Model World Trade Organization

Tunis Business School

The integration of SMEs in international trade
Internal and external Barriers

Study Guide for the Model WTO 2017

This study guide was elaborated to be the basis of negotiation during the Model WTO Tunis Business School 1st edition.

Model World trade organization is proposed by Dr. Leila Baghdedi and organized by Tunisian International Model United Nation Tunis Business School.

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"The Model World Trade Organization Tunis Business School 2017 organizing team welcomes you to the simulation and hopes that all delegations engage in a beneficial discussion about the issues at hand "

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Small and Medium Enterprises

Small and medium-sized enterprises are non-attached, independent firms which employ fewer than a given number of employees. While a broad generic definition can be taken for SMEs note that some countries have a very specific definition for what types of enterprises can be called an “SME”. For example, under the European commission laws a micro company has fewer than 10 employees and a turnover or balance sheet total less than €2m. A small company has less than 50 employees and turnover total no greater than €10m. A medium-sized company has fewer than 250 employees, a turnover under €50m and a balance sheet total of no more than €43m.

SMEs have been neglected in the trade debates due to their small contribution to the international trade, even though they represent 99% of an estimated 23 million enterprises in the EU and provide around 75 million jobs representing two-thirds of all employment, they even contribute to up to 80% of employment in some industrial sectors, such as textiles, construction or furniture.

SMEs possess a great potential that will enable them to actively participate in international trade , offer unlimited possibilities with a view to enlarge trading fields and markets and participate in creating a steady progress toward welfare and wealth. This is now possible thanks to many factors such as; technological progress, trade agreements including the SMEs in small way (e-commerce, Global Value Chain, reduced exporting costs).

There are many benefits that can be derived from including smaller firms in international trade. Benefits that will affect the same firms in the first place ; improving productivity, quality of products and mainly the stability and sustainability of these small firms.

Moreover, international and local economies, as well as Consumers can benefit from internalization of SMEs in the sense that a wider variety of products will be available. In addition to an equitable distribution and a broader spread of resources among society.

However, SMEs face different obstacles that can be categorized into 3 types:

- **Internal and specific impediment for SME's** : These firms face multiple constraints when it comes to their growth and development like shortage in human resources, lack of managerial skills as most of these firms owners are inexperienced, in addition to basic qualification SME's staff has.

- **Financial constraints and other exogenous factors:** Following the most severe economic crisis in decades and weak recovery during recent years, SMEs experienced stiffer credit terms than large firms, in the form of higher interest rates, shortened maturities and increased requests for collateral. This reflected heightened risk aversion on the part of banks.

- **Trade barriers:** Obstacles to trade are particularly burdensome for SMEs. Evidence suggests that a lack of information about foreign distribution networks, border regulations and standards and lack of IPR enforcement represent the main obstacles to trade for SMEs.

During the World trade Organization Simulation at Tunis Business School, these barriers will be discussed in 3 different Committees as follows:

Committee on SME growth and Development:

Because of their small size, SMEs face many problems related to their growth and development. Studies show that SMEs have difficulties in maintaining a long run life because of constraints they face like augmented costs, discontinuous information network and lack of knowledge. These constraints are divided into three major parts:

- **Human resource issues:** lack of managerial skills, staff qualifications, Time and knowledge and as a direct result this created limited information about the foreign markets regulation and standards as well as difficulties contacting overseas customers.

- **Transport and logistics:** due to their small capital compared to big firms SME's face multiple problems when it comes to transportation and export that comes from the high cost and their inability to access these services. This problem is more profound when it comes to the case of SMEs in developing countries due to poor infrastructure and undeveloped logistics market.

- **Access to distribution Networks**: Traditionally SMEs used direct contact with clients which proved to be more effective than the use of intermediaries in the distribution channel, particularly for services that have exclusive distribution strategies, a single product, clearly defined clients and episodic sales. The use of this "direct" model can make the product difficult to export for SME's especially if they want to target a wider set of clients.

Only a small part of the SMEs has been able to identify and exploit these opportunities and deal with the challenges, this is why it is crucial to hold a committee on SME growth and development both on the local and international level in order to ensure appropriate internalizations of SMEs.

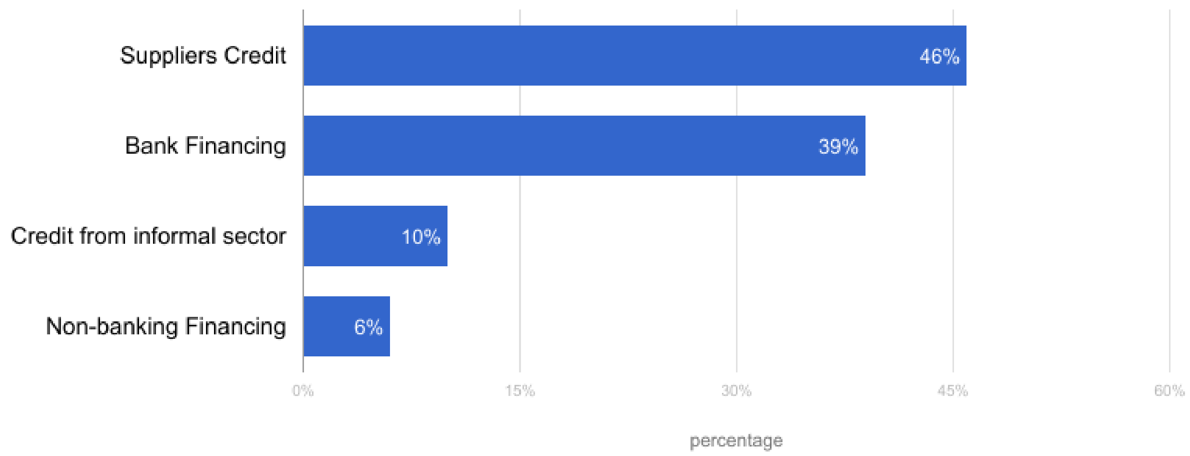
Committee on SMEs Access to Finance

The domestic business environment in each Member state of the World trade organization can cause internationalization barriers for SMEs, such as domestic policies and administrative practices. National initiatives could facilitate SMEs' access to finance, export insurance, more transparency and more efficient administration to increase international activities (both exporting and importing).

The leading barrier to the integration of SME's in the International trade is as Identified by many is the access to finance. Lending to SMEs, especially for longer maturity dates, is often inhibited by informational problems and transaction costs, including the absence of records of firm's past performance (required when requesting a loan), lack of collateral, and high fixed costs of financial transactions, all of which often translate into higher lending costs and greater risks for financial institutions, and hence higher interest rates and fees for SMEs than for larger firms. Indeed, recent research found that market failures, notably in financial markets (due to either financial crises or "information asymmetries"), fall disproportionately on SMEs, resulting in more credit rationing, higher "screening" costs and higher interest rates from banks than for larger enterprises. (Trade finance and SMEs, WTO 2016)

Understanding how SME exporters finance their operation is crucial. ***Figure 1*** shows types of working capital used by SMEs engaged in direct exports or IPNs*

Figure 1: Sources of external Financing for SME



Supply chain financing (supplier credit) is the most important source of financing for exporting SMEs (46%), followed by bank financing. These two sources of financing account for about 80% of exporting SMEs' working capital at the global level. Reliance on non-bank financing (e.g., factoring companies*) is very limited (6%) and lesser than reliance on credit from the informal sector (10%).

The problem of Access to finance is more defined in developing countries. This is due to the fact that local banks and financial institution may lack the capacity, knowledge, regulatory environment (laws), international network and foreign currency to supply export import activities of SMEs. Equally, traders may not know the products (banking services) available to them, or how to use them efficiently. Banks in some developing countries may be more risk-averse, in view of their smaller capital base and ability to handle international trade-related credit risk.

**International Production Network*

**receiving cash immediately against documentation such as the export contract, a process called "factoring" (Trade Financing and SME, WTO 2016)*

Committee on trade barriers:

There are different factors that affect SMEs participation in international trade and that represent a trade barrier. One factor is non ad-valorem tariffs, which consists of a form of import tariff that means that the customs duty is calculated as a percentage of the value of the product. There are also additive costs independent of the price of the good, such as specific tariffs (per unit tariff). These costs have a different impact on SMEs than on a large firm. It is undeniable that increasing the costs of a product whose price is 1TND by 1US$ does not have the same effect as increasing the cost by 1US$ for a product that yields 100US$, which creates a barrier for small and medium-sized enterprises and hinders their internationalization.

Studies show that higher costs allow firms to reach greater number of consumers, which makes it more difficult as the sales volume increase given that competition and firms own limits will increase more slowly once a certain level has been attained. Large firms already spend large costs in reaching new customers which makes them save more in case of a tariff increase, whereas, on the other hands, where costs are reduced, SMEs has a greater growth potential.

Furthermore, there are unfavorable foreign rules and regulations that may result in high tariff barriers. Costs like customs administration and restrictive health, safety and technical standards oppose in a way to the SMEs internationalization. Costs incurred for measures like Technical barriers to Trade (TBT) and the Agreement on the Application of sanitary and Phytosanitary measures (SPS) may set good standards for quality but excessively refrain small enterprises from expanding, even though there are articles on these agreements that discipline the cost raising effect.

These Non-tariff measures have an important fixed cost component, because it requires firms to comply with costs to enter foreign/new markets, or incur costs in order to obtain required certification or qualifications to provide some services or sell some goods. The NTM does not imply any variable costs afterwards; however, the fixed costs they imply represent a high share for an SME volume of affairs which may become a trade barrier for the small firms. In fact, unlike relatively large firms, SMEs are not able to spread these costs over large export values. The lack of transparency regarding trade rules and domestic regulations are additional challenges small firms. Papers found that exchange rate fluctuations have a worse impact on SMEs exporters on two way traders or large exporters.

**The Technical Barriers to Trade (TBT) Agreement aims to ensure that technical regulations, standards, and conformity assessment procedures are non-discriminatory and do not create unnecessary obstacles to trade. At the same time, it recognises WTO members' right to implement measures to achieve legitimate policy objectives, such as the protection of human health and safety, or protection of the environment.*

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