0.50	0.42	0.49
Percentage of Household members seeking Medical Health	0.13	0.29	0.13	0.32
Percentage going to Public Hospital	0.12	0.33	0.16	0.36
OFW	0.04	0.25	0.04	0.29
Wife Making Decisions	0.12	0.33	0.16	0.37
Calamity Affected	0.30	0.46	0.31	0.46

Table 6 shows the (OLS) regressions for the estimates on incomes and revenues, and probit estimates for poverty incidence. The natural logarithm of incomes and revenues are used in order to measure percentage changes, instead of absolute values. This makes it easy to compare the results with other estimates which are also in measured in terms of probabilities or proportions. The coefficients here are not intended to account for causal relationships but simply an attempt to determine the significant factors that are associated with the key outcomes. This is mainly to be used to determine whether

consumption factors also affect production, and whether the household characteristics are significantly associated with production.

The following results were significant for these variables used as determinants:

- Loans: Loans per se were not significant, but loans considered as production loans (coming from their NGO partners) are associated with higher incomes, revenues resulting in lower poverty. The point is that loans (usually enforced by NGOs, microfinance institutes and cooperatives) must be production loans (not used for consumption) if it is going to have any positive impact on the enterprises.

Table 6. Results of the Regression and Probit Estimates of Key Welfare and Income Indicators

Variables	Ordinary Least Squares Regressions		Probit Estimates
	Ln Incomes	Ln Revenues	Poverty
Loans	-5.42E-06 (1.42)	-5.41E-06 (0.54)	4.2E-06 (0.95)
Received Production Loans	0.6373 ** (8.72)	0.5942 ** (5.58)	-4.6E-01 ** (6.56)
Costs of Household Production	7.3E-05 ** (9.52)	8.3E-05 ** (10.94)	-3.4E-05 ** (5.60)
Costs of Household Production squared	-7.8E-11 ** (9.30)	-8.5E-11 ** (10.00)	3.6E-11 ** (4.96)
Proportion of Adults with College Education	1.2109 ** (6.25)	0.8236 ** (2.98)	-8.3E-01 ** (4.42)
Proportion of Adults with High School Education	0.3281 ** (4.17)	0.3022 ** (2.69)	-0.3787 ** (4.96)
Proportion Aged 5 years and below	0.3069 (1.46)	0.1003 (0.33)	-0.4933 ** (2.39)
Proportion Aged 6 to 14 years	0.3473 ** (2.30)	0.4000 * (1.90)	0.0835 (0.56)
Proportion Aged 15 to 20 years old	0.7461 ** (3.63)	0.3378 (1.17)	-0.2485 (1.23)
Proportion Aged 30 to 60 years old	0.1785 (1.28)	0.0534 (0.27)	-0.5432 ** (4.04)
Proportion Aged 61 and above	0.0905 (0.49)	0.0930 (0.34)	-0.5916 ** (3.30)

Electricity	0.1591 **	0.3589 **	-0.3150 **
	(2.49)	(4.01)	(4.98)
Working Phone	0.2744 **	-0.0785	-0.1943 **
	(4.89)	(1.01)	(3.49)
Road Accessible for the whole Year	0.1742 **	0.2314 **	-0.2276 **
	(3.16)	(2.97)	(4.11)
Strong Wall	0.0928	0.3263 **	-0.0644
	(1.33)	(3.32)	(0.96)
Owned Water	0.0282	0.2943 **	0.0042
	(0.40)	(3.04)	(0.06)
Sealed Toilet	0.3323 **	0.3857 **	-0.1571 **
	(5.54)	(4.59)	(2.70)
Beneficiary Household	0.0827 *	0.0679	-0.0483
	(1.64)	(0.97)	(0.95)
Percentage of Household members seeking Medical Health	-0.11453	0.36102 **	0.0350
	(1.18)	(2.79)	(0.40)
Percentage going to Public Hospital	0.1949 **	-0.0014	-0.1575 **
	(2.65)	(0.01)	(2.18)
OFW	0.3293 **	0.1505	-0.0468
	(3.68)	(1.06)	(0.54)
Wife Making Decisions	0.2721 **	0.4765 **	-0.3102 **
	(3.50)	(4.29)	(4.12)
Luzon	-0.2989 **	-1.0602 **	0.0407
	(3.82)	(10.12)	(0.51)
Visayas	-0.7326 **	-1.6371 **	0.4689 **
	(10.21)	(16.64)	(6.59)
Calamity Affected	-0.1599 **	0.0272	0.1038 **
	(2.83)	(0.36)	(1.87)
Constant	7.0194 **	6.8972 **	1.3478 **
	(53.78)	(37.46)	(10.27)
N	3011	2456	3279
R-sq	0.2302	0.2997	0.1267
F-test (for OLS)/LR chi-sq (for Probit)	37.01	43.02	533.3

Notes: Figures in parentheses are absolute values of asymptotic t-values. *, ** indicate significance at 10 and 1 percent levels, respectively.

- Costs of Production: This variable is intended to measure the increasing scale of the enterprise operations. With increasing costs, the production inputs are expected to increase proportionately. Because of this, “learning by doing” and knowledge spillovers are formed. Hence, costs of production or greater production scale are associated with higher incomes, and revenues, thus also decreasing the probability of being poor. This indicates a potential for these enterprises to expand and be profitable. Nevertheless, the effects of

production scale are non-linear, as shown by “squaring” or “doubling” the costs of production. As the enterprise further increased its size, there were lesser incomes and revenues observed, leading to a greater chance of becoming poor. Such observed decreasing returns can be explained if the technology is kept fixed even as scale of production is increased. Hence, innovation is necessary if the scale of production is to be raised. With more innovation, more production can be realized even without increasing inputs, thus reducing the additional costs of production. Technology then should be further improved as the scale of production increases

- Schooling: Households with more college education tend to have more incomes, revenues and a lower chance of being poor. Similarly, those with more high school education also tend to generate more incomes and revenues, and are able to move out of poverty.
- Age composition: Households with younger people (between ages 6 to 20) tend to receive more income and revenues and lower poverty incidence. This can be due to the fact that these children may complement the production activities of the parents (see Lim, et. al., 2002). In other words, parents and other working members are able to engage in production activities, because the children are able to handle household chores. In addition, having older people seems to decrease the chance of being poor. Perhaps, older persons in the household have accumulated enough pension or savings and are able to contribute to the family consumption. Alternatively, richer households can take care of older members since they have means of supporting them. Social security for the aged seem to be important in addressing poverty
- Amenities: Having electricity is associated with more incomes and revenues as the chance of being poor is decreased. The same effects are observed for those households that have working phones and are close to roads that are passable throughout the whole year. The only difference is the phones do not have a significant correlation with revenues. But enterprises with houses built on strong walls are associated with higher revenues. Houses with stronger walls may be one of the inputs used in the business. The results here show the importance of public goods.
- Water and Hygiene: These variables are related to the health of every member of the family, and so may have effects on production. Households that have their own water piped or delivered in their houses are associated with greater revenues. Those with sealed toilets are correlated with more incomes and revenues, and less poverty.
- Health: Accessibility and visits to medical practitioners and the public hospital seem to lead to more revenues and more incomes, respectively. Public hospital visits also result in lower poverty.
- Other income: Having an OFW tends to result in greater incomes for the household while having a wife make more decisions seems to draw in more income, revenues, lesser poverty and greater self-assessment in their financial condition. Perhaps, it is not so much the increase in income that matters but the wise allocation and use of funds that the wife brings into the picture that result in these positive effects. This suggests the importance of gender concerns.

- Environmental and Social Conditions. Households residing in Luzon and the Visayas seem to have lower incomes and revenues. Households in the Visayas also have a higher chance of being poor. It would seem that the economic conditions faced by these households are more severe, compared to Mindanao.
- Calamity: Households affected by calamities in any geographic location have lower incomes and tend to be poor.

These initial results indicate the value of business environment in affecting the revenues and incomes of these enterprises. In addition to these however there are other factors such as education, amenities as well as social conditions. This indicates the importance of directly addressing poverty and providing public goods to these enterprises.

V. The APEC Policy on SMEs and SE

This section provides the policy directions and recommendations for SME development in light of the above discussion. The purpose here is to provide a framework that highlights the role of SEs in employment creation, particularly in the way it can address the poverty situations encountered by most SMEs and to provide a basis for APEC intervention into the problem. A summary of existing programs of APEC is discussed in order to provide a context to the interventions.

Approaches for Supporting SMEs

Government policies on the SME can be classified in two ways, namely:

- Promotion of development of local industries to secure employment opportunities as assistance for anti-poverty measures and supporting social development
- Enhancement of assistance in infrastructure building, technology transfer, SME promotion, and development of supporting industries, Demarcation and coordination with other public funds are stressed. Assistance not only focuses on responding to the crisis, but is designed to strengthen the national financial system, develop core human resources, and upgrade business management and technical skills.

Both approaches are crucial in the development of the SMEs and to justify the role of government intervention since these firms are expected to produce positive social externalities or benefits that are unlikely to be evaluated by the markets. The first approach looks at the needs of the potentially profitable firms in particular and to determine its potential in achieving the expected goals of employment and the sustainability of its operations. Note that poverty is considered as an outcome instead of the point of intervention.

The second approach points fundamentally to the formation of industrial clusters. This refers to an agglomeration of companies, suppliers, service providers, and associated institutions in a particular field. Often included are financial providers, educational institutions, and various levels of government. These entities are linked by externalities and complementarities of different types and are usually located near

each other. Because of their proximity—by geography and activities—cluster constituents enjoy the economic benefits of several location-specific externalities and synergies. Such benefits include access to specialized human resources and suppliers, knowledge spillovers, pressure for higher performance in head-to-head competition, etc. Moreover, through these linkages, one cluster is inevitably linked with others and to the overall economy.

The importance of Global Value Chains for both SMEs and SEs cannot be overemphasized as developing countries undertake very little to no original R&D and primarily depend on foreign technology. Long-term contracts and subcontracting arrangements within global value chains are here very important forms of transnational cooperation and therefore also important channels for technology transfer, especially as the majority of these countries attract only limited foreign direct investment.

What is also missing from these approaches is the support needed to address fully the productivity and structural limitations faced by poor SMEs. Poverty for some SMEs can affect the quality of their inputs, including human capital, and their state of technology. Unfortunately, there is no institutional support for these firms that can directly influence their poverty status.

Government can be used to foster industries that are considered economically desirable and that would not otherwise be developed through private investment. An infant industry argument is often made in favor of state involvement in markets. However, when nascent industries have externalities that cannot be incorporated in pricing strategies, or when information is asymmetric, or capital or insurance markets imperfect, private investors can be reluctant to invest. When these industries have potentially important spillovers within or across sectors, the state however might decide to invest in these industries. In fact, it is often argued that many successful private sector firms in advanced countries owe their success, at least in part, to prior state incentives, and even ownership (e.g. China State Owned Enterprises). This line of argument links poor SME presence to economic development and thus suggests that the need for state intervention.

State intervention for impoverished SMEs can also offer a venue for the provision of public and merit goods. Various public goods are characterized by positive externalities associated with separation of consumption from payment, and by non-excludability of consumption for underdeveloped communities. Under standard economic assumptions provision of such public goods by private firms is at sub-optimal levels. Similar is the case of merit goods, such as basic nutrition or health services, which private firms are likely to supply at suboptimal levels. Hence, governments may choose to supply such goods through these SMEs.

Summary of APEC Policies

A number of Action Plans for SME Development had been developed by APEC SME ministers[5]. These are as follows:

[5] For a more comprehensive discussion of APEC Programs for the SMEs, see Aldaba (2013).

- 1998: Integrated Plan of Action for SME Development (SPAN). This serves as a set of broad guidelines for SME development in individual economies. It also provides a reference point for review of both individual and collaborative initiatives, programs and regulatory frameworks.
- 2005: Daegu Initiative. The initiative is intended as a long-term measure which runs in five year cycles with the objective of improving the economic and policy environments of all member economies to make them more conducive for SME innovation.
- 2006: APEC SME Innovation Center was established. Six areas were identified in the first cycle from 2006-2010, namely:
    - Developing human resources and technology through linkages between industry and educational and research institutions;
    - Accessing to specialist assistance and advice;
    - Enhancing availability of capital to innovative SMEs;
    - Networking and clustering for innovative SMEs;
    - Establishing appropriate legal and regulatory structures; and
    - Establishing a market consistent economic environment
- 2007: The Private Sector Development Agenda was launched o help APEC economies create an enabling environment for small business by using the World Bank's Ease Doing Business indicators. The 2007-2010 work plan to further this agenda include surveys and symposiums on:
    - Establishing a business (Australia) in 2007
    - Obtaining licenses (Peru) in 2008

- 2009: Access to capital (Singapore) in 2009
- 2010: Getting Credit (Japan) in 2010
- 2011: The APEC SME Green Innovation Conference was held in Seoul, Korea. This brought together government officials from SME-related and energy ministries and business representatives from innovative SMEs to share ideas and forge greater cooperation.

Also In May 2011, the 18th Small and Medium Enterprises Ministerial Meeting (SMEMM) was held in Big Sky, Montana, the United States, under the theme "Leveraging Partnerships with APEC Small Businesses to Foster Innovation and Create an Entrepreneurial Society". The first Joint Ministers Responsible for Trade and SME Ministers Meeting was also held in Big Sky, Montana on May 20th, 2011 and expressed the need for similar collaboration in the future. In November 2011, at the Leaders' Summit in Honolulu, APEC Ministers endorsed a set of 3 Codes of Business Ethics for the Medical Device Sector (Kuala Lumpur Principles), the Biopharmaceutical Sector (Mexico City Principles) and the Construction and Engineering Sector (Hanoi Principles).

- 2012: the 19th Small and Medium Enterprises Ministerial Meeting (SMEMM) was held in Saint Petersburg, Russia under the theme "Promoting SME Cooperation for Innovative Growth in the APEC Region." At the meeting, Ministers:
    - Reaffirmed the importance of addressing trade and investment barriers and improving the business environment for SMEs, including youth, women entrepreneurs, and MEs in the APEC region, and endorsed the results and efforts made by the SMEWG on

financing, open and transparent business environment and high transportation and related costs, recognizing the importance of addressing trade barriers identified in Big Sky, Montana at the 18th Ministerial Meeting;

- Agreed that corruption imposes a significant market access barrier and high costs for SMEs. To address this challenge, they endorsed principles for voluntary codes of business ethics for the medical device, biopharmaceutical, and construction/engineering sectors. They recognized the importance of working to raise awareness of these principles and welcomed progress in implementing these principles, through the development of codes of ethics by industry associations and companies and capacity building efforts;
- Agreed that effective protection of intellectual property rights (IPRs) and simultaneous reduction of trade and investment barriers in this field are among the key issues for further SMEs development in the APEC region. They welcomed Russia's proposal to organize a joint meeting of IPEG and SMEWG so as to facilitate further collaboration between the fora and to work further on the cross-cutting issues, including the formation of an accessible system of receipt of protection documents for the intellectual property items for SMEs;
- Recognized the importance of the Russian initiative to the creation of a common information resource for SMEs which will promote companies' inclusion in global supply chains and will ultimately foster innovation development in the APEC region;
- Endorsed the adoption of the "Guideline on Promoting SME Business Continuity Plans to Strengthen Reliability of Supply Chains", formulated by an Expert Group in Chinese Taipei, and urged APEC fora and governments to cooperate on assisting SMEs to develop disaster preemptive mechanisms in accordance with the Guideline;
- Welcomed work that promotes the exchange of best practices for instruments that support innovative SMEs and MEs and instructed officials to develop capacity-building activities to deliver effective economic and technical cooperation;
- Recognized the importance of the inclusion of young entrepreneurs in economic activities and, in this regard, supported the implementation of the Young Entrepreneurs Network (YEN) and welcomed the first YEN meeting that was held on August 2, 2012 in St. Petersburg, Russia; endorsing the results of the first meeting and agreeing with the format of this event on an ongoing basis as a part of the SME Working Group; and
- Reaffirmed the crucial role of SMEs and MEs as an integral part of economic growth and as a source of forward-thinking ideas; and instructed officials to pay special attention to innovative SMEs and MEs in the work of SMEWG in the near future (2013-2016).

- 2014: The United States hosted a launch workshop to facilitate the integration of SMEs into global supply chains. The workshop focused on obligations and expectations that translate across the supply chains to SME sub-contractors and suppliers. Companies shared information on the types of certifications that are required to ensure the integrity of the products produced within the supply chain. Five sectors are of high interest to regional SMEs: agriculture, food processing, electronics, automobiles and handicrafts.

Recommendations

These measures are all the two approaches that are used for developing SMEs. What is missing is the aspect of public goods which help the SEs prosper and in turn be useful to the rest of the SMEs in the community. Public goods become global (sometimes called international public goods) in nature when the benefits flow to more than one country and no country can effectively be denied access to those benefits. Global public goods can be divided into two categories:

- Final public goods: these are "outcomes", e.g. the eradication of polio and the expansion of education.
- Intermediate public goods, which contribute to the provision of final public goods. For example, International Labor Standards aimed at stopping worker exploitation and reducing migration that can also cross-border risks or decreasing underemployment.

The promotion and protection of cultural diversity, core labor rights, and the environment through global cooperation are also regarded as global public goods. For instance, health was shown to have a significant effect on SEs. Hence, this can be an important input coming from the international community. Health-specific global public goods fall into three broad categories:

- Information and knowledge, e.g. regarding the effects of risk behavior such as alcohol and tobacco consumption; knowledge of treatments; surveillance and information systems for communicable diseases that help control their spread.
- Control of infectious disease and implementation of sanitary conditions, e.g. because of cross-border health risks, action on HIV/AIDS or TB has global benefits.
- International rules and institutions, e.g. Sanitary and Phytosanitary Measures.

One of the key questions about global public goods is: how can investment in them be encouraged? Failure to provide global public goods is linked to collective action problems such as "free-riding". The free-rider term describes a situation when no individual is prepared to pay the cost of something that others may be expected to benefit from; instead, all hope that someone else will pay for it and they will benefit for free. Again in health, an example is the research and development (R&D) into medicines to combat neglected diseases, which requires high-levels of investment. There is little market incentive to develop such medicines, as those suffering from the disease typically have low purchasing power. In addition, countries worst affected by neglected diseases tend to have little capacity or resources to invest in R&D.

This "free-rider" problem is further aggravated by two factors. First, for the case of global public goods, there exists today no workable market or governmental mechanism that is appropriate for the problems. Apart from APEC, there is no mechanism by which global citizens can make binding collective decisions to produce such goods[6]. Second, in most discussions, global public goods are often

[6] This is known as the Westphalian dilemma. Under international law as it has evolved in the West and then the world, there is no legal mechanism by which disinterested majorities, or supermajorities short of unanimities, can coerce reluctant free-riding countries into mechanisms that provide for global public goods.

environmental in nature. One of the distinguishing features of most global public goods however is that they are generally "stock externalities." This term means that their impact depends upon a stock of a capital-like variable that accumulates over time. For example, the impacts might be functions of pollution concentrations or knowledge, which are augmented by flows of emissions or learning, and which depreciate according to some process such as precipitation or obsolescence. Because of difficulty of tracking the growth of such externalities over time, it is often difficult to create to form a consensus for collective action for their production.

Nevertheless, as we have seen in the survey of APEC policies on SMEs, in supporting this sector, APEC foresees the formation of a GVC which refers to a value chain that operates in more than one economy. GVCs not only cover vertical links (among different tiers of suppliers along the chain), but also horizontal links (the interaction among suppliers of the same tier). Along the GVC, a major part of value creation derives from product and process innovation, as well as branding and marketing.

The GVC however is only as strong as its weakest link. SEs can be developed as being valuable part of this value chain. If so, then it can also be its weakness because of its poverty constraints. In the weakest-link case, strong incentives exist for parties to cooperate and provide for the common defense (Hirschleifer, 1983), resulting in very little incentive (or possibility) for free riding. Weakest-link technologies, then, are ones where the non-cooperative outcome most closely approaches the efficient outcome only as long as countries have similar tastes and incomes. With weakest-link technologies, coordination and technological cooperation may be sufficient to produce reasonably efficient outcomes.

It is then up to the NGOs given their expertise and linkages with the rest of the world to link their production units (household enterprises) into the GVC. This means that the NGOs are able to provide the proper incentives for these firms, then the global community will voluntarily provide the public goods to enhance its productivity and increase its scale of production. For the NGOs, the following are ways that it can integrate their SEs into the GVC:

- **Integrating with other SMEs**:
  - facilitating the entry into the market of new, dynamic players;
  - strengthening business relations between SMEs and big companies;
  - helping SMEs become fully integrated international business partners;
  - streamlining business processes;
  - increasing returns on investments in ICT;
  - improving business transactions;
  - reducing administrative overheads or errors;
- **Complementing the larger companies:**
  - increasing their innovation capacity by partnering with other innovative established firms,
  - enhancing customer satisfaction through more flexible, personalized services;
  - shorter time-to-market delivery;
- **Coordinating with the rest of economy and society:**
  - promoting a more dynamic and competitive economy
  - facilitating the market entry of new players, on fair terms.

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