How SMEs can remain competitive in the face of crises

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II. Purpose

1. To monitor and analyze the possible impacts of emerging or existing economic crises and challenges on SMEs to help them conduct early preparedness and response in a timely matter.
2. To train SMEs to enhance the capacity of rapidly and properly responding to crises and provide them with knowledge and strategies to prepare and cope with these crises.
3. To study the strategies of SMEs’ responding to new global challenges and crises.
4. To stimulate cross-border cooperation and interactions on SME crisis management between related stakeholders, experts and SMEs of the APEC region.
SMEs are important: they contribute about half the GDP, half the employment, and most of the job growth in APEC.

SMEs and entrepreneurs are not all the same, nor have the same requirements!

There is a major economic and financial crisis (competitive wave) about every 5 to 10 years.

Crises, competitive waves can come from many sources.

It is not possible to predict the future. But it is possible to use scenarios and intelligence to anticipate and monitor key issues to help manage an emerging wave.

For every threat there is an opportunity. SMEs have proved resilient in previous crises.

For SMEs to remain competitive in crises and tsunami, they need good: cash flow; intelligence; management, and luck!

For the last decade many SMEs have had less access to bank finance!

SME managers are overwhelmed with more information available than ever before!

There is an opportunity to improve the management of risk by banks in lending to SMEs, and improve management of SMEs by getting banks, ICT suppliers, telcos and governments to work cooperatively to improve CI and management of SMEs.
What is an SME?

- 99.9% of all businesses are SMEs, employing less than 500 people,
- 98% employ less than 100,
- 80% employ less than 5 people

There is no consistent definition of SMEs across APEC, but the great bulk of SMEs employ less than 100, and most less than 20 people.
There are now about 77 million SMEs in APEC, about 30 million of them in China, ...

but there should be about 100 million in APEC, about 60 million in China.
There are big differences across economies in propensity to start an SME.

People start SMEs up (entrepreneurship) as a result of:

a) necessity (no job)

b) opportunity (for improved income and wealth)

GEM 2006 data
necessity driven start ups become more important in post crisis periods

Source GEM 2008 Executive Report
For every 1 million people, there are about 50,000 SMEs.

GEM suggests about 5% (50,000) people *try* to start a new business each year,

and of that 50,000, about 45,000 will *not* succeed...

..but 5,000 will succeed.

If the successful start up rate is 10% of the firm population (50,000 firms for 1 million people, or 1 SME for every 20 people), then 5,000 *will* start each year, of which about 1,000 (20 to 25%) are growth oriented.

If about 10% (5,000) exit each year, then the SME population is steady and it renews itself about every 10 years.
What do these SMEs contribute?

- **Micro** less than 5 employees: about 80% of SMEs
- **Small** 5 to 19 employees
- **Medium** 19 to 500 or so

Large firms make up less than 0.1% of businesses, contribute between 40% and 60% of employment, and about 50% of GDP.

Large firms usually destroy jobs, i.e., are net job destroyers.

SMEs contribute about half of GDP, and about half of all jobs. About 20% of jobs are from medium, 20% from small, and 20% from micro.

But SMEs, especially new micro and small enterprises create most of the growth and flexibility in the face of change.
About 1% of firms

Large firms employ about half the workforce, but add relatively few net jobs.

About 5% of firms

Fast growing firms contribute around 70% of net job growth.

About 20% seek growth

Small firms churn, add and destroy a lot of jobs, net addition varies with cycle and economy.

Over 90% of firms

How does the Entrepreneurial Engine work?
How does the Entrepreneurial Engine work and what finance is needed?

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**Fast growth firms need growth finance, which is usually equity (such as VC)**

**The vast bulk of SMEs need working capital, mostly debt funding. A larger proportion than usual tend to exit if finance is not available**
Not all Entrepreneurs are the same!

percent of adult population

actual entrepreneurs ~ 5%
- willing to bear some uncertainty
aspiring entrepreneurs ~ 20%

non entrepreneurs 75%
- wage earners, professionals etc
- less willing to bear uncertainty and risk

only a very small proportion are heroes, who risk all for growth
about 25% (1.25%) are growth oriented
about 75% (3.5%) are lifestyle entrepreneurs, not really interested in, or capable of growth
But it is this small proportion of the adult population (about 1% or less) and less than about 5% of SME population that drive international success, provide much of the resilience, and create around 70% of net jobs!!

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low   propensity to bear uncertainty   high
what are the entrepreneurial challenges of a Financial Tsunami?

The challenges in a downturn or crisis are that:

more people have to start an SME out of necessity, not because of choice or opportunity;

these necessity entrepreneurs are less likely to have appropriate management skills for an SME, or the appropriate attitude, to help them succeed;

It is more difficult for them to get finance, especially from risk averse lenders (eg banks) who might actually have the funds, but are not as effective at mobilising them;

even though there are entrepreneurial opportunities arising from restructuring and bankruptcy/exports, a generation of growth oriented firms may not be able to avail of these opportunities because of lack of finance and smart money;...and

d this leads to a slower economic and social recovery than is potentially possible, or it shifts the recovery to locations with more conducive entrepreneurial environments (eg the Japan lost decade becomes China's decade of entrepreneurial growth).
There is a major economic crisis every 5 to 10 years in APEC

The 1990
Japan crisis
bubble
economy
collapsed in
Japan, rising
Yen. Japanese
SMEs adapt by
moving to China
and Asia

The 1996/7
Asian crisis
Construction
bubble in
Thailand, supported by
cheap US bank
loans collapses as Hedge
Funds force
devaluation of
Baht, and
contagion
spreads.

The 2001
Tech Wreck
+ 911
The .com
bubble collapses in
USA, VC
money moves to
PRC.

2007 - GFC
Collapse of US
sub prime
bubble, Lehmans

2010 ?
Asset bubbles in
China, contagion
in Europe?

2003 SARS
Main impact on
HKG and SIN
Big impact on tourism

source: World Bank data base to 2008, National Agency Data 2009
Although GDP rate of change usually only moves in a band from -2% to + 10%, many smaller firms face much bigger fluctuations, depending on the market, the economy, and the product life cycle. Moves from at least +20% pa nominal growth to - 20% pa are not unusual.
Crises and competitive tsunami come from many sources

Using a modified Porter five-forces analysis.....
1. Technology allowed complex products to be created (e.g., securitised), traded, and leveraged.

2. "Deregulation" moves of 1999 to repeal the Glass-Steagall act allowed banks (such as Citi, and Lehmans) to ride the wave of asset inflation.

3. By 2007 this wave was shaped by a wave of SIV (Structured Investment Vehicles) write downs and Sub Prime defaults, and some bank runs from depositors (e.g., Northern Rock). By end 2007, the wave then came from the finance suppliers, mostly banks, who ceased to trust each other, so the interbank rates (e.g., LIBOR) rose steeply.

4. This then led to the sharp fall in the share prices of banks (by August 2008 Citi had fallen 58%, RBS 15.2%, Merrill 62%). This wave led to collapse and/or restructuring of many banks or near banks (Wachovia, Merrill Lynch, UBS, Indy Mac, Washington Mutual), Investment banks (Bear Stearns, Lehmans) Insurance providers (AIG), Mortgage Providers (Freddie Mac and Fannie Mae), and private equity providers (Allco, Babcock and Brown).

5. Regulators and central banks scrambled to inject liquidity to the markets, partly by taking a stake in the banks. This has changed the whole pattern of competition.
Other "crises" and competitive tsunami also reshape that landscape

Some of these waves are innovations *initiated* by entrepreneurs, and SMEs....Eg

1. social networking, Facebook, Web 2, mobile computing, i phone etc

2. Changing customer attitude to use of mobile computing, changed ways of social interaction

3. development of new apps, new products, new markets.

4. sends waves of new entrants and competitors

... so competitive waves are superimposed on business cycle waves, and longer waves (Akimatsu flying geese, Schumpeter, Kondratieff etc)
no one can predict the future!

There are no monopolies on crystal balls!
..but we can use scenarios of impact and probability
Using scenarios of impact and probability

Examples of scenarios:

A  China mainland economy doubles (or halves) economic activity
B  new technology which reduces energy cost by 90% (eg fusion)
C  earthquake destroys Tokyo or San Francisco
D  successful quantum computing => reduces encryption security for electronic transactions
E  Contagion from Greek debt default

Impact | Probability
--- | ---
H | M
H = High
M = Medium
L = Low
Examples of scenarios:

A. China mainland economy doubles (or halves) economic activity in a year

B. New technology which reduces energy cost by 90% (e.g., fusion) in 5 years

C. Earthquake destroys Tokyo or San Francisco in next 5 years

D. Successful quantum computing => reduces encryption security for electronic transactions

E. Contagion from Greek debt default
..we cannot track all events, so focus on key issues, and monitor them.

we can not track everything!!!

instead focus on key issues, prioritised by probability * impact

and then monitor the main ones as to movement, and 
to see how we might affect probability or impact:

A  China mainland economy halves

E  Contagion from Greek debt default
We then monitor how the crisis, or wave, is transmitted to a client..

...such as an Asian exporter to Europe

Contagion from Greek debt default

eg:

1. Banks raise capital requirements, restrict supply of loans
2. Investors express concern, raise risk premium, withdraw or impose tighter conditions
3. Increased competition for export markets in Europe
4. Agencies change regulations for credit guarantee, tighten capital adequacy rules etc
For every threat there is an opportunity!

For example:

In a mortgage, sub prime crisis - there are opportunities to short the market, buy up underpriced assets, consolidate sectors, etc.

After the tech wreck collapse, there were more opportunities to access programmers in Bangalore to test new .com ideas.

In a contagion crisis....?
Previous economic crisis: 96/7 Asian Crisis in Korea and Chinese Taipei

Although the 97 Asian crisis hit Korea harder than Chinese Taipei, Korea GDP had caught up by 2001.
Previous economic crisis: 96/7 Asian Crisis in Korea and Chinese Taipei

Population of SMEs (index 1991 =100) in total and manufacturing

Employment in SMEs (index 1992 =100) in total and manufacturing

most of that catch-up was due to SME resilience
Both Korea and Chinese Taipei had developed good SME policy frameworks prior to the crisis.

Entrepreneurs and SMEs are resilient. Restructuring opportunities as Chaebol restructured allowed Korean SMEs to bounce back and catch up to Taipei within 2 years.

The ability to develop an internationally competitive industrial structure which is able to adapt quickly and take advantage of opportunities is very important in the face of a turbulent global environment.

To remain competitive, SMEs facing a major crisis or tsunami can try to:

a. ride the opportunities it creates
b. weather it out, seek assistance
c. exit
To remain competitive in crises SMEs need: 1. Good cashflow

.... they need good
1. cashflow
2. intelligence
3. management
4. luck, timing

but bank lending has been harder to get for most SMEs!

cash is king in a crisis
The proportion of bank lending to SMEs in most economies has declined.

Bank lending on small loans or to SMEs as a % of total lending has declined in most economies for which data are available over the last 15 or so years.
Real growth of bank lending to SMEs has been negative, falling...
but real growth in bank lending to large firms has been positive, growing
And even equity (VC) markets in the USA has slowed since 2001

....and it has slowed even more in 2008/9

USA Venture Capital Placements in nominal $US

Total VC (all stages)

Early stage + seed VC

Asian crisis

Tech wreck

2007/8 Financial Tsunami
Increasing intangible assets of SMEs and start ups make SME lending unattractive to banks

BIS Basle II rules make banks rethink SME lending, and discourage uncollateralised lending

Banks push collateral loans, usually housing, in lieu of SME business loans

Banks push personal and credit card loans

Banks channel SMEs to trade credit, or trade credit from large firms is more accessible to SMEs

Improved efficiency of equity markets for SMEs

SMEs tap other debt sources (bonds, etc)

Banks need to find better ways of lending on intangibles

APEC and BIS need to monitor the effect and revise Basle II if appropriate

SME lending gets tied even more closely and susceptibly to housing cycle

Higher costs of borrowing for SMEs

Difficult to borrow for SMEs which are not part of supply chain, or for SMEs in developing (2020) economies

APEC needs to look to ways to improve equity markets. Currently SME equity markets are very inefficient in most economies
To remain competitive in crises SMEs need: 2. Good intelligence

.... they need good

1. cashflow
2. intelligence
3. management
4. luck, timing

SMEs facing a major crisis or wave can try to:

a. ride the opportunity it creates
b. weather it out
c. exit

There is now so much info available most managers are overwhelmed!
To remain competitive in crises SMEs need: 2 Good intelligence

on key issues related to....

a. ride the opportunity it creates
   - emerging opportunities - eg www.springwise.com
   - consolidation & rationalisation opportunities

b. weather it out
   - sources of finance - eg government programs
   - policy maker attitudes about support

c. exit
   - market for potential buyers or investors
   - timing of competitor moves
Many firms make important strategic and tactical decisions without timely accurate information.

The average score is about 55% of the time, not much better than tossing a coin.

For about 23% of firms their decisions are worse than tossing a coin - ie less than 50% of the time.

So there is a lot of room for improvement, which is usually easy to make.
But the cost of competitive intelligence is relatively higher for SMEs

\[ y = 4.7613x^{-0.8112} \]

\[ R^2 = 0.496 \]

So an SME with only 50 employees, typically spends about nine or ten times more per $ of turnover than a firm with 1000 employees for competitive intelligence.

Putting this together for an alternative model...and a role for SCMC?

Summing up, to remain competitive in the face of crises and competitive tsunami, SMEs need:

- better cashflow - but banks are reluctant to lend to SMEs
- better intelligence - but this is expensive for SMEs
- better management - but SMEs do not have time to get this in a crisis
An alternative model using ICT and mobile technology

Traditional model:
Bank provides funds, but little advice or knowledge. SME only provides bank with information on a periodic basis.

Alternative ICT model:
Bank provides funds conditional on SME using knowledge and education services to stay competitive, using mobile technology. SME provides bank, via cellphone or computer, with information on a regular basis, is matched against data base, and advised on an exception process.
How it works...for the SME customer

1. An SME approaches a bank for a loan, on line or in person

2. The bank loan assessor may rate the credit risk as high based on normal criteria, but sees potential, so seeks further diagnostic assessment

3. The diagnosis reveals gaps in management skills, so the bank requires as a condition of the loan that the applicant undertake specific training and maintain up to date information on unique web site

4. Bank loan provided at discounted rate, backed by government credit guarantee

Better management and returns for the SME and bank
Better management and returns for the SME and bank

**How it works... for the bank**

1. Bank identifies opportunities to reduce risk of lending to SMEs via active risk management, and training of assessors/loan managers, moves more to IRB Basle II base

2. Appropriate relevant training developed, or bought in, and...

3. First tier of benefits from improved risk management and compliance as made available on-line to bank staff assessing or managing SME loans

4. Second tier of benefits from active risk management of SME clients, and as bank on-line learning platform is made available to SMEs
but requires a consortium approach, where SCMC may play an important role.

- **IT companies, Telcos**
  - Work with banks, government, Industry Associations etc to develop better access platforms and services, and to grow market.

- **Government agencies**
  - Collaborate in design, accreditation standards etc.

- **Banks**
  - Give access to SME clients to platform and content via an extranet, internet.
  - Monitors performance against portfolio, and improves risk selection and management.

- **Industry Associations**
  - Design curriculum in conjunction with SMEs, government, banks etc.
  - Implements assessment and accreditation.
  - Gives access to mentors.

- **Universities, Content Developers**
  - Design and update content in conjunction with industry associations, SMEs, banks, and government.
  - Role in accreditation and articulated education.

- **SME client**
  - Access to mentors and chat
  - Cases and examples
  - Assessment
  - Library and text
  - Content learning material
  - SME - Bank shared website
  - Intelligence and news
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Thank you!