

Chapter 2

Emerging Economies and Financing of SMEs

Liang Han

Shihezi University, China & University of Reading, UK

Xin Xiang

University of Reading, UK

Xingquan Yang

Shihezi University, China

ABSTRACT

Existing evidence has shown that SMEs make great contributions to innovation, job creation and economic growth. This chapter reviews recent literature on (1) the important roles played by SMEs in emerging markets and (2) the impacts of financial development on SME finance in such markets. It also uses a unique database from World Bank Enterprise Survey (WBES) to document the financing patterns, constraints and other financial issues of SMEs in emerging markets. The descriptive statistics derived from WBES show clear variations of SME financing patterns between emerging and developed markets and shed light on the important role played by financial development in financing SMEs.

INTRODUCTION

It has been widely accepted that Small and Medium-Sized Enterprises (SMEs) make significant contributions to economic growth, creation of employment and innovation (e.g. Storey & Greene, 2010), in both developed and emerging economies. The social-economic environment in emerging economies in which SMEs operate differs significantly from that in developed economies in terms of institutional framework (Hussain, Farooq, & Akhtar, 2012), norms, resources and infrastructures (Hitt, Dacin, Levitas,

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Arregle, & Borza, 2000). Hence, SMEs in emerging economies possess unique characteristics in various ways such as the obstacles they face and access to finance. For example, in Asia-Pacific countries, SMEs have poor access to bank credit, accounting for 11.6% of GDP and 18.7% of total bank lending, given the established bank-centred financial system in such countries (Asian Development Bank [ADB], 2014). Indeed, the access to and the costs of finance for SMEs have been recognised as one of the most important determinants of small business start-up, survival and success (Mach & Wolken, 2012).

The aim of this chapter is to document the important roles played by SMEs in emerging economies, their unique characteristics and how financial development in emerging economies influences SME finance, in terms of financing patterns, financial constraints and corporate innovation. The evidence provided in this chapter is mainly derived from existing literature and the information collected from World Bank Enterprise Survey¹ (WBES). The remainder of this chapter is organised as follows. Section 2 provides background information on emerging economies and documents the key features of SMEs in emerging economies, especially the key obstacles which constrain the development and growth of SMEs. It also reviews relevant literature on the important roles played by SMEs in emerging economies. Section 3 focuses on SMEs finance in emerging countries in terms of the key financing patterns, financial market development and the importance of financing SMEs in emerging economies. Section 4 concludes and provides implications for policy makers and future research.

EMERGING ECONOMIES AND SMES

It has been widely accepted that SMEs make a significant contribution to the socio-economic and political infrastructure in both developed and developing countries, especially in the nations in transition from planned to market-oriented economies (Hussain et al., 2012). By reviewing existing literature and analysing data from World Bank Enterprise Survey (WBES), this section documents the key characteristics of the emerging economies, SMEs, the contributions they make and the constraints they face in emerging economies.

Emerging Economies

Emerging economies are those “low-income, rapid-growth countries using economic liberalization as their primary engine of growth” (Hoskisson, Eden, Lau, & Wright, 2000, p.249) and they differ significantly from developed economies in terms of institutional framework in which businesses operate. Economically, emerging economies usually have higher GDP growth and lower GDP per capita, compared with developed economies. For example, over the last decade between 2006 and 2015 (Table 1), countries with low to middle income had an average GDP growth at 5.66% annually, higher than that of countries with high income (1.37%) and this is especially pronounced in East Asia and Pacific countries which has an average annual GDP growth rate at 8.48%. Table 1 also shows that high income countries have a much higher GDP per capita (US\$40,000) than that of low income countries (\$532). Due to economic globalisation, the variation in export has become narrow between emerging (low to middle income countries) and developed (high income) economies, ranging from 20% (Latin and Caribbean countries) to 34% (Middle East and North African countries).

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