

Enhancing the role of SMEs in Global Value Chains

Main Findings & Conclusions

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Global Value Chain



GVC: an useful notion but (still) fuzzy reality

- ◆ **GVC encompasses production and distribution:**
 - the chain of interrelated steps that “add value” through the transformation of primary ingredients into a product or service sold to the final customer or user;
 - in case of many goods or services GVC are already clearly visible as back-bone of the world economy, in other cases they are only emerging;
- ◆ **GVC are a pervasive pattern of organisation on global scale of production and distribution based on lasting inter-dependences among enterprises of different sizes (SMEs and also TNCs) scattered around many locations;**
 - GVC are interesting for academics because they are a specific form of organisation: neither the pure textbook market nor classical vertical integration.

Five GVC studied



- ◆ We have found many differences between the five studied GVC :
 - ◆ Characteristics of the key deliverable (product or service);
 - ◆ Methods of delivery and support
 - unique vs. multiple; legal vs. illegal (piracy);
 - simple transaction based vs. long term liabilities;
 - ◆ The regulatory environment of the product/service;
 - role of national regulations: strong in medical instruments, weak in software and cinema
 - ◆ Structure – the existence of a “Focal Point” in each GVC-
 - Focal point position : share of “value added” generated in production as opposed to distribution and delivery
 - 80% in SPI, 65% to distribution in auto; but beyond 50% in cinema and software.

"Focal firms" in GVCs

- ◆ In some GVC, "focal firms" (FF) are structuring the rest of activities belonging to the GVC;
 - ◆ Focal firm is active both in the "production" as well as in the "distribution" portion of the GVC:
 - FF has the capacity to organize the production of complex goods or services;
 - FF has the capacity to organize its global distribution
 - FF are usually well known TNCs, listed on world stock exchanges
 - ◆ In auto, software and cinema GVC, FF are very present:
 - ◆ FF are of lesser importance and size in GVC of SPI and tourism.

Role of FF

◆ In automotive industry

- command of global economies of scale,
- control of product architecture
- investment capacity – strong cash-flow;

◆ In SPI

- command of economies of scope,
- innovation,
- manage IPR,

◆ Software

- Control standards and connectivity,
- Manage brands
- Have enormous investment capacity.

◆ Tourism

- FF = tour operators integration and bundling capacity

◆ Cinema

- command of economies of speed and timing;
- IPR management
- complex financial contracts



FF performance

- ◆ Financial performance differs
 - FF do extremely well in software and cinema;
 - FF do rather well in SPI and tourism
 - FF are under pressure in automotive industry
- ◆ Labour productivity growth of listed enterprises (many are or aspire at the role of FF) is much stronger than in the rest of the economy (SMEs)
 - In Japan 1995-05 share in GDP rose by 7 % points, share in labour force by 5 points;
 - In US: 7,5 points in GDP but 2,5 pt. in labour force;
 - In EU-15 : 8 points in GDP, while % 4.5 in labour force
- ◆ Overall – the SMEs economic and financial performance seems problematic when compared with large, listed enterprises

SMEs in GVC

◆ Role and place of SMEs

- ◆ Efficient mass and niche suppliers in auto, SPI, software
 - Master specific techniques and technologies
- ◆ Component innovators : in all five industries;
 - Holders of specific intellectual assets and secrets;
 - Often radical innovations;
- ◆ Distributors/customizers/integrators : except in tourism
 - They know the final client

◆ SMEs: partners but also competitors of FF

- ◆ Potential final product innovators, challengers of FF:
 - in SPI,
 - in software (Skype);
 - in cinema (cinema d'auteur, cf. Cannes 2007);
- ◆ Critical know-how holders

Weakness and Strengths



◆ Focal firms

- ◆ do overlook the whole GVC;
 - aspire at optimising and stream-lining the whole GVC, including the behaviour of the final customer;
- ◆ (well) equipped to manage critical knowledge, technologies and Intellectual Property Rights issues;
 - are able to absorb (take) advantage of SMEs strengths;

◆ SMEs

- ◆ do not fully grasp the GVC structure and FF's role;
 - excellent at optimising single processes;
 - punctual innovators
- ◆ have the (basic) primary knowledge of clients, techniques, and institutions that remains often undocumented;
- ◆ Often strategically weaknesses

Opportunities and Threats

◆ Focal firms

- ◆ under permanent shareholder's value pressure
 - ever shorter time horizon;
 - Ongoing global consolidation : M&A among giants;
 - Aspire at "Factory less enterprises"
- ◆ Press SMEs at both ends of GVC;
 - Internal complexity is growing;
 - Fierce competition among global brands

◆ SMEs

- ◆ GVC – an internationalisation opportunity;
 - to remain in GVC often requires growth (delocalisation)
- ◆ Strive successfully and survive despite FF pressure
 - on prices, delocalisation, client/information, know/how, payment conditions;
 - important sunk fixed costs – longer-term perspective

Critical dimension in GVC



Trans-enterprise coordination mechanisms

- ◆ **Upstream – production**
 - explicit stratification of suppliers, with limited partnerships in auto;
 - networks and local clusters in tourism and SPI– extended partnerships; in MSE – vertical integration possible;
 - global partnerships in software;
 - project based (cinema)– short term – contracting; clusters possible
- ◆ **Downstream – distribution**
 - growing pressure on retailers by FF (take-overs) in auto;
 - retailers as customisers and integrators (software, classical auto);
 - pressure from distribution on producers in tourism;

Policy suggestions

◆ Why specific, GVC/SME oriented policy instruments?

- ◆ **Offensive reasons :**
 - help local SMEs (also clusters) to enter, remain and move the up the GVC
- ◆ **Defensive reasons:**
 - prevent SMEs (also clusters) from being dropped off of GVC

◆ How?

- ◆ **Selective access for independent SMEs**
 - to technology and R&D capacities
 - to advise in GVC strategy and negotiation capacity;
 - possibly selective access to GVC related funding.
- ◆ **Adopt a legal framework specific to intra-GVC relations**
 - adapt contract laws to GVC situations;
 - Develop adequate IPR protection instruments
- ◆ **Develop international dispute settlement mechanism SME-TNCs**
 - In GVC practice, legal contract enforcement is seldom an option for SMEs- It usually means the end of the relation
- ◆ **Encourage explicit or implicit governance/coordination of GVC including SMEs**

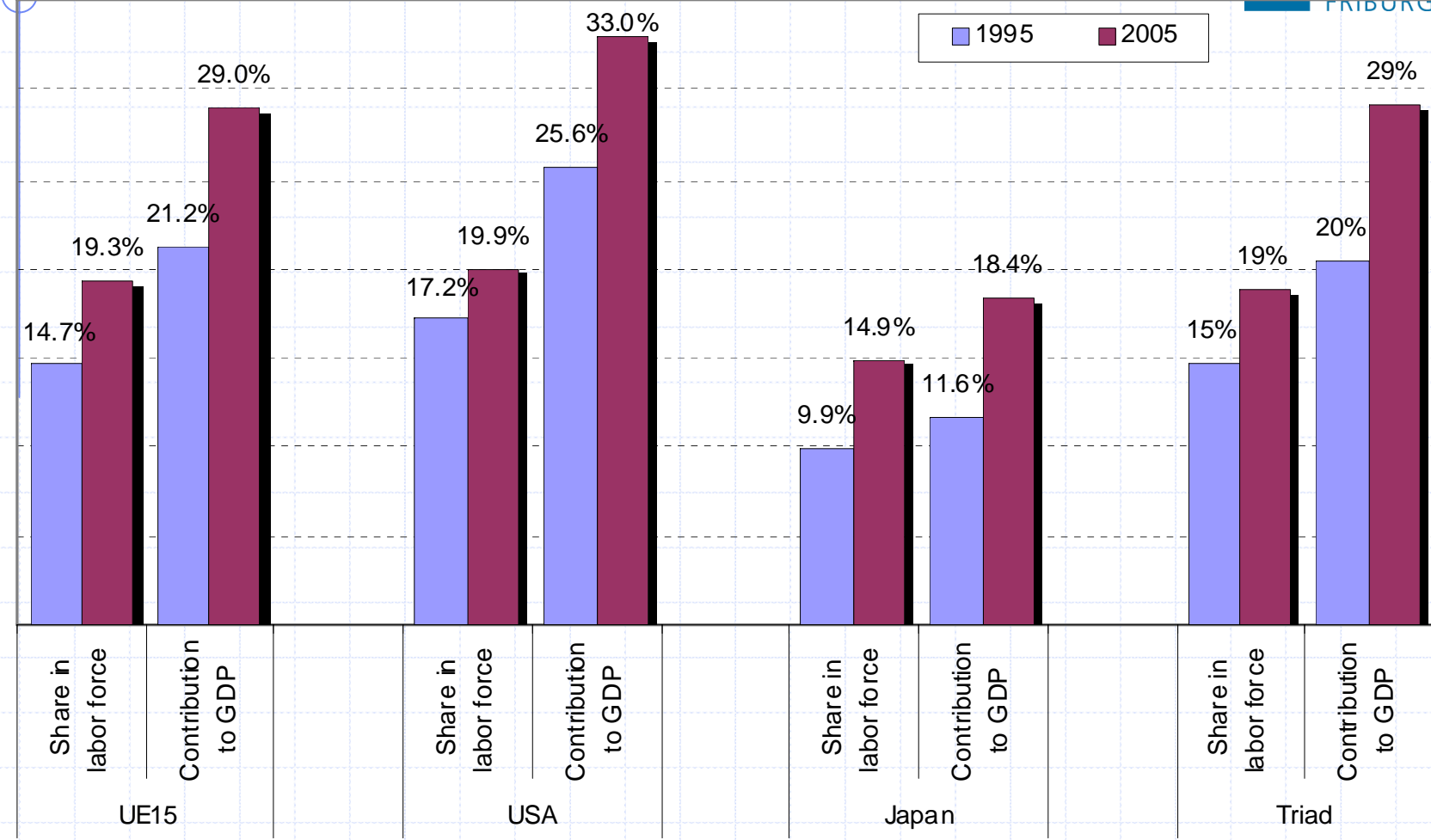
Litmus test of any GVC policy !!!

- ◆ Is the productivity issue within GVC a “zero sum game » between FF and SMEs or not?
- ◆ Are GVC creating growth and jobs or only do they increase financial wealth?
 - ◆ How to explain the extraordinary performance of the large, listed enterprises as compared to the SMEs?
 - very high capital intensity, (high level of equipment);
 - Outstanding, motivated, qualified labour force;
 - Master-minding of innovation rhythm – financial optimisation;
 - a price mark-up capacity due to strong brands and more generally of unique marketing capacities
 - ◆ Or is it their pricing power with respect to the suppliers and distributors that allows the FF to harvest the financial fruits of technical productivity gains and competitiveness achieved by SMEs in other segments of the value chain?

Appendix I: The uneven productivity game



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Profit indicators for selected global industry sectors¹

As a percentage of revenues

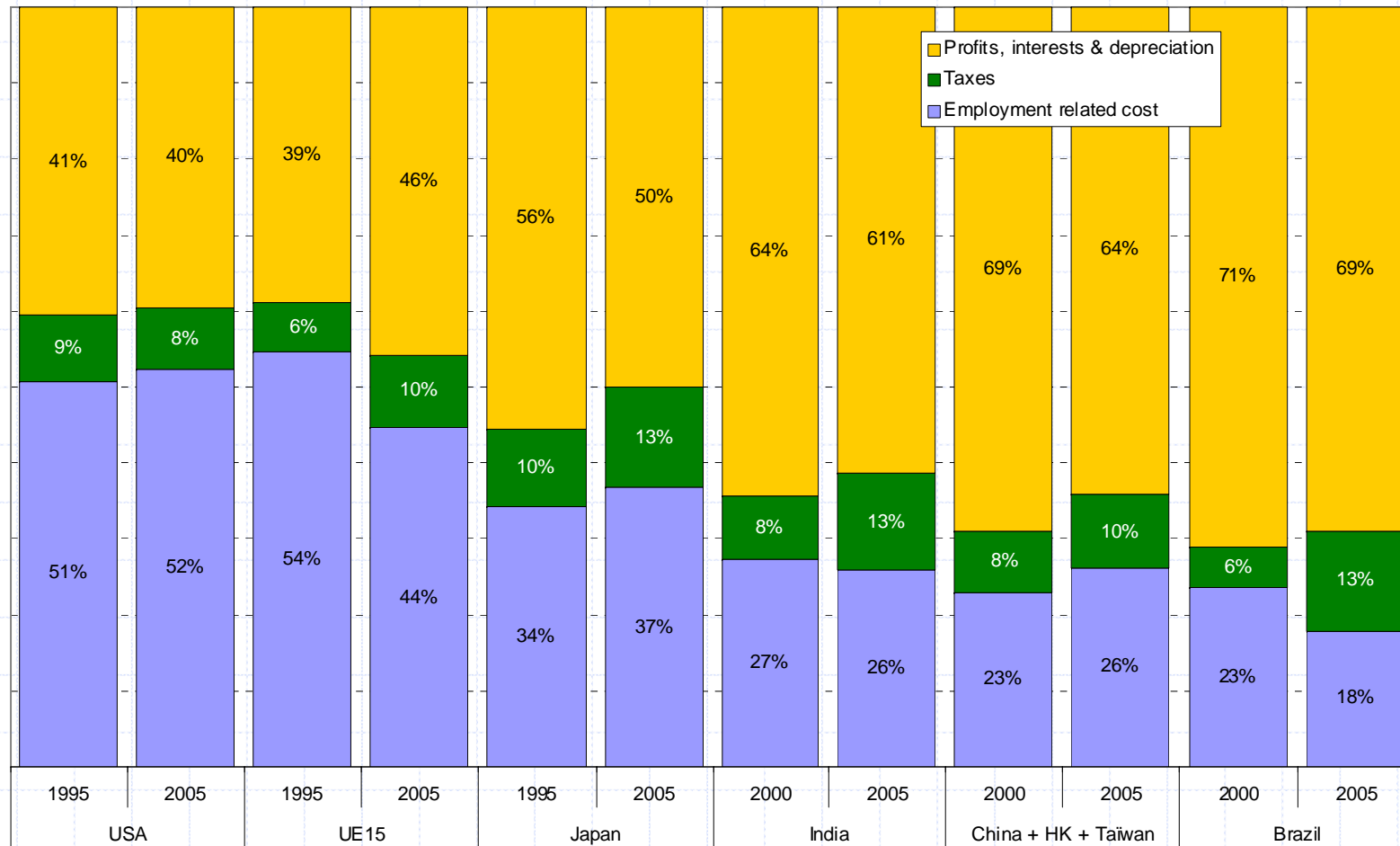
	Operating surplus ²			After-tax profit		
	2004–05	Change ³		2004–05	Change ³	
		2001–02	1995–99		2001–02	1995–99
Airlines	3	3	–3	2	3	–1
Automobiles	4	0	0	2	1	0
Chemicals	9	3	1	6	3	1
Computer hardware	5	2	0	4	4	0
Industrial machinery	8	2	2	5	3	2
Mining	22	4	9	17	6	9
Oil and gas producers	14	3	5	9	3	4
Retail	5	1	1	3	1	1
Software	26	2	0	18	5	3
Telecommunications	16	3	–2	9	13	–1
Utilities	14	3	1	7	3	1

¹ Revenue-weighted average of firms included in the World Equity Market Index. ² Revenues minus total operating expenses. ³ Average 2004–05 minus average 2001–02 and 1995–99, respectively.

Sources: Datastream; BIS calculations.

Table II.5

Value added composition of listed enterprises



Appendix II Research design

