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Micro, small and medium enterprises (MSMEs) in the Philippines: What we know and what we don't know

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ABSTRACT

The availability of national firm level data particularly on micro enterprises in many developing countries still remains limited up to this date. The Philippines is no exception, which in turn limits the extent of empirical analysis on the economic contributions of micro, small and medium scale enterprises. This paper presents a novel dataset of Philippine micro, small and medium enterprises and the existing literature concerning the challenges and development issues of MSMEs in the industrial and developing countries. Using a dataset on over 1,700 MSMEs collected as part of the AIM Policy Center's Enterprise Survey 2009, this paper discusses the characteristics of these firms and their perceptions on government policies on improving the business environment. This paper also draws on the wider literature on this topic in order to map out key areas where further information and evidence on Philippine MSMEs could be useful in informing more nuanced and possibly better-fitting policies.

INTRODUCTION

Many consider micro, small and medium enterprises (MSMEs) an important lever of inclusive growth. Small(er) firms receive special focus in the development policy literature, as these tend to be associated with microfinance, low skilled labor and rural sector prevalence—all part of the realities faced by the poor.[1] Unsurprisingly promotion of MSMEs are often a key plank in countries' development strategies. The Philippine Development Plan published in March 28, 2011, for example, noted that "the Philippine MSME sector is a critical driver for the country's economic growth. The sector serves not only as potential supplier and subcontractor to large enterprises but is also a part of the support system for logistics services." (p.74). Further, the studies reviewed by Roxas (2007) concluded that a competitive MSME sector in developing and emerging countries is a precondition for sustainable development because they generate massive employment, help diversify economic activity, and contribute significantly to local development.

Nevertheless, systematic data collection on MSMEs remains sparse in many developing countries, and this is notably the case in the Philippines. With the exception of a few administrative and survey-based data sources, detailed information on Philippine MSMEs is largely missing, in turn limiting the extent of empirical analysis on various aspects surrounding their contribution to economic and human development. Without this detailed information, policies may not necessarily respond to the different challenges faced by micro, small and medium scale firms, resulting in one-size-fits-all strategies that may not work at all. In order to help address this information gap, this paper briefly reviews the existing datasets on Philippine MSMEs, and it provides what could be the first descriptive and detailed analysis of MSMEs using a novel dataset on over 1,700 MSMEs collected as part of the AIM Policy Center's Enterprise Survey 2009. This paper also draws on the wider literature on this topic in order to map out key areas where further information and evidence on Philippine MSMEs could be useful in informing more nuanced and possibly better-fitting policies.

In what follows, section 1 briefly revisits various definitions of MSMEs and the data sources on these firms in the Philippines. Section 2 examines a novel dataset on over 1,700 MSMEs surveyed in 2009, in order to paint more nuanced profiles of these firms. Section 3 reviews the wider literature on the topic while section 4 highlights some enterprise studies in the

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[1] Ayyagari, Demirguc-Kunt, Maksimovic (2011), Aldaba (2008),Leidholm (2001), Marcucci (2001), Leidholm and Mead (1993), and McPherson (1991).

country. In the last section, the paper concludes with recommendations on key areas for further research in order to better understand the dynamics of MSMEs and their role in inclusive growth.

I. DEFINITION AND STRUCTURE

There are many definitions of MSMEs. Industrial countries like the United States use employment size of less than 500 to describe small enterprises.[2] In developing countries, where market size and firm size are much smaller, employment size of less than 100 or 250 are often used (Biggs, 2003). In the Philippines, the Republic Act No. 9501 or the Magna Carta for Micro, Small and Medium Enterprises defines MSMEs as any business activity or enterprise, whether single proprietorship, cooperative, partnership or corporation, engaged in industry, agribusiness, trade, and services, categorized based on total assets as follows:

Micro	:	not more than PHP 3,000,000
Small	:	PHP 3,000,001 – PHP 15,000,000
Medium	:	PHP 15,000,001 – PHP 100,000,000
Large	:	above PHP 100,000,000.

Alternatively, the Micro, Small and Medium Enterprise Development Council (MSMED Council) of the Philippines adopts a categorization based on the number of employees:

Micro	:	1 – 9 employees
Small	:	10 – 99 employees
Medium	:	100 – 199 employees
Large	:	more than 200 employees.

The main source of MSME data in the Philippines is the National Statistics Office (NSO). The agency uses the categorization based on employment size in its establishment surveys. From 1999-2010, 91 to 92 percent of all establishments in the country are micro (see table 1), while on the average small- and medium-sized enterprises are only 8 and 0.4 percent respectively. Similar to the number of medium enterprises, large enterprises only account for 0.4% on the average of the total number of enterprises for the 11-year period. This data shows

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[2] The United States Small Business Administration defines a small business for research purposes as an independent business having fewer than 500 employees.

that for each size, the number of enterprises has not been increasing significantly. Establishments are exiting the market every year as seen in the year-on-year negative growth rates for each size category. On the average, micro enterprises have a negative growth rate of 0.5% while small enterprises have -0.8%. Alarmingly, the medium enterprises recorded the most declines with -1.3% on the average. These figures manifest the missing middle phenomenon experienced by most of the developing countries (UNCTAD, 2001; Gomez, 2008).

Table 1. Number of Establishments by Firm Size (1999-2010)

Year	Micro			Small			Medium			Total MSMEs			Large			TOTAL
	total	%	g.r.	total	%	g.r.	total	%	g.r.	total	%	g.r.	total	%	g.r.	
1999	751,543	91%		68,781	8%		3,239	0.4%		823,563	99.6%		3,206	0.4%		826,769
2000	747,740	91%	-0.5%	67,166	8%	-2.3%	3,070	0.4%	-5.2%	817,976	99.6%	-0.7%	2,984	0.4%	-6.9%	820,960
2001	743,948	92%	-0.5%	61,759	8%	-8.1%	2,923	0.4%	-4.8%	808,630	99.6%	-1.1%	2,958	0.4%	-0.9%	811,588
2002	743,426	92%	-0.1%	60,566	7%	-1.9%	2,874	0.4%	-1.7%	806,866	99.7%	-0.2%	2,594	0.3%	-12.3%	809,460
2003	743,628	92%	0.0%	60,785	8%	0.4%	2,922	0.4%	1.7%	807,335	99.6%	0.1%	3,027	0.4%	16.7%	810,362
2004	713,566	91%	-4.0%	64,501	8%	6.1%	2,980	0.4%	2.0%	781,047	99.6%	-3.3%	2,876	0.4%	-5.0%	783,923
2005	714,675	91%	0.2%	62,811	8%	-2.6%	2,851	0.4%	-4.3%	780,337	99.7%	-0.1%	2,643	0.3%	-8.1%	782,980
2006	720,191	92%	0.8%	57,439	7%	-8.6%	2,839	0.4%	-0.4%	780,469	99.7%	0.0%	2,596	0.3%	-1.8%	783,065
2007	720,084	92%	0.0%	58,198	7%	1.3%	2,919	0.4%	2.8%	781,201	99.7%	0.1%	2,668	0.3%	2.8%	783,869
2008	697,077	92%	-3.2%	58,292	8%	0.2%	3,067	0.4%	5.1%	758,436	99.6%	-2.9%	2,973	0.4%	11.4%	761,409
2009	710,863	91%	2.0%	63,555	8%	9.0%	3,007	0.4%	-2.0%	777,425	99.6%	2.5%	3,080	0.4%	3.6%	780,505
2010	709,899	91%	-0.1%	61,979	8%	-2.5%	2,786	0.4%	-7.3%	774,664	99.6%	-0.4%	3,023	0.4%	-1.9%	777,687
Average	**726,387**	**91%**	**-0.5%**	**62,153**	**8%**	**-0.8%**	**2,956**	**0.4%**	**-1.3%**	**791,496**	**99.6%**	**-0.5%**	**2,886**	**0.4%**	**-0.2%**	**794,381**

Note: g.r. - growth rate
Source: National Statistics Office

Based on the 2009 List of Establishments of the National Statistics Office (NSO), there are 780,437 business establishments operating in the Philippines. Based on employment size, micro enterprises represent 91.4% (710,822) of the total number of establishments, small enterprises at 8.2% (63,529), medium enterprises at 0.4% (3,006), and large enterprises at 0.3% (3,080) (see table 2). In terms of industry classification, 50% of the MSMEs are in the wholesale/retail trade and repair services sector, followed by the manufacturing sector at 14%. The large enterprises, on the other hand, are being dominated by the manufacturing sector at 31%.

Table 2. Total Number of Establishments by Industry and Firm Size

SECTOR	Micro	Small	Medium	Total MSMEs		Large		TOTAL
Agriculture, Hunting and Forestry	2,616	1,161	115	3,892	96.7%	132	3.3%	4,024
Fishery	886	255	28	1,169	97.5%	30	2.5%	1,199
Mining and Quarrying	262	126	16	404	95.5%	19	4.5%	423
Manufacturing	101,214	9,896	887	111,997	99.2%	953	0.8%	112,950
Electricity, Gas and Water	502	690	118	1,310	92.4%	107	7.6%	1,417
Construction	1,307	983	122	2,412	95.0%	127	5.0%	2,539
Wholesale and Retail Trade	366,291	18,884	458	385,633	99.9%	292	0.1%	385,925
Hotels and Restaurants	87,732	9,405	165	97,302	99.9%	64	0.1%	97,366
Transport, Storage and Communications	6,976	2,178	153	9,307	98.5%	137	1.5%	9,444
Financial Intermediation	21,503	4,837	107	26,447	99.5%	131	0.5%	26,578
Real Estate, Renting and Business Activities	42,365	4,920	385	47,670	98.5%	705	1.5%	48,375
Education	7,619	6,095	280	13,994	98.5%	211	1.5%	14,205
Health and Social Work	30,044	1,405	124	31,573	99.6%	112	0.4%	31,685
Other Community, Social and Personal Service Activities	41,546	2,720	49	44,315	99.9%	60	0.1%	44,375
Average	**50,776**	**4,540**	**215**	**55,530**	*97.9%*	**220**	*2.1%*	**55,750**
Total	**710,863**	**63,555**	**3,007**	**777,425**		**3,080**		**780,505**

Source: National Statistics Office

In the aggregate, MSMEs account for a large share of total employment. In 2009, MSMEs employed 63% of the total number of workers in all business establishments. Of the total number of jobs generated by MSMEs, micro enterprises account for 48%. Table 3 shows that 35% of the jobs are generated by MSMEs in the wholesale/retail trade and repair services sector while 18% are from the manufacturing sector. Among large enterprises, the manufacturing sector comprised 32%, followed by real estate renting and business activities at 27%.

Table 3. Total Number of Employees by Industry and Firm Size (2009)

SECTOR	Micro	Small	Medium	Total MSMEs		Large		TOTAL
Agriculture, Hunting and Forestry	9,808	33,385	16,315	59,508	42%	83,675	58%	143,183
Fishery	3,383	6,637	3,959	13,979	52%	13,139	48%	27,118
Mining and Quarrying	1,039	3,642	2,304	6,985	27%	19,328	73%	26,313
Manufacturing	259,534	254,489	123,501	637,524	49%	674,012	51%	1,311,536
Electricity, Gas and Water	2,564	21,079	17,030	40,673	44%	51,905	56%	92,578
Construction	5,429	30,459	16,975	52,863	36%	93,657	64%	146,520
Wholesale and Retail Trade	817,124	370,740	62,589	1,250,453	91%	125,662	9%	1,376,115
Hotels and Restaurants	233,396	227,301	21,660	482,357	95%	24,281	5%	506,638
Transport, Storage and Communications	26,463	54,675	20,727	101,865	49%	105,677	51%	207,542
Financial Intermediation	80,738	85,884	14,112	180,734	54%	156,413	46%	337,147
Real Estate, Renting and Business Activities	109,368	122,355	52,683	284,406	33%	568,199	67%	852,605
Education	31,594	154,077	39,345	225,016	71%	93,134	29%	318,150
Health and Social Work	51,031	35,024	17,628	103,683	66%	53,968	34%	157,651
Other Community, Social and Personal Service Activities	99,611	49,286	6,698	155,595	83%	31,248	17%	186,843
Average	**123,649**	**103,502**	**29,680**	**256,832**	*56%*	**149,593**	*44%*	**406,424**
Total	**1,731,082**	**1,449,033**	**415,526**	**3,595,641**		**2,094,298**		**5,689,939**

Source: National Statistics Office

This section provided an overview of MSMEs in the Philippines by looking at the official government definition of MSMEs and the changing structure of these enterprises over time.

However, due to confidentiality issues in the establishment surveys of NSO, firm level data are not publicly available, limiting the analysis at the macro level. In what follows, a novel dataset of MSMEs is presented that could offer a better understanding of Philippine enterprises at the firm level.

II. PROFILE OF PHILIPPINE MSMEs

Available statistics on Philippine enterprises are usually at the macro or aggregate level. Firm level information is limited that could provide greater understanding on the dynamics of these enterprises. Garcia et al. (2007) noted that the lack of an official, comprehensive and updated database has been a perennial problem among researchers and policy makers doing policy and research work on MSMEs (see annex 1). The cost of data collection is also too high due to the large number of enterprises. Hence, only a few undertake firm level data collection/surveys.

The AIM Policy Center's Enterprise Survey 2009 provides an extensive set of data of the country's micro, small and medium enterprises.[3] A nationwide survey was conducted across twenty-nine (29) cities outside the National Capital Region. The methodology involved face to face interviews using a structured questionnaire. The respondents were randomly selected based on the official list of business establishments provided by the cities covered. There are sixty (60) respondents per city and thirty (30) of which are from micro enterprises while the remaining thirty (30) are from small and medium enterprises. A total of 1,740 respondents, mainly owners, managers, or owner-managers, were interviewed.

The APC Enterprise Survey provides one of the largest dataset describing certain characteristics of firms. It shows the aspects on which the different categories of enterprises are similar and disparate. From the discussion that follows, it is evident that in order to effectively craft policies promoting the development of the sector, there is a need to consider how structure of enterprises differ across size categories. The study also features a good coverage of microenterprises. The official data from the National Statistics Office on micro, small, and medium enterprises contains a wide coverage of the sector but certain limitations were set to microenterprises as it does not cover the following: sari-sari stores with no regularly paid employee; sellers in open stalls in public markets; operators of tricycles, jeepneys, calesas and pedicabs; government postal and telegraphic offices; letting and operating of real estate; public

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[3] The data was generated as part of the Philippine Cities Competitiveness Ranking Project.

education; public medical, dental and health services; and activities of membership organizations. Chua (2004) emphasized that a good coverage of microenterprises is important as the development of the sector is seen as a good strategy to bring about pro-poor economic growth. The APC Enterprise Survey provides a better coverage of these micro enterprises.

Ownership. The survey data shows that majority of Filipino MSMEs (46%) are managed by its owners especially among microenterprises (55%) as shown in figure 1 below.

Figure 1. Ownership of Enterprises
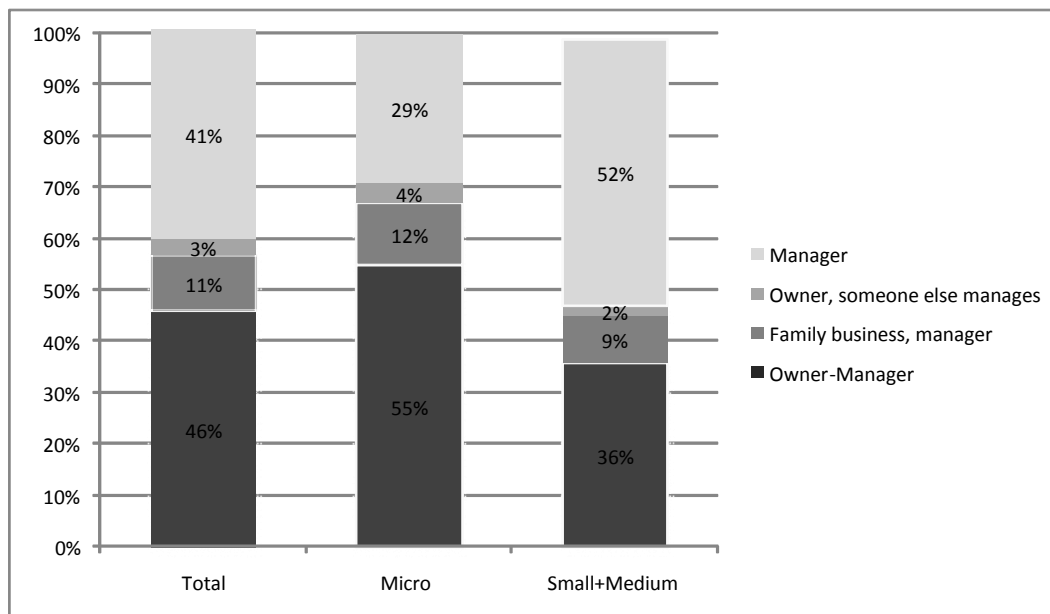
Enterprises being managed by its owners pose several advantages. The owner-manager is essentially the definitive decision-maker, thus affecting the operation and revenues of the business (Culkin & Smith, as cited by Dunning, 2003). Innovation can be easily formulated and implemented since decision-making go through fewer hierarchy level than large firms. Most MSMEs also operate in niches and have direct contact to customers, making them more aware of customer feedback, which could facilitate better innovation as compared to large enterprises (Tiwari & Buse, 2007). Furthermore, the majority (62%) of the managers who participated in the survey have been handling the business for less than five years, making them more open to developing products that will better suit the market demands. It would be interesting to explore the type of ownership of these enterprises whether they are sole proprietors or corporations for better policy recommendations.

Gender. The gender dimension of MSME development is also evident in the study. Sixty three (63%) or 2 out of 3 respondents in the study are female managers/owners. Of the 63%, 52% are in micro while the remaining 48% are in small & medium enterprises. Within the Asia-Pacific Region, the share of women SME owners is evident with 35% of all SMEs being headed by women. Among the 24 markets covered in Asia-Pacific, Middle East and Africa, the Philippines ranked second in terms of entrepreneurial activity rate of female at 40.1% (Women-owned SMEs in Asia/Pacific, Middle East and Africa: An Assessment of Business Environment, 2010). Further research can also be done on the survival rate of enterprises that are being managed by women, how it differs in management style, and whether this has an effect on the performance of the firm.

Initial capitalization. The data shows that 30% of the respondents started their business with a capital of less than PHP 150,000. During the time of the survey, 50% have already achieved an asset value of PHP 150,000 to less than PHP 3 million. This means that 522 out of the 1,740 enterprises that were surveyed grew in terms of asset value since its first operation (see figure 2). The data also verifies the proliferation of microenterprises in the country, with around 59% that started as a microenterprise. According to Chua (2004), this is the low households' response to market opportunities. These enterprises are usually in the form of sari-sari stores, and other businesses that offer goods and products that are readily consumable.

Figure 2. Initial capitalization and present asset value of enterprises

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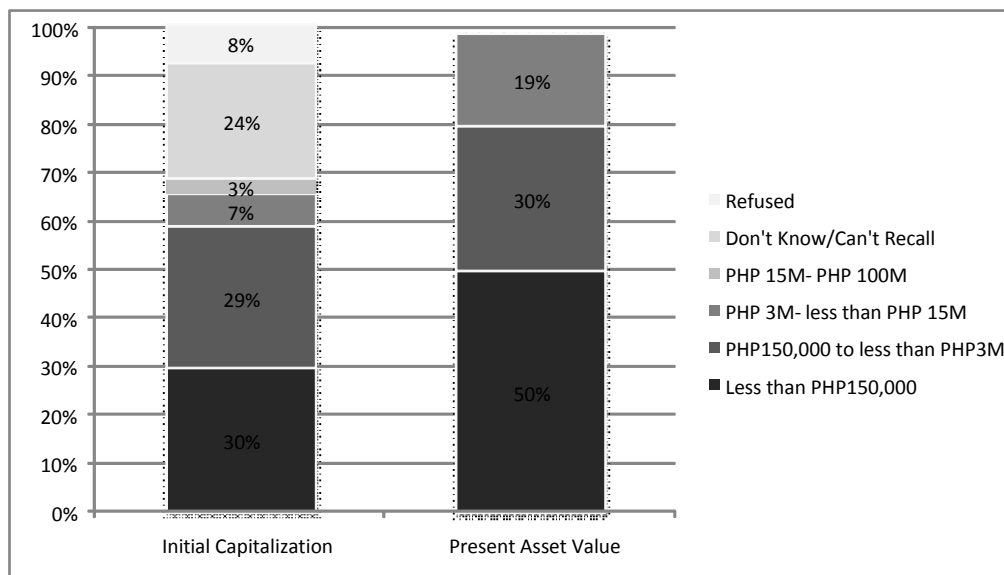
Age of firm. On the average, the microenterprises included in the study have been in operation for 12 years, while the small and medium enterprises have been around for 15 years. As seen in figure 3, as firms mature, the number of enterprises with present asset value of PHP 150,000 to less than PHP 3 million decreases while those with present asset value of PHP 15 million to PHP 100 million increases with age. These patterns pose interesting questions on how long would a micro enterprise graduate to small enterprise and whether bigger enterprise is better than the small ones in terms of productivity and other economic contributions.

Figure 3. Firm age and present asset value
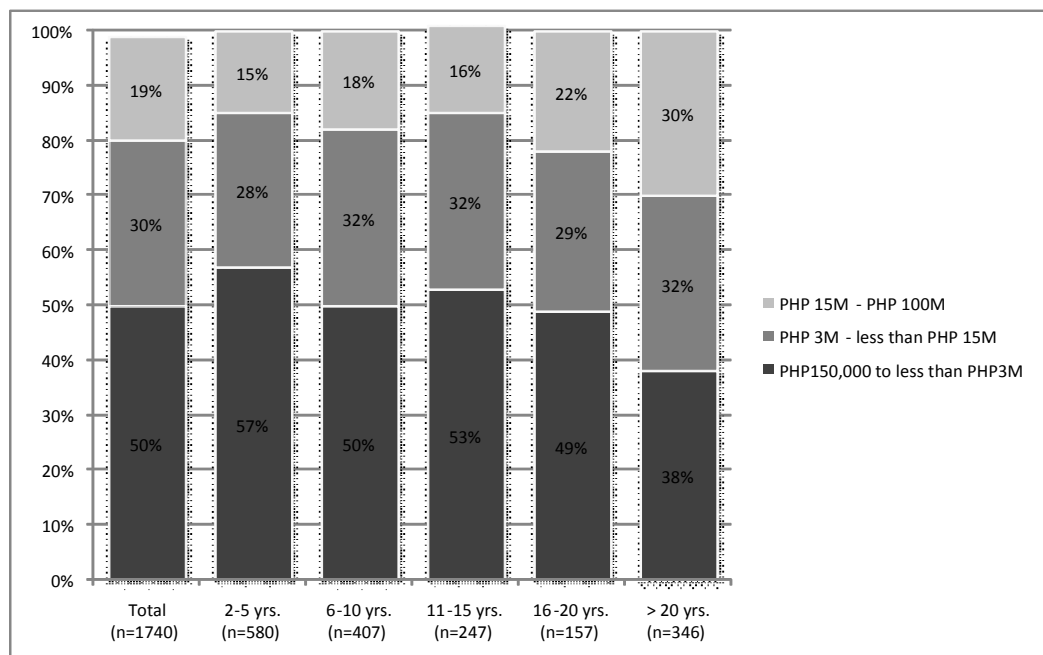
Starting a Business. Respondents were asked on what they see as important factors to starting a business. Table 4 shows that the two top factors for both micro and small-medium enterprises are low start-up cost or capital and strategic location. Interestingly, entrepreneurs did not regard the regulatory cost of doing business, infrastructure, and macroeconomic instability as constraints to starting a business. These factors are the major constraints to doing business identified in the survey of enterprises in the Philippines commissioned by the Asian Development Bank (Pernia, 2008). The study of Klapper, Lewin, and Delgado (2009) using the data from the World Bank's Enterprise Surveys covering 99 countries also indicates that a better business environment promotes greater entrepreneurial activity.

Table 4. Top 10 Factors Considered Important by Entrepreneurs in Starting a Business

Factors	Micro		Small & Medium	
	Rank	%	Rank	%
Low start-up cost or capital / *"maliit lang ang puhunan"*	1	27.8	1	21.4
Strategic / *"matao or daanan ng tao"*	2	19.1	2	16.3
Near target market for product or service / *"malapit sa target customers"*	3	11.8	5	7.9
Continuing family business or legacy / *"itinutuloy lang ang sinimulang ng pamilya"*	4	11.3	3	13.2
Source of income / *"gustong kumita o kailangan ng pera"*	5	10.7	7	7.7
Accessible to customer transportation / *"malapit sa sakayan"*	6	10.5	4	11.1
Sellability of product or service / *"mabenta o madaling ibenta"*	7	9.5	5	7.9
Experience in running a business / *"marunong na sa business"*	8	6.9	8	6.7
Entrepreneurial spirit or the want to start a business / *"hilig o gustong magnegosyo, ayaw na maging empleyado"*	9	6.6	9	6.5
Profitability of product or service / *malakas/mataas ang kita*	10	4.2	10	5.8

Note: No. of observations for micro is 619 while small and medium is 416.
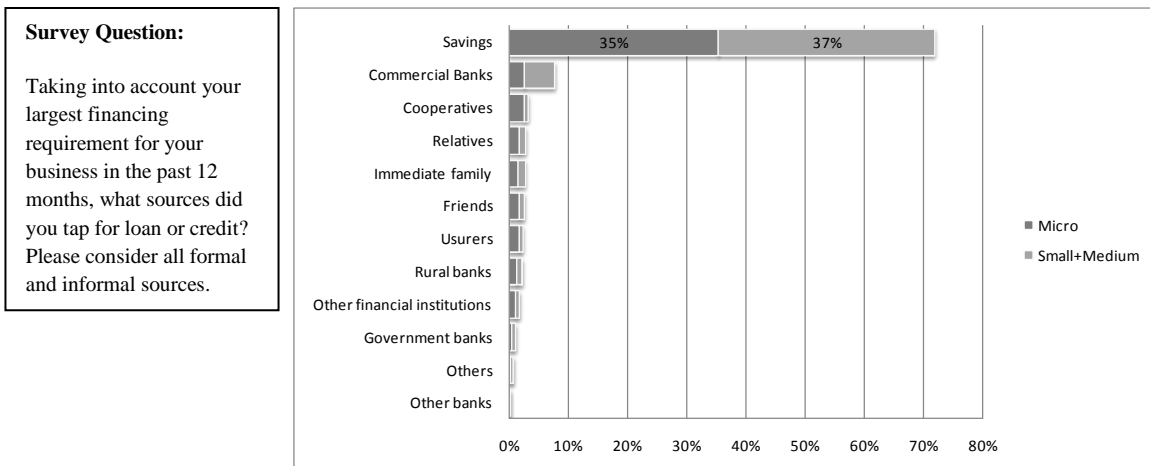Source: Philippine Cities Competitiveness Ranking Project 2009

Relocation of business. It is also important to note that majority of the enterprises were very reluctant to relocate even if moving costs were not that high hypothetically ("If moving cost were not an issue, I would locate this business to another city"). As shown in figure 4 below, the response of micro and small-medium enterprises are the same in almost all aspects. For instance, 18% of both micro and small-medium enterprises disagree with moving to another city while only 3% agree with the idea of relocating. This could be related to the strong cultural and social factors that influence entrepreneurs in starting a business such as the strong familial ties of Filipinos. This necessitates further studies on how these factors influence the expansion of businesses and how it eventually affects the growth and graduation of enterprises.

Figure 4. Reluctance of entrepreneurs to relocate

Survey Question:

If moving cost were not an issue,
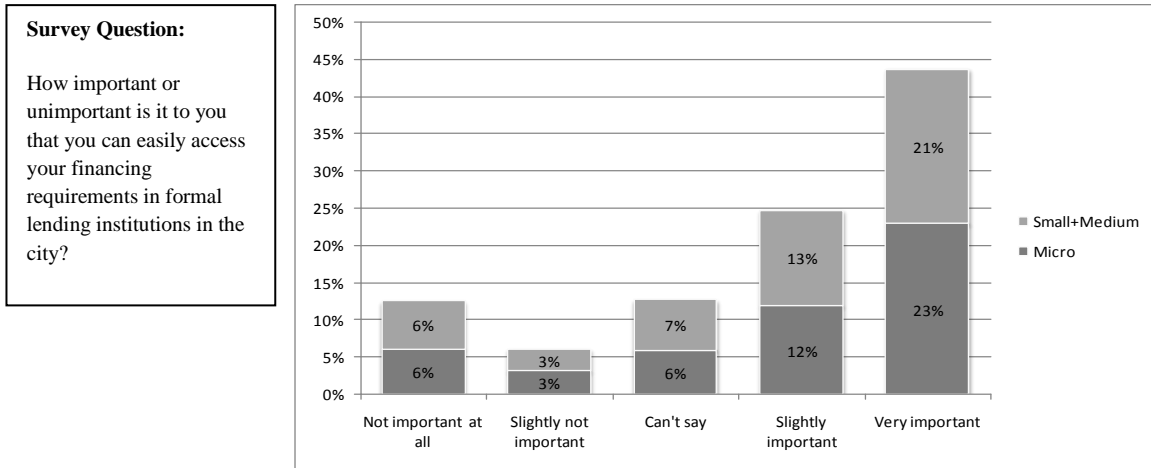I would locate this business to another *city*
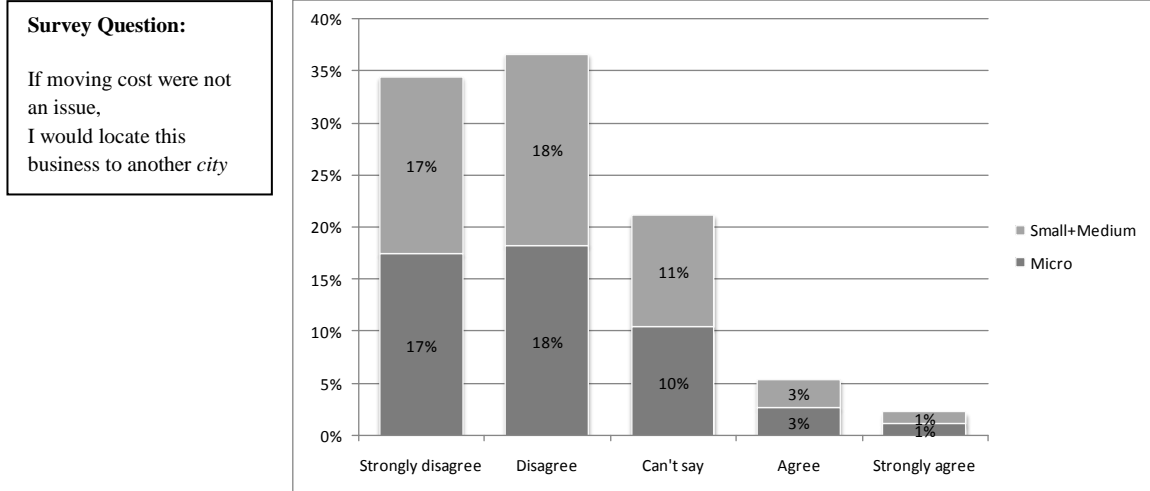
Access to finance. The study reveals that generally, MSMEs has very low access to formal lending institutions as manifested by the large percentage of micro and small-medium enterprises (35% and 37% respectively) using their own savings for business needs (see figure 5). Despite this low access to credit, 43% of the respondents still consider access to credit to be very important in their business operations (see figure 6). The percentage of micro enterprises that consider access to formal lending institutions is higher by 2% compared to small and medium enterprises (23% vs. 21%). The results in other responses did not vary significantly between the two enterprise categories.

Figure 5. Sources of credit

Survey Question:

Taking into account your largest financing requirement for your business in the past 12 months, what sources did you tap for loan or credit? Please consider all formal and informal sources.

Figure 6. Importance of formal lending institutions

Survey Question:
How important or unimportant is it to you that you can easily access your financing requirements in formal lending institutions in the city?

Lamberte (2001) recognized that in the Philippines, while the policy environment of financial institutions improved considerably since the early 1990s, some banks still face some constraints in extending their services to MSMEs. This is validated by the results of the survey, which shows that some enterprises prefer informal sources of credit as seen in table 5 below.

Table 5. Top 5 Reasons for Borrowing from Informal Sources

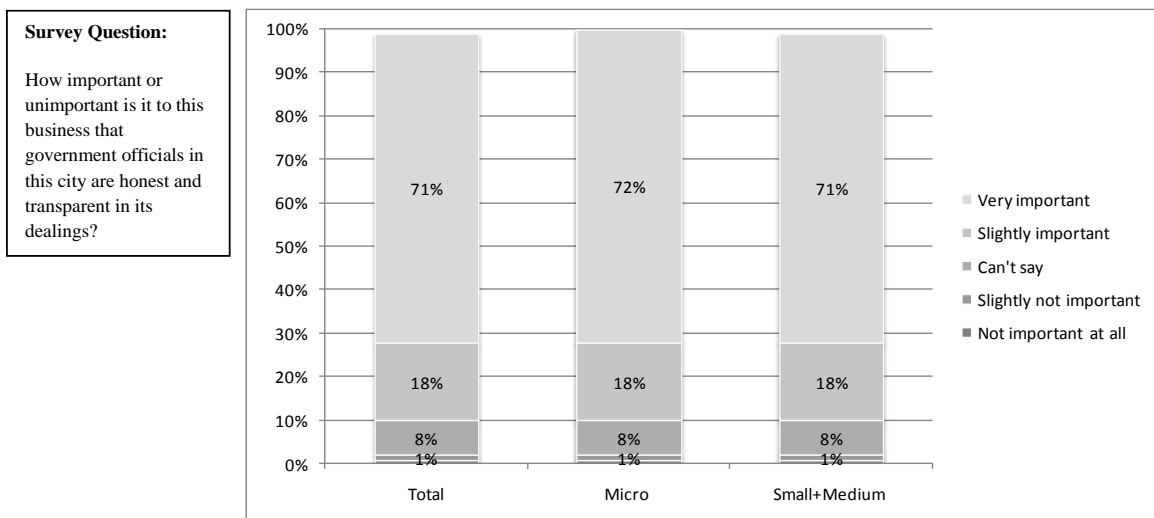| Reasons	Micro		Small & Medium	
	Rank	%	Rank	%
No interest/ very little interest / "walang tubo o maliit anf interes"	1	54	1	74
Fast transactions / "mabilis o madaling makautang"	2	30	2	28
No requirements or less requirements are needed / " wala o kaunti lang ang requirements"	3	26	3	19
Pay only when able or flexible payment schedule / "hindi pwersahang magbayad o pwedeng mapakiusapan pag walang pambayad"	4	20	4	9
No collateral needed / "hindi naghihingi ng collateral"	5	19	4	9

Note: No. of observations for micro is 74 while small and medium is 43.
Source: Philippine Cities Competitiveness Ranking Project 2009
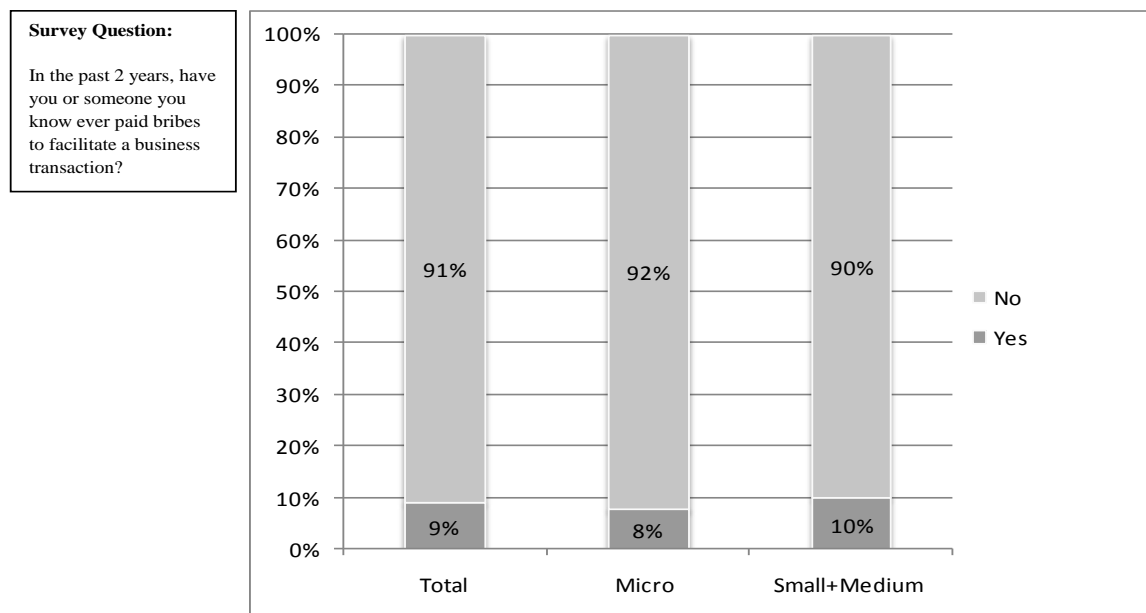
Corruption burden. Corruption remains to be one the challenges that affects doing business in the Philippines. An anti-corruption manual for SMEs prepared by AIM Hills Program on Governance in 2011 points that enterprises are the common target of government officials asking for bribes. Further, according to a survey on good local governance of the Social Weather Stations (SWS) among individuals in 2010, 69% believed that "*the sources of corruption are the government employees who ask for bribes*".

This is validated by the findings of the APC Enterprise Survey showing that most entrepreneurs gave high importance to honesty and transparency of their local government units. As illustrated in figure 7, 71% of the respondents found it very important to have honest and transparent government officials in their city. This perception is shared by entrepreneurs regardless of the size of the enterprise (72% for micro and 71% for small and medium).

**Figure 7. Importance of government officials being honest and transparent**

Survey Question:

How important or unimportant is it to this business that government officials in this city are honest and transparent in its dealings?

Figure 8. Incidence of bribery in the past two years

Survey Question:

In the past 2 years, have you or someone you know ever paid bribes to facilitate a business transaction?

Incidence of corruption is also experienced by MSMEs in other countries. For instance in India, SME Times News Bureau (2011) reported that almost all Indian SMEs have been victims of corrupt officials at least once. In the Philippines, a survey of enterprises conducted by SWS in 2003 showed that 72% reported to have been asked for a bribe on taxes or licenses transactions while another 35% reported a bribery incidence connected to a government transaction. The incidence of bribery as perceived by MSMEs in the APC Enterprise Survey is quite low compared to these surveys. As illustrated in figure 8, only 9% experienced or knew someone who had to pay bribes to facilitate a business transaction. The perception of MSMEs on the prevalence of corruption in the city is also quite low as shown in figure 9 below. The anti-corruption manual of AIM Hills Program provided some good guidelines for SMEs in implementing programs to avoid the incidence of corruption. These include, among others, a) make it a policy to prohibit bribery in any form, b) implement a policy on gifts and entertainment, c) require that conflicts of interest be declared, and d) create a code of conduct.

Figure 9. Overall rating on the prevalence of corruption
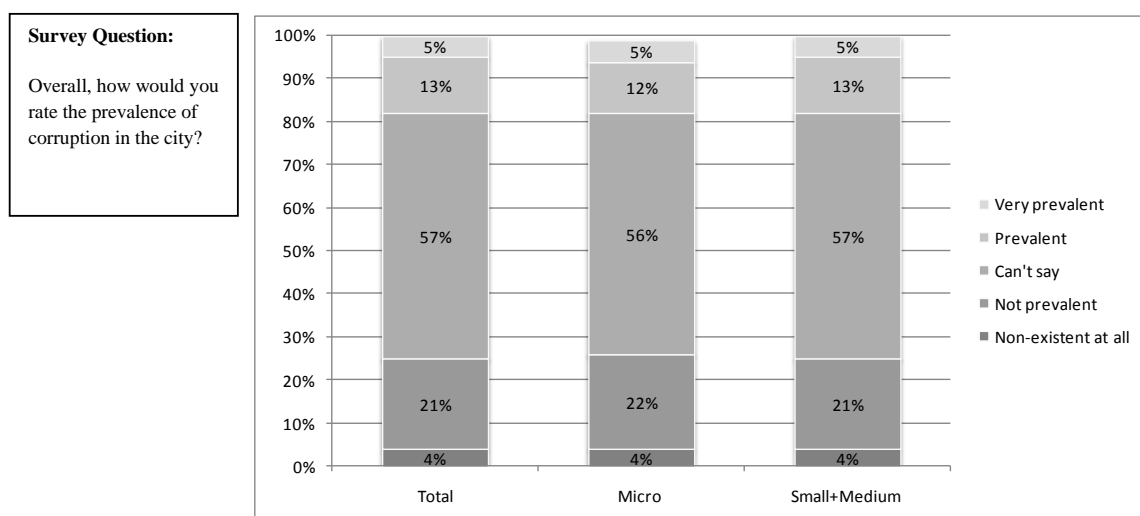
This section presented the profile of MSMEs using the APC Enterprise Survey 2009. In general, micro and small-medium enterprises share similar characteristics in terms of factors considered in starting a business, locating a business in a city, access to credit, reasons for using informal financing channels, and perceptions of corruption. The only striking difference between the two categories is the type of ownership i.e. 55% of micro enterprises are managed by the owner-manager while this is 36% for small-medium enterprises. However, it is important to note

that because of the sampling design, small and medium enterprises were grouped into a single category. The characteristics among micro, small and medium enterprises may be further nuanced if small and medium enterprises were differentiated. Hence, future research disaggregating the analysis across the three enterprise categories will be highly valuable in formulating appropriate policy instruments for each group.

As mentioned at the beginning of this section, the only available MSME statistics in the Philippines are at the macro level. This makes it impossible to conduct firm level analysis that could facilitate better understanding of local firm dynamics. As a result, studies investigating the growth dynamics of enterprises are very limited in the country. In order to determine the information and research gaps with respect to MSMEs in the Philippines, a review of international research in MSMEs is presented in the following section. This review could shed light on key aspects to be explored further in the Philippines. In particular, the subsequent section presents studies on firm graduation and other issues confronted by MSMEs.

III. INTERNATIONAL MSME RESEARCH

Microenterprise Dynamics

Much of the analysis on the structure of enterprises are static in nature. In order to understand the patterns of growth across categories of enterprises, one needs to look at the dynamic issues of these enterprises. Leidholm and Mead (1991) provided a great contribution in this respect. They examined the question of microenterprise dynamics at four different levels: the individual, the enterprise, the subsector, and the economy as a whole.

At the individual level, the characteristics of the entrepreneur such as education, experience, gender, age, motivation, and abilities can have a significant effect on patterns of growth of the enterprise. At the firm level, it is important to examine the firm over its entire life cycle from birth to net growth and possible disappearance. Explanatory variables to be examined include the size and age of the firm, its location and subsector, and the gender and other characteristics of the entrepreneur. Information on these can be collected in three types of surveys. One is through cross-section enumerations of enterprises in locations where previous studies have been done. Second is bore hole surveys, which traces the past evolution of selected firms. Last is through the use of longitudinal or prospective surveys, which follows the firms

over time. The choice between firm level and establishment level should also be clear (see box 1).

The subsector level looks at the dynamics of groups of firms engaged in the production and distribution of related products and services. Key issues that can be examined include the changing roles of firms in the distribution channel, and the level of specialization and competition. Intersectoral linkages and changes at the macro level is the fourth level of analysis. The main element in the intersectoral linkages is how positive linkages across sectors can be reinforced to create opportunities for development. At the macro level, the central task is to determine the relative importance of enterprises of different sizes and types including their sectoral and locational dimensions.

Understanding these different levels of enterprise dynamics can help in improving the analysis of enterprises and policy interventions to support the development of MSMEs.

Box 1. Establishment vs Firm Level Data

The US Census Bureau defines an establishment as a specific physical location where business activity occurs while a firm reflects all the establishments under common operational control. Haltiwanger, Jardin, and Miranda (2010) emphasize that "measures of job growth derived solely from establishment-level data have the virtue that they are well-defined; when we observe an establishment grow we know there are net new jobs at that establishment. In contrast, job growth observed in firm-level data may reflect the many changes in ownership stemming from mergers, acquisitions and divestitures that are ubiquitous features of market economies… Having only establishment-level data is inadequate as well. If the only data available are at the establishment level, the relationship between growth and the size and age of the establishment may not provide much information about the relevant firm size and firm age." (p.5)

In the Philippines, the National Statistics Office in its Census of Philippine Business and Industry defines an establishment as an economic unit under a single ownership or control, i.e. under a single legal entity, engaged in one or predominantly one kind of economic activity at a single fixed location. In actual practice, however, there are difficulties in applying the definition of an establishment. Thus, it is defined in operational terms to take into account the organization and record-keeping practices of establishments by making the single location and activity criteria more flexible (see Technical Notes at www.census.gov.ph).

Measuring Growth and Contribution to Job Creation

It is widely accepted that **s**mall enterprises contribute significantly to employment given the labor intensiveness of the sector compared to large enterprises and its dominance in many developing countries. Most studies measure the growth of firms in terms of changes in the number of workers. This indicator is frequently used since this is the most easily and accurately

remembered over time by entrepreneurs and it does not have to be deflated (Leidholm & Mead, 1993). Others use sales or output, value added, and assets.

Early studies in industrial countries that have tried to find empirical evidence on which firm size contributes more to job creation (i.e. small versus large) started in the late 70s. US politicians together with the US Small Business Administration in the early 80s were giving public pronouncements that small firms contribute more to job creation. Birch (1979) found that 8 out of 10 new jobs were generated by firms employing less than 100 workers. In later years, however, Davis, Haltiwanger, and Schuh (1993) disputed the conclusions of Birch due to several fallacies in the analysis. They argued that size distribution data cannot provide inferences on the relationship between job creation and firm size. Job flows from different sizes are frequent especially during periods of unemployment spells. Employees from large firms can migrate to small firms during this period, hence, creating an impression that small firms generated most of the jobs. Birch's classification of businesses into classes using base year employment suffers from statistical fallacy known as regression to the mean. Davis et al. explained that this bias arises "whenever employers experience transitory fluctuations in size, or whenever measurement error introduces transitory fluctuations in observed size" (p.15). Lastly, the dataset (i.e. Dun and Bradstreet Market Identifier) used by Birch suffers from two key problems: large discrepancy on the employment figures with that of the US Bureau of Labor Statistics and the dataset does not track firm births and deaths. To correct these fallacies, Davis et al. used the US Longitudinal Research Database (LRD) and analyzed the manufacturing sector from 1972 to 1988. The LRD contains detailed information on establishment characteristics including entry and exit of firms. To avoid regression to the mean bias, they classified businesses based on the average of employment in year *t-1* and *t*. Davis et al. concluded that large firms created the most new jobs and there is no relationship between establishment size and net job creation.

Using a different dataset, Neumark, Wall, and Zhang (2008) attempted to shed light on the contribution of small firms in the US. Neumark et al. used the National Establishment Time Series (NETS) dataset, which covers almost all firms and establishments in the US (average of 13.1 million firms and 14.7 million establishments), to analyze all sectors in the industry and not only the manufacturing sector as studied by Davis et al. (1993). The study provided some truth to the earlier work of Birch regarding the role of small firms to job creation. Using base year employment size, smallest firms registered a high net job creations rate. However, when average

employment size was used (similar to that of Davis et al.), net job creation rate for small firms falls from 10.9% to 2.9%. More recent studies also support the notion that small firms contribute significantly to job creation. Moller, Schjerning, and Sorensen (2009) for instance, found that small firms account for 8% of the total gross job creation in Denmark. Ayyagari, Kunt, and Maksimovic (2011), concluded that small firms in developing countries contribute more to job creation than large firms, however, with a caveat that the growth rates of small firms were probably overestimated due to the absence of job destruction data in the analysis.

An additional improvement to the analysis of firm growth dynamics is the inclusion of the firm age variable. Two recent studies have contributed greatly in this area, however with differing findings. Haltiwanger, Jarmin, and Miranda (2010) analyzed the critical role of firm age in the employment growth dynamics in the US using the LBD dataset for the period 1976 to 2005. The study categorized small firms with less than 500 workers and large firms with 500 workers and above. Firms with less than 10 years of operations are considered young while those operating for 10 years and above are classified as mature firms. Consistent with the earlier findings of Neumark, Wall, and Zhang (2008), there is inverse relationship between net growth rates and firm size when firm age is not controlled for. Once age controls are included, the study found no systematic relationship between net growth rates and firm size. Specifically, the study found that small firms have high rates of job destruction than job creation and young firms have high rates of both job destruction and job creation.

On the other hand, the study of Ayyagari, Demirguc-Kunt, Maksimovic (2011) provides analysis on the contribution of small and medium enterprises (SMEs) and young firms to total employment, job creation, and growth across 99 developing economies. The study used the World Bank's Enterprise Surveys for cross-country comparisons with 47,745 samples surveyed in the period 2006-2010. Small firms are those with 5-19 employees, medium firms with 20-99 employees, and large firms with 100 or more employees. Two cutoffs for young firms were used: less than 2 years and less than 5 years. The findings contrast to that of Haltiwanger, Jarmin, Miranda (2010) who concluded that US large mature firms has the greatest share of employment. Ayyagari et al. found that it is the small mature firms that have the largest share in employment and job creation in developing countries.

The studies discussed above however failed to include the role of micro enterprises in the analysis of firm growth dynamics. This is particularly important in developing countries such as

the Philippines where micro enterprises largely dominate the sector (91% on the average of total establishments from 1999-2010) and where extensive firm level data from government statistics is lacking.

Two scholars (Carl Liedholm and Donald Mead) from the University of Michigan made substantial research on the dynamics of micro enterprises in developing countries particularly in Africa and Latin America. In the early 90s, Leidholm and Mead led the USAID Growth and Equity through Micro-enterprise Investment and Institutions (GEMINI) project[4] in Dominican Republic, Botswana, Kenya, Malawi, Swaziland and Zimbabwe between 1990 and 1995 with more than 43,000 surveyed enterprises. Micro and small enterprises in this region were classified as those firms with less than 50 employees. Liedholm and Mead (1993), drawing from the surveys conducted in these countries, found that two-thirds of all enterprises consist of only one person and mostly operated/owned by women. Further, findings showed that some industries grow more rapidly than others and male-owned enterprises grow faster than female proprietors. Finally, majority of the micro and small enterprises in this region do not grow or graduate to the next scale.

The succeeding section presents some evidence on the factors affecting graduation of firms drawing heavily from the studies of Liedholm and Mead and the comprehensive literature review on the topic by Gomez (2008).

Limited Graduation of Enterprises

In the absence of a longitudinal dataset similar to that in the US, estimating graduation rates of micro and small enterprises poses a great challenge among developing countries. Measuring graduation rates is costly since data collection has to be repeated twice. An alternative method is by determining the percentage of small enterprises during the time of the survey that have started as micro. This approach however cannot account the number of firms that did not survive the initial years of operations.

Liedholm and Mead (1993) reported that only less than 25% of the enterprises surveyed in the GEMINI project grew while about 66% remained in the same size category. Similar

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[4] The GEMINI Project was a six-year applied research, development, and services project of the Bureau for Private Enterprise, USAID from 1989 to 1995. GEMINI offered technical assistance, training, economic research, and information to USAID missions and bureaus, implementing organizations, host-country governments, and other organizations involved with microenterprise development. Visit www.usaid.gov for more information.

findings were found in the study of Biggs, Ramachandran and Shah (1999). Only around 10% of firms with less than 10 workers ever grow to the next category in five Sub-Saharan countries. The World Bank report as cited in Berner, Gómez and Knorringa (2008) also showed that over a period of 5-6 years the graduation rates in Kenya and Ghana were 10% and 20% respectively. Gomez (2008) noted that around 75% of enterprises do not survive the initial two years, and only about 20% of those that survived grew at all. Of those that survived and grew, only 1% to 4% actually graduated into the next size category.

Explaining Non-Graduation

The lack of growth or graduation of enterprises stems from the characteristics of these enterprises. The typology of informal enterprises developed by Rogerson (1996) may prove useful in the analysis. Rogerson distinguished two categories of informal enterprises - survivalist and micro or growth enterprises. The survivalist type of enterprises are those that are compelled to starting a new enterprise due to unemployment and other economic shocks. The profits derived usually fall short of the minimum standard level of income, with little capital investment and no skills training necessary for expansion. Hence, poverty and the attempt to survive are the main features of these enterprises. On the other hand, the micro or growth enterprises have the potential to expand to a small enterprise. This kind of enterprise is usually composed of some family members and a few paid workers with little capital and formality.

There are significant differences between survivalist and growth enterprises. First is motivation. Survival entrepreneurs are simply not interested in expanding their business. They are forced into creating a firm by unemployment or other economic shocks, while growth-oriented entrepreneurs make an affirmative choice based on the identification of a specific business opportunity (Reynolds et al. as cited in Gomez, 2008). Second is the attitude towards saving. Survivalist enterprises barely have a decent income for basic household expenditures; hence, profits cannot be reinvested for capital accumulation. Daniels as cited in Berner, Gómez and Knorringa (2008), found that two-thirds of enterprises surveyed in Kenya were earning below the minimum subsistence wage set by the government for unskilled workers. Third is market positioning. Survival enterprises normally operate in saturated markets with low income clients whose buying power is limited to cheap products. Since survivalist enterprises are also poor, moving the business to another location is too costly. Last is the differential access to

business support services. Zandniapour et al. as cited in Berner et al. noted that the amounts loaned by survival entrepreneurs from micro-credit schemes are too low than the loans given to growth-oriented entrepreneurs.

Determinants of Graduation

While most of the micro enterprises failed to graduate to the next scale category as evidenced from the work of Liedholm and Mead, patterns of growth can still be drawn on those firms that have actually graduated. Table 6 summarizes the key characteristics of enterprises that are likely to expand based on the analysis of five African studies conducted by Liedhom and Mead (1998).

Table 6. Key determinants of micro and small enterprises' survival and growth

Factors	Survival likelihood (higher if enterprise is:)	Growth likelihood (higher if enterprise is:)
Age	Older	Younger
Past growth	Grown in past	-
Initial size	Smaller	Smaller
Sector	Not in trading	In particular sectors that vary by country
Location	Urban, not in home	Urban, not home
Gender	Male-owned	Male-owned

Source: Liedholm and Mead (1998)

Similarly, Gomez (2008) synthesized from several studies the profile of growth-oriented entrepreneurs. These entrepreneurs are usually run by male, educated, have managerial competencies and attitude to reinvest capital, employ paid workers, and locate their business outside of home (normally in urban or larger cities).

The significant difference between survivalist and growth-oriented enterprises merits dual policy approach for these sectors to function as true engines of growth. Even if not motivated to grow, survivalist enterprises engage into business for consumption smoothing, which is important in helping a large number of very poor people become less poor. Growth-oriented enterprises on the other hand can make a substantial contribution in the area of growth by creating more jobs and helping people move out of poverty.

Other Issues on MSME Development

Inequality and Poverty Alleviation

It is widely assumed that proliferation of MSMEs in an economy will bring in more equitable distribution of income and alleviation of poverty. Mazumdar (2001) analyzed the performance of SMEs and large enterprises in manufacturing sector in Asian economies and how it contributes to equality and poverty reduction issues. The study found that the factors affecting the degree of inequality are not just the distribution of employment size but also the productivity differences between small and large enterprises. Hence, policies should be directed toward reducing this productivity differential to reduce inequality. The study also identified three patterns of size distribution and productivity differential among Asian countries. Hong Kong is the ideal type for having an even size distribution of employment and small productivity differential between small and large enterprises. Korea on the other hand had a greater number of large enterprises until the mid 70s, making it the opposite of the Hong Kong case. The typical pattern among Asian countries is the bipolar distribution of firms. However, this pattern yields greater inequality when there is a wide gap in the productivity between small and large firms, and it exacerbates the missing middle phenomenon because small firms will find it difficult to grow. The ability of MSMEs to generate employment opportunity for the poor people in rural and urban areas makes it an ideal avenue for labor to make transition from subsistence agriculture to non-farming occupations (Harris, 2009). According to Biggs (2003), wage differential between large and small enterprises in industrial countries is around thirty-five percent (35%). The case is more severe in developing countries as the difference is as large as fifty percent (50%). This raises some questions on the real contribution of MSMEs to employment. In the Philippines, recent data show that 63% of workers of all registered establishments are employed by MSMEs. However there is no data that show the quality of jobs that were created and whether these jobs contribute to poverty alleviation.

An empirical study conducted by Beck, Kunt, and Levine (2005) showed that SMEs do not alleviate poverty or decrease income inequality. Using the constructed database for manufacturing sector (see Ayyagari, Beck & Demirguc-Kunt, 2003) covering 45 countries, the study provided the first cross-country evidence on the links between SMEs and economic growth and poverty alleviation. It analyzed the relationship between the size of SME sector and

economic growth as measured by per capita GDP. In order to determine the relationship between SMEs, income inequality and poverty, four measures were used: (1) the growth rate of the income of the poorest quintile of the population during the 1990s, (2) the growth rate in the Gini coefficient, (3) the growth rate in the percentage of the population living on less than a dollar a day, and (4) the growth rate in the poverty gap. The analysis yielded three results. First, there is a robust, positive relationship between the relative size of the SME sector and economic growth. Second, the cross-country analyses do not support the conclusion that SMEs exert a causal impact on long-run growth. Lastly, the study did not find a significant relationship between SMEs and poverty alleviation. It should be noted, however, that the analysis only covered the manufacturing sector to enable cross-country comparisons. The structure and performance of SMEs (including industries other than manufacturing) in each country differ, hence, single country in-depth analysis may be necessary to find evidence whether SMEs do not in fact alleviate poverty or decrease income growth.

Innovation

Aside from its contribution to economic growth, enterprises are also known to be engines of innovation. In the US, Acs and Audretsch as cited in Biggs (2003) found that innovation rate is higher in small firms than large firms in some industries. The study noted that the high rate of innovation among small firms can be explained by the apparently better exploitation of SMEs on university-based research than large enterprises. Biggs emphasized however that this technology transfer is not necessarily the case for developing economies since these economies invest low on research and development. Technology transfer happens normally when large and multinational companies operate in developing countries, which in turn can facilitate the transfer of knowledge and technology from the host country to the branch country. This finding is similar to that of Pernia and Maligalig (2008) whose analysis showed that Philippine firms were only able to acquire new technology due to purchasing of new machineries and transfer from international client firms. The study also confirmed the findings on the use of university-based research as source of innovation that in the Philippines, despite having a well developed university system, only one of the 716 firms surveyed reported universities as the most important source of technology.

IV. MSME RESEARCH IN THE PHILIPPINES

Much of the research on MSMEs in the Philippines revolved around the policy environment within which these enterprises operate. Particular attention has been given to the manufacturing sector on how productivity and value creation can be further boosted. Financing issues of micro enterprises are also a common subject matter of local studies. Below discusses some of these studies.

Aldaba (2008) reviewed the policies and programs toward the development of Philippine manufacturing industry and the creation of linkages in the global production networks. It is widely known that linkages to the external or global market can facilitate transfer of technology, skills and management practices. The study surveyed 23 manufacturing companies in the electronics, auto parts, and garments sector to assess the effects of the government's SME promotion policies on networking in the three industries. It found that, except in the automotive parts industry, clustering activities in the electronics and garments are still very limited. The study recommended the creation of a separate government office that would coordinate SME policies and programs to support the integration of SMEs in the global production chain.

Bilateral agreements with other countries may facilitate this integration to the global market, which may necessitate a strong MSME sector that can meet the requirements of the global value chain. However, local small enterprises have not been growing. Pernia and Maligalig (2008) in its survey of more than 700 firms in the country showed that many companies still lack the potential for exports and global integration.

The study of Tamangan, Josef, and Habito (2004) assessed the SME sectors of the Philippines and Japan in the context of promoting these SMEs through a bilateral partnership and cooperation. The authors suggested identifying and opening some Japanese markets to Philippine SME exports. Further, the study found that most of Philippine enterprises exporting to Japan are large scale. Hence, there is need to identify and develop small enterprises that have the potential to export to Japan. It noted that a long-term policy challenge for the Philippines is how to manage globalization and creating new sources of growth by increasing SME exports.

Studies have shown that one of the major constraints for MSMEs to grow is the lack of access to finance. This is particularly cumbersome to micro enterprises due to the lack or absence of collaterals to apply for loans. Lamberte (2001) reviewed the existing policy framework and programs for bank lending to MSMEs and poor households in the country. The study identified

the constraints facing local banks in lending to MSMEs. These include macroeconomic instability, inadequate infrastructure, regulation on deposit mobilization, shortage of capital, competition with government banks, inadequate supervision from the Central Bank, and loan portfolio regulations. Similarly, Llanto (2003) suggested that an efficient financial market would require a favorable and stable policy environment, transparent and appropriate legal and regulatory framework, and an efficient information infrastructure.

More recent studies have analyzed the investment climate and its role on firm performance. Pernia and Salas (2005) investigated the investment climate at the national and sub-national levels. The paper presented the weak performance of the country in terms of attracting investments as shown in several competitiveness reports such as the World Competitiveness Yearbook, Global Competitiveness Report, and the Doing Business Report. The study used the Investment Climate and Productivity Survey (ICS) of the Asian Development Bank to analyze the investment climate at the sub-national level. ICS covers 716 randomly selected business establishments in the country covering Metro Manila, CALABARZON, Metro Cebu, Davao-General Santos, and Clark-Subic. Results of the analysis at the firm level showed that the investment climate as measured by bureaucratic red tape and corruption, infrastructure, access to finance, labor market flexibility, and export orientation is critical to business performance in terms of productivity, investment rate, employment growth, and sales growth. A simulation has also been formulated to determine the effects of an improved business climate at the sub-national level. It showed that labor productivity increases by 62% to 197% if the provinces were to have the investment environment of Metro Manila. A similar analysis using the ICS data found that small enterprises tend to suffer more from weak investment climate than the medium-size and large firms (Pernia & Maligalig, 2008).

V. RECOMMENDATIONS

This paper presented a novel dataset of Philippine micro, small and medium enterprises and the existing literature concerning the challenges and development issues of MSMEs in the industrial and developing countries. Some of the researches done at the local level were also discussed. It should be noted that most of the literature in the industrial countries did not cover the dynamics of micro enterprises. This was however extensively covered in the studies done among the developing countries particularly in Africa. From the review of foreign studies and the existing

literature on MSMEs in the Philippines, it is apparent that there is still plenty of research areas that have not been investigated. The main challenge for understanding firm dynamics particularly on MSMEs is the absence of readily available data at the firm level. Due to confidentiality issues, the National Statistics Office cannot share the establishment data collected from the series of establishment surveys that the agency had undertaken. Hence, development organizations, multilateral agencies, and academic institutions usually implement their own survey of establishments to get this firm level data. However, this is too costly to be sustainable.

The studies in the country normally lump MSMEs as one homogeneous group that is being compared to large enterprises. As Aldaba (2008) noted, SMEs are not homogeneous and one set of policies have different effects in firms. The evaluation made by the Department of Trade and Industry and the German Technical Cooperation on the SMED Plan 2004-2010 suggested that the current plan failed to present a clear rationale of why MSMEs should be supported. The proponents recommended to have a rationale which clearly presents the MSMEs as an engine of growth by providing evidence on the sector's contributions to the economy. Hence, substantive empirical research on the sector are much needed. Given this gap on MSME research, this paper recommends further studies to find empirical evidence on which size category contributes more to growth, contributory factors to firm graduation, dynamics of different firm sizes, and which sectors promote pro-poor employment. Implementing a follow up round of the AIM Policy Center Enterprise Survey may be beneficial in addressing these research gaps.

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Annex 1

State of Philippine MSME Database

The lack of an official, comprehensive and updated database has been a perennial problem among researchers and policy makers doing policy and research work on MSMEs. Due to the large number of operating business enterprises and the high cost of data collection, data management remains to be a big challenge. The nature of businesses also makes the survey respondents most sensitive to any administrative burden. This burden then leads to low response rate and data quality concerns (Garcia, Castillo, Santos, Brucal, & Lemence, 2007).

The NSO is the main source of statistics on Philippine MSMEs. The Census of Philippine Business and Industry (CPBI) is done every five years. The CPBI is a nationwide census of establishments covering the sector of agriculture and fishing, mining and quarrying, manufacturing, electricity, gas and water, construction, and business services. It aims to gather information on the structure and trend of economic activities which would be useful for the construction of national and regional accounts, formulation and monitoring of economic plans/policies, and preparation of market research and feasibility studies useful for both the government and the private sectors (Virola, 2007). The agency also conducts an annual survey of establishments; however, these reports are usually released 15-24 months after the year of data collection. This makes the data more or less an imprecise tool for analysis and decision-making. The confidentiality clause in the census also prevents the public from accessing firm-level data (Lagua, 2003).

Another issue that remains to be solved is the coverage of the existing databases. The Department of Trade and Industry (DTI), has come up with a database management system that monitors the individual SME. The Business Profile Management System (BPMS) is a web-based system that allows DTI regional and provincial offices, bureaus, and agencies to update their own clients' business profiles. It includes a product coding and business matching facilities that allows local as well as exporting firms to be matched with their requirements (Bureau of Micro, Small, and Medium Enterprises, n.d.). The list is based from the Business Name Registration System for sole proprietorship and the Securities and Exchange Commission (SEC) for partnerships and corporations. Cooperatives are also included based from the list of the Cooperative Development Authority (CDA). This mechanism however has inadequate coverage since the recording of information is on a voluntary basis. It is the prerogative of the entrepreneur to register certain information on his/her business and avail the services offered by the DTI.

Information on the level of informal economy is also a big challenge for researchers and policymakers. According to Lagua (2003), the country has a large section of small business constituting the so-called underground or informal economy. Since they don't register, keep books or pay taxes, it is very difficult to gather and process statistics on them. Clearly, the DTI will not have any record on these enterprises since they are not registered and the data collected by the NSO census is limited such that they do not include the following:

1) sari-sari stores with no regularly paid employee;
2) selling in open stalls in public markets;
3) operators of tricycles, jeepneys, calesas and pedicabs;
4) government postal and telegraphic offices;
5) letting and operating of real estate;
6) public education;
7) public medical, dental and health services; and
8) activities of membership organizations.

Lastly, the MSME statistics in the Philippines is largely fragmented. Different agencies such as the NSO, DTI, and Bangko Sentral ng Pilipinas (BSP), gather certain information that address sectoral concerns that feed to the plans and programs of these agencies. However, "there appears to be no concerted effort to gather holistic data on MSMEs that will have cross sector purpose and that which would avoid duplication of effort and resources" (Garcia et al., 2007, p. 8).

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