

Globalization, World Trading System and Indian SMEs

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Mind your own business?

Scenario #1

Two years ago a delegation of small HDPE woven fabric and bag manufacturers from North India met us with a problem. Nepalese HDPE woven bags were cheaper by 25% and played a havoc with local market. Within two months every factory in North India was on the verge of closure. Their sales were dropped by 80% within two months!

Scenario #2

In another instance, a large number of small manufacturers that consumed any of the raw materials as iron and steel, aluminum, copper and PVC, have seen their profits disappear in thin air during the last couple of years. They are perplexed. The demand remains either steady or rising and though the cost of raw material increased, they have not been able to push up the price of the finished products. It used to be a simple game earlier; whenever the prices of the raw material were increased, markets absorbed the increase in the prices of their finished products also. No more so. What happened?

Scenario #3

During the same period, Indian exporters chiefly the small and medium enterprises, came across newer challenges in the foreign markets. A large variety of Indian exports were increasingly subjected to trade barriers : Leather goods, Chiffon skirts, Iron and Steel, Castings etc. in US; Leather products, carpets, gray cotton etc. in EU, garments in Turkey, the list is expanding day by day. Why India?

Scenario #4:

During last few years, one after another, instances of cheap imports hurting domestic manufacturers came to light. Diesel Engines, hand tools, electric fittings and decorative lights, locks, sports goods, pencil cells, stationery, the list kept increasing and gave sleepless nights to the small manufacturers and China, wherefrom most of this stuff emanated, became a scary dream. Why China raced ahead of India?

The four scenarios described above highlights the new system we as are in. At the center of problem of HDPE manufacturers was a bilateral treaty between India and Nepal which required redefining of Rules of Origin in new open trade environment. In the case of manufacturers consuming raw material produced by large companies, absence of effective Anti- Trust Laws or Competition Policy hurt the SMEs because of which large producers manipulated the prices. When the prices of these commodities were at all time low internationally, Indian companies lobbied and they got away with higher rate of import duties on these commodities. The higher duties provided them the cushion to increase the prices of these raw materials. It would have been an old story but for one thing. Though the customs duties for raw material got increased the corresponding increase in finished products (which consumed these raw materials) was not done or could not be done as they were already around Bound Rate¹ sealings. Many product categories, therefore, suffered due to 'reverse-tariff-escalation'. That is their effective rate of protection was reduced considerably due to the anomaly. And, finally, because import regime became liberal after removal of Quantitative Restrictions, the

¹ As a signatory to the General Agreement of Tariffs and Trade (GATT)⁹⁴, under WTO, India has bound 67% of its tariff lines. The binding is at two levels 25% and 40%. If applied tariff was above 40% in 1990, it was bound at 40% and if it was less than 40% it was bound at 25%.

threat of traders to resorting to imports if they increased the prices kept a tab on the prices of the finished products. Cost increased, prices of their products stabilized, the casualty: their profits

Similarly, Indian exporters faced the barriers partly in response to the barriers we erected for the import of rest of the world and partly because we were not sensitive to the concerns of the consumers in the markets we exported. What is important to understand is that the blockage was done not just by anti-dumping measures or safe-guard measures- the instruments provided to Governments through WTO regime, but also by consumer and community led movements against alleged use of child labour, cruelty against animals, health hazards etc.

In the case of cheap imports from China, part of the problem was that Chinese were not governed by that time by WTO rules and partly that they have been able to derive competitiveness over India because of attaining economy of scales in production of items they exported and that they build world class infrastructure which was efficient and economical.

Mind everybody else's business too!

What do Indian SMEs must to survive and grow in this fiercely competitive global environment? ...Many of the implications remain to be understood. But one thing is clear -- nothing is as before. The world has become an increasingly interwoven place. As Francis Fukuyama- one of the greatest sociologist of our times- states, never before in human history so many nations moved towards market economy and liberal democracy. The fall of Berlin Wall proved symbolic to the falling of barriers between nations.

In order to appreciate the dynamics of today's trading environment, we need to understand what Friedman terms as 'the one big thing to know'- **globalization**. What is globalization? Let's try to capture the most debated phenomenon of our times.

Globalization, is the extraordinary explosion of both technology and information, in ways that have considerably reduced the twin concepts of time and space. It refers to global economic **integration** of many formerly national economies into one global economy, mainly by free trade and free capital mobility propelled by Information and Communication Technology. The very word "integration" is derived from "integer", meaning one, complete, or whole. Integration is the act of combining into one whole. It follows that in order to be competitive the productive plant of each country would be torn out of their national context (dis-integrated), in order to be re-integrated into the new whole, the globalized economy.

Paul Streen pints out to two important faces that have emerged of globalization are :

- a. Growing legal and institutional framework within which the regimes of contemporary international trade, finance and investment are being conducted. The emergence of World Trade Organization is the one of the most important example of this kind of trend.
- b. Another form of globalization is emergence of powerful communities and groups around issues which are essentially global as the environmental issues, women's and anti-nuclear movements, human rights struggles and like. Groups like Amnesty International, Green Dot, WWF, Consumer bodies have become phenomenally powerful and are challenging national governments.

How the system affects SMEs?

Michael Porter describes that the four most important exogenous forces that work on the enterprise:

- Regulations
- Macroeconomics
- Consumer preferences

- Technology

Globalization affects all the four forces in varying degrees which influences the World Trading Environment which in turn have had great impact on the enterprise.

Regulations

As globalization stretched social, political and economic activities across political frontiers, regions and continents, the magnitude of interconnectedness grew rapidly. The flows of trade, investment, finance, migration, culture etc. has been rapid. The growing intensity and velocity of global interactions can be associated with their deepening impact such that the effects of distant events can be highly significant elsewhere and even the most local developments may come to have enormous global consequences. Evolution of a global regulatory mechanism was a natural out come of this setting.

The emergence of World Trade Organization is just a beginning of convergence of global regulatory mechanism of newer genre. There has been multilateral agreements earlier also like on environment and labour. What differentiates the WTO and new genre of multilateral institutions is their formidable capability to influence trade of a particular country; their verdicts could scare away the investors and the global financial institutions from a particular country at a lightening speed. Because the boundaries between domestic matters and global affairs became increasingly blurred, whereas the impact of General Agreement on Tariffs and Trade (GATT)- the predecessor of WTO, was confined to international trade, the impact of WTO agreements is all pervasive- domestic trade, international trade, regional trade, global trade. And why just Trade, WTO influenced all the factors of trade.

The Economic System and the Macroeconomics:

An *economic system* is the system by which the economy is organized. For example, if an economy is organized through markets, it is a market economic system. Macroeconomics deals primarily with aggregates (total amount of goods & services produced by society) and absolute levels of prices. It address issues such as level of growth of national output (GNP & GDP), Interests rates, unemployment and inflation. In practical terms both the economic system and the macroeconomics set the parameters within which the enterprise operate.

For countries who opted to be players in the new World Trading Environment- influenced by globalization, the road is not much different. Market economy and liberal trade policies. What does that mean? In the words of Thomas Friedman, it means: Making the private sector primary engine of growth; Low rate of inflation and price stability; Shrinking the size of bureaucracy- liberalization and privatization; Balanced budgets; Removing restrictions on foreign investment; Elimination of quotas and monopolies etc.

Consumer Preferences:

The dramatic developments in Information Communication Technologies have led to, seemingly contradictory, globally convergent as well as divergent consumer choices. The convergence could be seen in consumers preferring the products that are of the best quality, environment friendly backed by world class service. The divergence is seen as increasingly customers prefer the customized product than the mass produced product of previous century. The preference is for the supplier who could cater to the consumer's sensibilities which could be individual or religious or related to particular life style.

And top of it is the tool in the hand of the consumer, the internet, which makes cost of the comparison shopping to zero. The customer can easily and quickly find the lowest price of any product and service. It is almost impossible to get away with bad corporate behaviour.

Technology :

If integration is the hall mark of globalization, it has its own defining technologies: computerization, miniaturisation, digitalization, internet...and so on. Recent innovations in science and technology have provided us with a "new set of tools" which greatly increase productivity and efficiency in all areas. Technology has changed the rules of competition, rendering many traditional business strategies and processes obsolete. The change in technology is transforming products, services and markets as well as customers and competition.

Today, when the buyer of a General Electric (GE) product calls for customer support, the bell rings across seven seas in India where the an employee of yet another company under contract from GE, attends the query of the customer. GE saved millions of dollars by outsourcing the customer support. Technology made it possible. But a fundamental question arises: where is the boundary of a company (GE) or a country (US) ? It is blurred. The functions of GE were disintegrated to be re-integrated in global economy. The advancement in Information Technology alone has changed the face of business. It requires much greater attention than what is being accorded by SMEs till now. What IT is capable of doing is to alter the rules of value-chain and the market completely for a given product. Hitherto unknown value propositions are emerging challenging the traditional ways.

Besides IT, the speed of advancement of technology is increasing rapidly. It is pushing change in Product Standards and broadening consumer choices. Though, the changes have influenced all sectors, certain sectors have had greater impact as :

- Services (from health care to banking and finance to transport to IT enabled services)
- Agriculture
- processed food
- Automobiles
- Electricals and Electronics
- IT and Telecommunication hardware
- Fabric and Textiles

Summing up :

Studying external environment is rare phenomenon in SMEs. This orientation is incompatible with the centripetal characteristic of the SME which causes resources to be applied almost exclusively to existing products, problems and prfitabilities. Even in the pre-globalized world, all progressive companies applied their most important resources in well organized efforts to find out what is happening around the world. Today, this is an absolute must even to survive. This is the pre-condition to do business in the new World Trading Environment.

In all the four scenarios we discussed in the beginning, though the turn of events have been beyond the capacity of small manufacturers to stop, yet they have not been entirely helpless. Most of these events could have been foreseen and planned for. SMEs will have to make determined efforts to know the new system : the threats it exposes them to, the opportunities it springs, the obligations it imposes as well as the rights it enshrines.

To conclude, let me quote what FISME President Mr. Dinesh Singhal said recently, "Globalization has thrown many challenges to SMEs. One of the greatest conceptual challenges is that on one hand,

the individual SMEs would be fiercely competing with each other within the nation and beyond, at the same time they would be forced to collaborate and work together than ever before to safeguard their own mutual interests to survive. The relevance of associations and consortiums would increase considerably. Those who would realize their importance would have greater chance to succeed and survive.”

Influence of Trading Environment on SMEs : At a glance

Sl.	Business function	Trading Environment influenced by
1.	Business idea	- Agreements on Trade Related Aspects of Intellectual Property Rights (TRIPS) under WTO covers Patents, Trade Marks, Copyrights, Industrial Designs, Geographical indications etc
2.	Access to funds	- General Agreement on Trade in Services (GATS) - Degree of openness of Financial sector in the country*
3.	Access to Technology	- TRIPS - Degree of openness of trade regime* - Credibility of legal framework*
4.	Access to competitively priced raw materials	- Degree of openness of trade regime* - Presence of Regulations that discourage collusive and monopolistic behaviour of large producers (Competition Policy or Anti-Trust Laws)*
5.	Infrastructure (Power, Rail, Road, Ports)	- Macroeconomic stability and prudential budgeting* - Level of private participation in infrastructure* - Credibility of legal framework* - General Agreement on Trade in Services (GATS) - Plurilateral Agreement on Govt. Procurement*
6.	Taxation	- Absence or presence of VAT* - Macroeconomic management of economy*
7.	Access to markets / Level of competition	- Multilateral Agreements like: GATT, GATS and TRIPS - Regional Agreements (SAPTA) - Bilateral Agreements (like with EU, USA, Bangladesh, Sri Lanka, Nepal, Mauritius etc.) - Competition Policy or Anti-Trust Laws* - Public Procurement Systems* - Degree of openness of trade regime*
8.	Degree of Quality/ Innovations	- TRIPS - Degree of openness of trade regime* - Consumer redressal & legal framework* - Competition Policy or Anti-Trust Laws*
9.	Competitiveness	- Degree of openness of trade regime* - Competition Policy or Anti-Trust Laws* - Quality of Infrastructure including power* - Competitive Financial sector* - Legal framework*
10.	Ability to exploit growth opportunities	- Insolvency and Bankruptcy laws* - Legal framework* - Attitude of society towards failure*

* Areas where Indian system needs improvement to create enabling environment for growth of economy in general and for SMEs in particular.

