Global TNCs and Local SMEs: How to Promote Linkages? Why?

This article traces the scope and dimensions of global opportunities that emerge in the era of globalisation through the rapid growth of Transnational Corporations (TNCs) which Indian SMEs could exploit, with a backdrop of SSI performance in India, particularly with reference to SSI exports. The article prescribes a dual strategy of vertical integration of local SMEs with global TNCs for the production of intermediate goods and horizontal cooperation through "networking" among local SMEs to link up with global TNCs for the production and marketing of consumer goods. The role of policy makers as a facilitator of the process is emphasised.

Small & Medium Enterprises (SMEs) play a predominant role in most developed and developing economies not only because of their number and variety but also due to their involvement in all segments of the economy. Their contribution to regional development, their complementary role to support the large sector, and as a basis for technological innovations and adaptations are widely acknowledged (APO, 2002). SMEs, in most countries, make up the majority of businesses and account for the highest proportion of employment. They produce about 25% of OECD exports and 35% of Asia's exports (Fisher and Reuber, 2000). SMEs account for a considerable share of industrial enterprises, employment and production and therefore, occupy a place of strategic importance in Indian economy as well.

However, since the early 1990s, SMEs have been exposed to intense competition due to the accelerated process of globalisation and therefore, their survival as well as growth is under strain. But globalisation has also led to the emergence of new opportunities through the rapid growth of TNCs in the global market and many SMEs would have taken advantage of these opportunities by linking themselves to these global TNCs.

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Does Globalisation hamper or pamper the Growth of Indian SMEs?

To ascertain whether globalisation hampers or pampers the growth of SMEs, it is essential to understand and demarcate SMEs from the rest of the manufacturing industry. But there is no official definition for an SME in India and therefore, a clear cut demarcation is not possible. The Government of India has officially defined a small-scale enterprise under the Industries Development and Regulation (IDR) Act, 1951, in terms of upper limit of original investment in plant & machinery at Rs.10 million (Ministry of SSI, 2003). But the recently introduced Small and Medium Enterprises Bill, 2005 (SIDO, 2005) has proposed a definition for a medium enterprise in terms of investment in plant & machinery in the range of Rs.50 million to Rs.100 million and proposed to revise the upper investment limit for a small-scale enterprise to Rs.50 million. If this definition is accepted, then SMEs would cover all enterprises having investment in plant & machinery up to Rs.100 million. But there is no single source of data, which provides statistics on the size and composition of SMEs in India. Therefore, growth analysis of SMEs in India in this article is confined to the growth of Small Scale

Industries (SSI) based on data provided by the SIDO (SIDO website). The growth trends in SSI in terms of units, employment, production and exports for pre-globalisation and globalisation periods are given in Table 1. They indicate that the growth of SSI has come down considerably in the globalisation period since 1990/91 compared to the pre-globalisation period of 1970s and 1980s.

emerging in the global market as a result of globalisation, exports as a percentage of total production in the SSI sector would have gone up in the globalisation period compared to the pre-globalisation period.

The annual share of exports in the production of SSI sector is presented in Figure 1. The annual share of exports in the production of SSI hovered around 5% to 6% in the pre-globalisation period during 1973/74 to 1990/91 but the share increased more or less, steadily since then: from about 6% in 1990/91 to almost 12% in 2002/03. This supports the argument that a considerable proportion of SSI enterprises in the globalisation period would have grown penetrating the international market rather than the domestic market.

Table 1: Growth of SSI in India: Pre-Globalisation & Globalisation Periods* (in %)

Period	*Units*	*Employment*	*Production*	*Exports*
Pre-Globalisation Period(1973/74-1990/91)	9.51	7.00	19.80	20.73
Globalisation Period(1990/91-2002/03)	5.18	3.96	13.92	19.98

** Compound Annual Growth Rates.* *Source: SIDO*

However, the decline is more drastic in terms of growth of units and employment relative to that of production and particularly, that of exports. While the growth of units and employment has declined by almost 50%, the decline of growth was less significant in production and only marginal in exports, in the globalisation period as compared to the pre-globalisation period. This could be the outcome of four factors: (1) New Small Scale Enterprises might not have come up as significantly in the globalisation period as in the pre-globalisation period due to the threat of competition, (2) Those new Small Scale Enterprises that have come up in the globalisation period might be much more capital-intensive than those that had come up in the past, (3) A significant proportion of existing Small Scale Enterprises might have strengthened their competitiveness through modernisation, among others, particularly to take advantage of the developments in the international market, and (4) Those Small Scale Enterprises, which lacked access to basic infrastructural facilities and which could not strengthen their competitiveness, would have exited from the market. If a considerable proportion of Small Scale Enterprises in India has grown by taking advantage of the opportunities

How SSI exports have grown in relation to total exports of the country is the other important issue. The share of SSI exports in total exports has gone up steadily (Figure 2). However, the increase was more significant in the pre-globalisation period than in the globalisation period: the share of SSI exports in total exports increased from about 16%

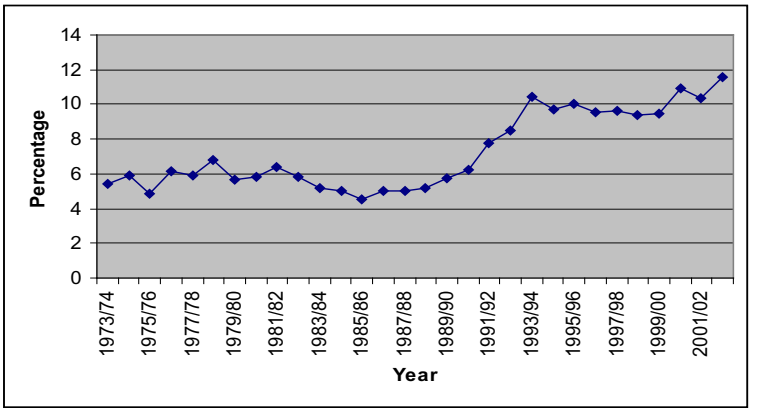

Figure 1: Exports as a Percentage of Production in SSI Sector: 1973/74 – 2002/03

in 1973/74 to about 30% in 1990/91 but thereafter the increase has been only modest. The share of SSI exports increased from about 30% in 1990/91 to about 36% in 1993/94 but declined steadily thereafter to about 33% in 1996/97, increased again to about 35% by 1998/99 and hovered around 33% to 34% till 2003/04. Considering the fact that, the economic environment in which SSI functions has become much more competitive since the early 1990s than in the past, even the modest increase in the share of SSI exports in total exports in the globalisation period can be treated as significant.

SSI export performance, both as a percentage of SSI production and as a percentage of total exports, indicates that the sector, at least partially, could sustain its competitiveness and grow with reference to the international market even in the era of globalisation. This could be due to the fact that those SMEs, which are competitive, would have grown catering to international demand rather than domestic demand. This necessitates us to understand what are the opportunities that globalisation offers to local SMEs and how the SME sector at large should exploit these global opportunities for their advantage in the future?

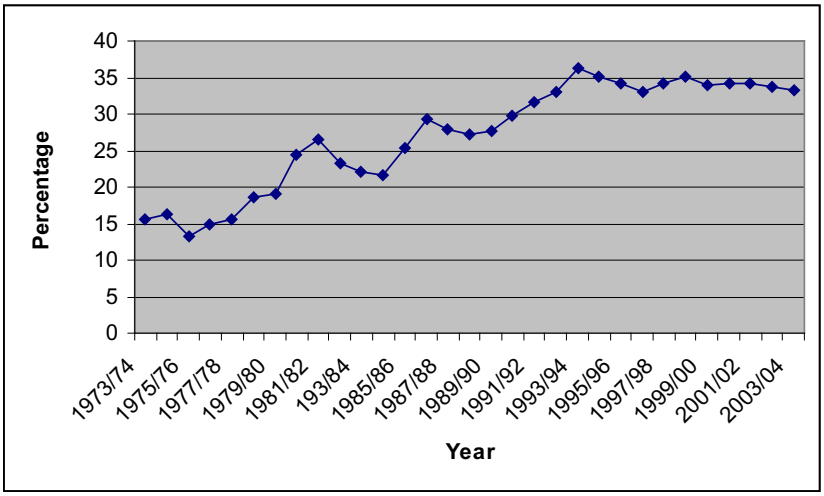

Figure 2: SSI Exports as a Percentage of Total Exports: 1973/74 – 2003/04

Global Opportunities through TNCs for Local SMEs: Scope and Dimensions

Globalisation has facilitated two major developments, both of which have significant implications for SMEs in developing countries like India: (1) Globally spread complex integration strategy of production network of Transnational Corporations (TNCs), and (2) Global expansion & procurement strategy of TNC Super Market Chains. Both are necessitated by the need for sustaining competitiveness in terms of cost and quality. Today competitiveness matters much more than in the past. TNCs are looking for firms, which could supply intermediate as well as consumer products of quality but at a reasonable price because they are under constant pressure to cut down costs to sustain their global competitiveness.

Complex Integration Strategies and Global Spread of Value Chains of TNCs:

Since the 1990s more and more TNCs adopt complex integration strategy as a means of enhancing competitiveness. Complex integration strategy is based upon a firm's ability to shift any part of its value chain to wherever it is most profitable. Complex integration reflects a willingness to locate various functional activities—not just production but also R&D, finance, accounting, procurement, etc.—wherever they can be done best to fulfil the firm's overall strategy (UNCTAD, 1993). TNCs have been adopting complex integration strategies because of major changes in the World economy. These include (a) advances in information technology, (b) cross-national convergence in demand patterns and (c) an intensification of competition world-wide (UNCTAD, 1993).

Firstly, advances in informatics and telecommunications have increased the capacity to process and communicate information, and have reduced costs. Information technologies are also critical in coordinating activities throughout the value chain. Information technology also allows the value chains of firms under separate ownership to become more integrated. As a result, TNCs are able to locate different parts of their value chains in diverse locations in the international market not only to procure raw materials and intermediate products but also to carry out various phases of their production and marketing activities, to improve efficiency and performance.

Secondly, demand patterns in the global market are converging partly due to a convergence in income levels leading to a similarity in spending patterns and partly due to the spread of communication technologies and an increase in tourism and educational and cultural exchanges. As a result, an increasing number of products of identical or similar design are being sold in many markets. Examples include clothing, electronic goods, cameras, automobiles, etc. Some TNCs have shifted to complex integration because they want to serve world-wide markets.

Thirdly, intensifying international competition has also been driving TNCs to adopt complex integration strategy. This is largely due to accelerating inflow of FDI, particularly since the late 1980s, due to the favourable regulatory changes world-wide for FDI inflows. The total FDI inflow, which was just US$ 59 billion in 1982 increased to US$ 208 billion in 1990 and US$ 648 billion in 2004. FDI inflow increased at an average annual growth rate of about 23% during 1986-1990 and about 21% during 1991-1995 but grew at a rapid rate of almost 40% during 1996-2000 (UNCTAD, 2005). What is more noteworthy is that the inward FDI performance index (calculated as a ratio of a country's share in global FDI inflows to its share in global GDP) increased steadily for developing countries from 0.977 in 1990 to 1.353 in 2004 and for South Asia from 0.115 in 1990 to 0.418 in 2004 (UNCTAD, 2005). All these have led to increasing competition world wide, particularly in developing countries like India. Increasing competition forces TNCs to adopt complex integration strategies through location of parts of the value chains abroad. According to a recent UNCTAD survey, India is the second most attractive global business location in the World, first being China (UNCTAD, 2005). This portends the likely dramatic increase of FDI into India in the future.

It is the increasing adoption of complex integration strategies by TNCs, among others, which has given a boost to the growth of international subcontracting relationship between SMEs of developing countries and TNCs of developed countries (UNCTAD, 2000). As part of the complex integration strategy, TNCs go for international subcontracting in a wide variety of industries such as automobiles, electronics, transport equipment, chemical products, leather products, garments, software, etc. Even horizontally linked activities such as HRD, R&D, procurement, finance & accounting, legal services, etc are outsourced. The steady growth of complex integration strategy widens opportunities for international subcontracting and encourages the vertical integration of SMEs with TNCs in the global market.

Subcontracting relationship offers multi-fold benefits for SMEs, particularly in the manufacturing sector. SMEs in general are found wanting in terms of technological robustness, marketing ability, financial resources and managerial skills. Subcontracting and supply relationships with large enterprises including TNCs are one of the few most important shortcuts to leapfrog over the "traditional" barriers and constraints on SMEs and their domestic and external competitiveness. Generally subcontracting and other collaborative supply relationships would help shorten the period for capacity building and ongoing learning needed by SMEs to come up with required product quality and

design, delivery timeliness plus their ongoing innovation and differentiation. All those are the major bridgeheads to the competitiveness of firms at the domestic or global level. TNCs can often be a valuable source of capital and modern technologies. Hondai (as quoted in Hayashi, 2002) identifies three major benefits, which SMEs can obtain from subcontracting transactions with large scale parent firms: (1) The reduction of information and transaction costs through subcontracting ties, which includes easy and cheap acquisition of new technologies, product designs, production processes, management methods, marketing and input materials, (2) The reduction of risks and uncertainty and an increase in the expected rate of profit as a result of stable orders and better payment conditions, and (3) The improvement of creditworthiness (eg: debt guarantee by parent firms).

Empirical evidence for how SMEs could benefit from subcontracting is available from the experience of Japanese manufacturing. Industrial subcontracting in Japan is unique due to its extensity as well as intensity. It is extensive because subcontracting relationship between SMEs and large firms is present in every two-digit level industry in Japanese manufacturing and it is intensive because on an average, about 50% to 63% of the SMEs have worked as subcontractors to large firms (by selling almost 100% of their output to their parent firms under subcontracting arrangements) since the 1960s. It was this subcontracting relationship, which played a major role in the qualitative transformation of Japanese SMEs over the period of three decades from 1960s up to 1980s. Rapid quantitative and qualitative developments in Japanese manufacturing leading to intense competition among large firms prompted them to invest/offer technical, managerial and financial assistance in/to subcontractors (Nishiguchi, 1994; Whittaker, 1997; Hayashi, 2005). The present global economic developments seem to offer similar opportunities and Indian SMEs should seize them for their development and growth.

Global Procurement and Global Spread of TNC Super Market Chains:

Another major development in the globalisation era is related to growth of TNCs in the services sector, particularly trade. In fact since the early 1990s, FDI has been growing remarkably in the services sector and as a result, the share of services sector in inward FDI stock increased from 49% in 1990 to 60% in 2002 (UNCTAD, 2005). Among services, FDI in trade has increased rapidly, particularly in developing economies and Central & Eastern Europe. FDI in trade in the world economy increased at an average annual rate of about 11% (from about US$ 174 billion in 1990 to about US$ 533 billion 2001) during 1990-2001 (UNCTAD, 2003).

An important development as a result of this rapid growth of TNCs in the trade sector is the global procurement of goods, particularly from developing countries, which provide economic sources for a wide variety of consumer goods for TNCs. The retailing industry has seen aggressive global procurement of goods and international expansion by many leading players in recent times: Wal-Mart of the US has been spreading into Latin America, Europe, China and South Korea and currently knocking the doors of India for entry; Carrefour of France has been rapidly expanding across Asia and Latin America; Royal Ahold of the Netherlands has been strengthening its presence in Europe, the US and Argentina. The entry of TNC Super Markets into India is only a matter of time. These global "Super Market Chains" (which are located primarily in industrialised and rapidly industrialising countries) acquire consumer goods globally, particularly from developing countries. (In the meantime, Indian metros have also been experiencing the growth of domestic super market chains such as Food World, Big Bazar, Nilgiris, etc. These super market chains also offer convenient market outlets for SMEs engaged in the production of consumer goods.)

Today, in many super market chains of Japan such as Akafudado and Daiei, SME products of

China have a significant presence, apart from that of South Korea, Taiwan and Thailand. The 99 Yen shops and 100 Yen shops in Japan, One-Pound shops in the UK and super markets in Australia are virtually flooded with Chinese goods, a significant proportion of which obviously is from SMEs. The global procurement and expansion of super market retail chains have been driven by the need to locate the best merchandise wherever available across the world and to generate new growth opportunities. This has again opened up vast global market opportunities for local SMEs in developing countries like not just China but also India.

Thus globalisation has led to the opening up of opportunities to SMEs from manufacturing TNCs as well as TNC Super Market Chains for both intermediate and consumer products. How and to what extent will Indian SMEs be able to exploit these global opportunities to their advantage?

How to Promote Linkages with TNCs to Exploit Global Opportunities for SMEs?

There is no smooth and comfortable route for Indian SMEs to exploit the global opportunities. Concerted efforts are needed on the part of the stakeholders—SMEs as well as the Government—to strengthen and promote the competitiveness of the sector and link the local SMEs with global TNCs. In the current competitive economic environment, it would be appropriate for SMEs to go for a dual strategy to exploit the global opportunities: (1) Vertical integration with TNCs, located within the country as well as abroad (for the production of intermediate goods), and (2) Horizontal cooperation (commonly known as "networking") with other SMEs (to cater to the large quantity demand of consumer goods from TNCs).

Vertical Integration with TNCs:

SMEs should be encouraged to go for vertical integration for the manufacturing of intermediate goods for TNCs located within the country as well as abroad. The ability of the SMEs to compete in the global market place depends on their access to certain critical resources the most important of which are finance, technology and managerial skills. TNCs have been an important means for SMEs to gain access to new technologies and management know-how (UNCTAD, 2000). Therefore, Indian Policy Makers, on a priority basis, should adopt policies to deepen the developmental effects of Foreign Direct Investment by attracting TNCs willing to forge such linkages and then to undertake measures to promote such linkages between TNCs and SMEs (Bala Subrahmanya, 2005). SMEs should be encouraged and guided to involve in "intra-national exports", that is, sales to foreign firms, which operate within the home country of the supplier (Acs and Preston, 1997). A suitable strategy needs to be developed at the state level, to encourage the already established TNCs to forge links with the local SMEs who have "certain minimum technological capabilities". This is important because the type and strength of linkages established depends to a large extent on the technological and other resource capabilities of local firms (UNCTAD, 2000).

Similarly, efforts should be made for progressively linking Indian SMEs with global TNCs through international subcontracting. In the long run, international subcontracting relationship should act as the means of sustaining the competitiveness of such SMEs. Schmitz (2005) concludes from recent studies that in chains characterised by captive (subcontracting) relationships, developing country producers experienced rapid product and process upgrading. It will be worthwhile for SME Associations to hire global consultants to find "ways and means" to join international subcontracting linkages with TNCs.

Horizontal Cooperation through Clustering & Networking:

In both developed and developing countries there is mounting evidence that clustering

and networking helps SMEs to raise their competitiveness (Humphrey and Schmitz, 1995). Through networking, individual SMEs can address the problems related to their size and improve their competitive position (Ceglie and Dini, 1999). Through horizontal cooperation (that is, with other SMEs occupying the same position in the value chain), SMEs can collectively achieve scale economies beyond the reach of individual small firms and can obtain bulk-purchase inputs, achieve optimal scale in the use of machinery and pool together their production capacities to satisfy large-scale orders (Pyke, 1992).

Cooperation between SMEs located in the same value chain can occur even when large clusters of firms do not exist. Such cooperation between SMEs can be advantageous for mutual learning and collective innovation. Networking of SMEs is not necessarily tied to being in the same locality and can still lead to collective efficiency. The external economies tend to be small but the gains from joint action can be substantial (Humphrey and Schmitz, 1995). But evidence shows that in spite of the potential benefits for SMEs, inter-firm cooperation and networking do not always emerge spontaneously (Ceglie and Dini, 1999).

Indian policy makers have been laying emphasis on the promotion of clusters. Cluster development approach has been adopted by different institutions that are involved in SME development such as SIDBI, SBI and NPC, apart from SIDO. However, these approaches primarily aim at technology development, modernisation and energy & environmental conservation (Bala Subrahmanya, 2004). But they do not aim at linking the SMEs with TNCs for their market expansion and growth. Further, "networking" has not yet been an objective of India's SSI policy. In fact, evidence shows that horizontal cooperation among SMEs does not emerge spontaneously even though it confers benefits of various kinds on SMEs. Therefore, there is a need for intervention of an external agent acting as a catalyst for promoting horizontal cooperation among SMEs. Indian SME policy should explicitly adopt this strategy and facilitate SMEs to link with TNCs.

Conclusion

The growth of SSI segment of SME sector in India has come down considerably in the era of globalisation. The decline of growth has been conspicuous in terms of units, employment and production but not exports. SSI sector has grown more towards the international market than towards the domestic market in the globalisation era. This is substantiated further by the fact that SSI exports as a percentage of SSI production as well as of total exports has improved considerably in the recent period compared to the earlier period. This could be because globalisation has led to the emergence of new opportunities for SMEs in the international market. Those SMEs, which are competitive, would have gained significantly by exploiting these opportunities.

Globalisation has been offering the global market to SMEs primarily through facilitating two major developments: adoption of complex integration strategy for their production network by TNCs and global procurement strategies & global expansion of TNC super market chains. The former offers scope for vertical integration through international subcontracting for the production of intermediate goods whereas the latter for horizontal cooperation among SMEs in the production of consumer goods to cater to the large scale demand of TNC super markets. Both vertical integration with TNCs and horizontal cooperation among SMEs would be beneficial as it would facilitate SMEs to overcome their traditional barriers in terms of technological, financial and marketing deficiencies. While SMEs should take pro-active role in adopting these strategies to penetrate the global market steadily and successfully, the role of Policy Makers as a facilitator is equally crucial and imperative. How far both SMEs and Policy Makers would make efforts towards the "successful adoption" of these strategies, would be decisive for the future SME development in India. ❐