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**Background Paper
Strengthening MSMEs' Competitiveness
and Innovation in the Digital Age**

Purpose: Consideration
Submitted by: Viet Nam



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BACKGROUND PAPER

STRENGTHENING MSMEs' COMPETITIVENESS AND INNOVATION IN THE DIGITAL AGE

I. BACKGROUND

Setting the stage: MSMEs in the digital economy

The digital age is now a reality in many economies, both developed and emerging. Governments, businesses and individuals are migrating their activities to the Internet at an increasing pace and up-take of digital technologies is reaching new heights. In this environment, data and digital technologies are becoming essential for participation in the global economy.

The digital age, especially the Internet also enables MSMEs to overcome important barriers. It gives them access to skills and talent, markets, financing, technology and applications. It also helps them with product development, collaboration and communication and reduced red tape.

Ensuring that MSMEs can fully participate in the digital age will therefore be essential if APEC economies are to have competitive businesses, stronger economies and inclusive societies. MSMEs account for most new job creation and are an important source of innovation and growth. Evidence also shows that small digital firms tend to grow faster than non-digital ones, and digitalisation is strongly correlated with firm dynamism. Young MSMEs are often the vehicle through which radical innovations and new business models enter the market, as older incumbent firms often focus on incremental changes to established technologies. To foster stronger, more sustainable and more inclusive growth, it is therefore important to give room to MSMEs and young firms, to experiment with new technologies and organisational models, and to foster their growth. Furthermore, by facilitating the ease of starting and running a business, digital technologies may be seen as an important lever for economic development, including the reduction of poverty and progress towards a more inclusive society.

Barriers for MSMEs

Unfortunately, MSMEs commonly lag in uptake of digital technologies compared to their larger counterparts. This holds back their ability to innovate and can hamper their efforts to integrate into GVCs.

The high cost of ICT adoption and a lack of adequate financing help explain why smaller firms are less likely to adopt digital technologies than large firms. Additional challenges include: (i) reluctance of managers to adapt to technological change, possibly due to a lack of knowledge, time or mistrust; (ii) considering the Internet mainly as a way to cut cost rather than for expanding commercial opportunities; (iii) high costs of ICT infrastructure; and (iv) lack of ICT skills and expertise, including lacking motivation or resources to train employees or to recruit specialists. Moreover, firms are not all equally well-equipped to deal with the challenges that ICT poses, such as privacy and security. Finally, the overall use of ICT is also affected by a slow pace of structural change in economies, notably the lack of reallocation of resources from firms that use little ICT to more ICT-intensive firms.

Tackling these issues requires a holistic approach that addresses digital infrastructure (notably broadband), skills (including digital skills), trust in the digital economy, and overall economic framework conditions. However, it is important that policy for MSMEs be considered in the wider context of economies' overall approach to the digital economy, its opportunities and challenges.

At the same time, a number of trade-related policy issues could be prioritized to continue to support APEC's commitment to facilitate MSMEs access to, and greater participation in, GVCs. On the output side, MSMEs can engage in international production networks *directly* (by supplying intermediates through exports) or *indirectly* (by supplying local MNEs and larger domestic firms with products that are then exported). They can also benefit from GVCs on the

input side through greater access to competitively priced imports, new technologies embodied in new capital products made available through international trade, or transfers of technology from leading internationally-oriented firms.

In this context, it is an ideal moment for APEC to strengthen efforts in 2017 on "strengthening MSMEs' competitiveness and innovation in the digital age". To help MSMEs in the Asia - Pacific region, APEC has worked extensively on building a sound business environment, enhancing management capability, promoting entrepreneurship, facilitating market access and internationalization of MSMEs, and improving innovation and financing. All of these activities contribute to the competitiveness and innovative capacity of MSMEs in APEC member economies. Currently, several initiatives, plans and projects are conducted at different levels:

- The 2015 Boracay Action Agenda to Globalize MSMEs recognized that 'a big gap remains to be addressed' on 'the direct participation of micro and small enterprises in regional and global trade', and identified that 'special consideration must be given and extra effort must be made to enable micro and small enterprises to benefit from free trade'. The Agenda laid out eight actions, among which two focus on the application of digital technologies – first, greater use of IT and automated systems to increase the efficiency of complying with RTA/FTA-related requirements; and second, greater promotion of taking up internationalization opportunities by MSMEs through ICT and e-commerce.
- The 2017 - 2020 Strategic Plan of APEC's SME Working Group was put forward in September 2016, with an emphasis on the capabilities of MSMEs to actualize the benefits of globalized trade, particularly in the area of digital trade. Among the four strategic priority areas of the strategic plan, the first is "entrepreneurship, innovation, and the Internet and digital economy". A range of activities are proposed under this priority area, including continued implementation of the Digital Economy Action Plan 2015 and development of the APEC Best Practices in SME Innovation.
- The APEC Online-to-Offline (O2O) Initiative is a major ongoing project to improve MSME's competitiveness in digital economy. The first phase works on the New Era of Growth for APEC SMEs through O2O Business Models. In cooperation with the top e-commerce platforms such as eBay, Amazon and Alibaba, the project expands internationalization opportunities for SMEs through online portals. The following phase will work on Enhancing SME Digital Competitiveness and Resilience towards Quality Growth, which comprises the establishment of an APEC SME O2O Expert Network and the publication of an APEC SME Digital Competitiveness and Resilience Guidebook.

With various initiatives proposed and projects ongoing, it is necessary for APEC to develop an overarching strategy to link current activities and to devise new activities that would further strengthen MSMEs' competitiveness and innovation in the digital age. Such a strategy is timely and indispensable - it would be well-aligned with the previous efforts toward enhancing MSME global competitiveness (Ball, 2013), innovation and sustainability (Nanjing, 2014), advancing modernisation and standards and conformance (Iloilo, 2015), and making MSMEs engines of quality growth and prosperity (Lima, 2016), and contribute to the broad APEC goal of creating greater prosperity through more balanced, inclusive, sustainable, innovative and secure growth.

II. KEY ISSUES

1. Facilitating MSMEs' greater participation in GVCs

- Continue efforts to facilitate MSMEs' access to, and greater participation in, GVCs, both on the input and output sides;
- Better understand the determinants of the domestic linkages between MSMEs and larger firms to identify how policy can make GVC participation more inclusive; and
- Bring together stakeholders to support the prioritizing backbone services (such as logistics, finance, e-commerce, etc.).

2. Facilitating the business environment for MSMEs in the digital age

- Shaping MSMEs policies in the digital age;
- Promote policy-makers' understanding of the economic and social impacts of the digital transformation on policy, focusing on MSME policy;
- Foster linkages between the public and private sector, as well as academia, among APEC member economies; and
- Share experiences on how digital transformation is taking place in APEC economies;
- Enhance MSME's competitiveness through support for information, training, consulting and business matching;
- Promote green, sustainable and innovative MSMEs.

3. Promoting start-ups and innovative MSMEs

- Develop the sustainable and friendly ecosystems for start-ups and innovative MSMEs;
- Continue efforts to promote MSMEs' capacity to innovate and strengthen their competitiveness;
- Enhance business ethics through the promotion of good business standards for MSMEs;
- Establish a network of digital start-ups, MSMEs and supporting universities.

III. EXPECTED OUTCOMES AND KEY DELIVERABLES

1. Facilitating MSMEs' greater participation in GVCs

- APEC could launch an initiative to help MSMEs make the most out of the new opportunities that the evolving GVC landscape provides.

2. Facilitating the business environment for MSMEs in the digital age

- APEC economies could develop a framework for government policy towards MSMEs suited to the digital age as a means to help assess their own policy settings and developing an approach that can leverage the role of MSMEs in the digital age for strong, inclusive and sustainable growth.

- APEC could launch an initiative to prepare a whole-of-government approach to broadband policy-making to strengthen business conditions access for MSMEs.

3. Promoting start-ups and innovative MSMEs

- APEC SMEMM Statement on Promoting Start-ups.

- APEC could launch a Strategy on green, sustainable and innovative MSMEs.