

SMEs in ASEAN Economic Community: Promoting Participation in Regional Production Networks for Inclusive Growth

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SMEs in ASEAN

- SMEs play important role in promoting regional integration, including in ASEAN economic integration
 - More than 90% of firms in ASEAN Member States (AMS) are SMEs
 - Contribute significantly to employment

SMEs in ASEAN countries: Relative Size and Employment in 2000 (estimates)

Year 2000	SMEs as % of all firms	SME workforce as % of total employment
Brunei	98	92
Indonesia	98	88
Malaysia	84	39/m
Philippines	99	66
Singapore	91	52
Thailand	96	76/m
<i>Cambodia</i>	99	45
<i>Myanmar</i>	96	78
<i>Vietnam</i>	96	85

Source: Asasen, et al. (2003)

Note: Percentages refer to shares in national totals.

/m: manufacturing only.

SMEs in ASEAN

- As one of the key elements in the third pillar of ASEAN Economic Community
 - AEC views SMEs agents for inclusive growth
- But ASEAN is not so clear on how it achieve the goal of its SME development agenda.
 - ASEAN however is clear on what it envisions for ASEAN SMEs by 2015

SMEs in ASEAN

- ASEAN initiatives on SMEs:
 - ASEAN Policy Blueprint for SME Development (APBSD) 2004-2014
 - Outlines framework for ASEAN SME development as a measure to narrow development gap
 - By 2015, ASEAN SMEs would comprise world-class enterprises:
 - Major parts of regional and global supply chains;
 - Able to take benefit from ASEAN economic integration
 - Innovative and competitive
 - Strengthen resilience

SMEs in ASEAN

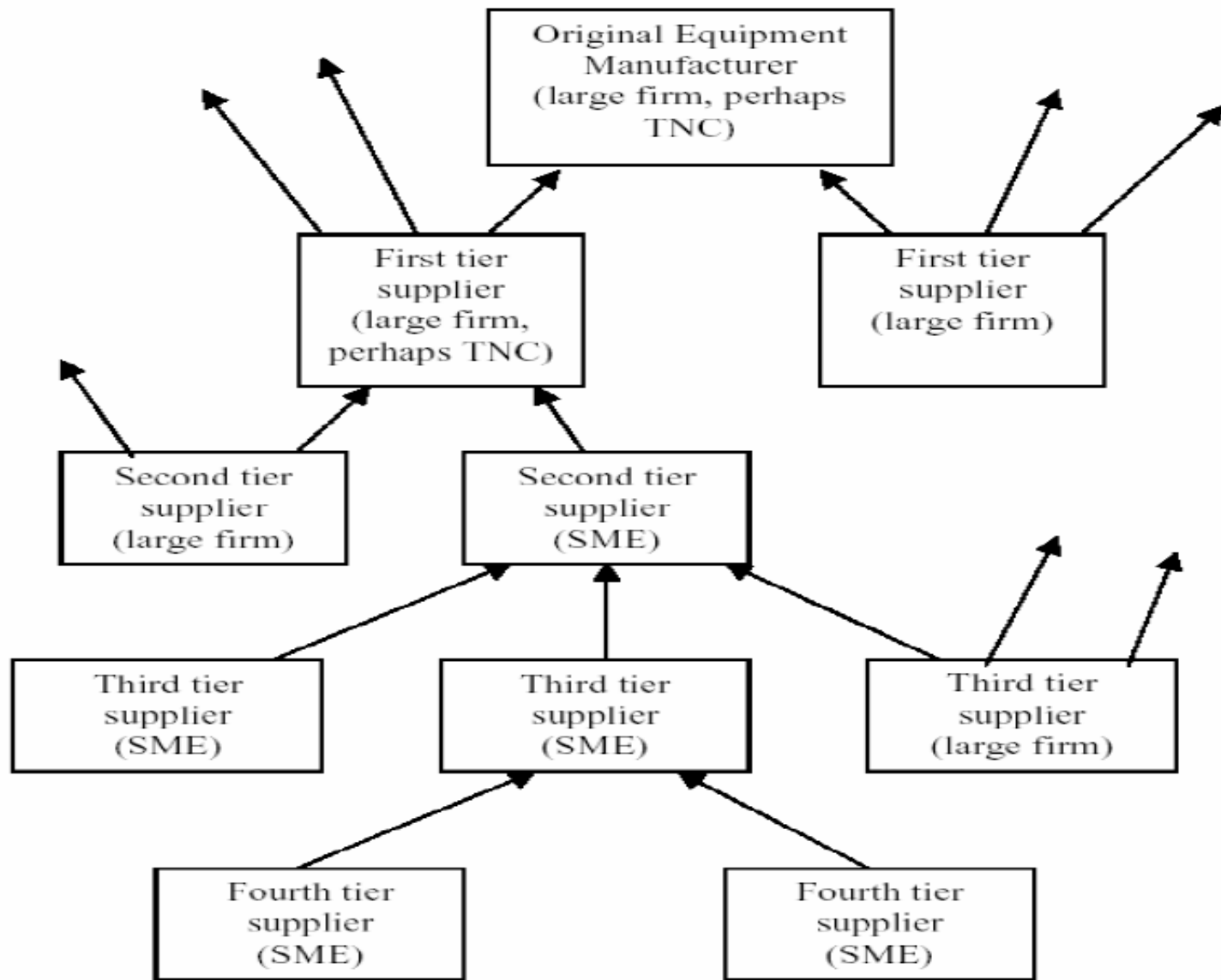
- ASEAN initiatives on SMEs:
 - Strategic Plan of Action for ASEAN SME Development
 - Enhance resilience and competitiveness
 - Element of the action plan:
 - Access to financing
 - Facilitation
 - Technology development
 - Promotion
 - Human resource development

This paper...

- Supports the idea to further integrate SMEs in ASEAN countries with international production networks (IPNs) as a strategy to achieve the objective of ASEAN SME development
 - AEC is designed to bolster IPNs
- Draws results from ERIA research that examines the determinants of SME participation in IPNs
- Also discusses access to finance, a closely related issue to SME participation in IPN.

Participation of SME in production networks

- The economies of many AMS are integrated to the East Asia production networks. Hence, there is a chance for SMEs to benefit more from these networks.
- SMEs are usually parts of lower-tier in the network (competitiveness are: low cost structure and flexibility).
- But significant threat of survival. They typically are used as price breakers and capacity buffers, and thus, can be dropped at short notice.
- Improving competitiveness addresses survival threat. Building technological capability is one way to do so.



Source: Abonyi (2005)

Firm characteristics of SME participating in production networks

- SMEs participate in international production networks (IPN) are substantially different to those do not.
- They are younger, larger, have higher intensity of foreign ownership.
- Productivity is another important determinant.
- Thus, SMEs participated in IPN prepare themselves by mimicking the characteristics of exporting firms.

Average Value of SME Characteristics, between SMEs Participating and Not-Participated Participating in Production Networks

Characteristic	In Production Networks	Not in Production Networks	Statistically Different
Size (employees)	66.2	52.1	Yes ⁺
Age (years)	10.6	13.8	Yes ^{**}
Share of foreign ownership (%)	18.2	7.2	Yes ^{**}
Labor productivity (sales/employee, thousand USD)	26.8	23.0	No ²
Loan interest rate (%)	6.1	8.9	Yes ^{**}
Interest Coverage Ratio, ICR ⁴	250.0	77.5	Yes [*]
Credit interest rate (%)	6.2	8.9	Yes ^{**}
Distance to industrial parks or EPZs (hours)	1.0	0.9	No ³
Distance to port (hours)	1.3	1.2	No ³
Skill intensity ⁵	0.4	0.3	Yes ^{**}

Firm characteristics of SME participating in production networks

- Innovative SMEs have better chance to participate in IPNs.
 - Mostly process innovation (eg. Improving business strategies)
- SMEs in IPNs are less financially constrained, and have better access to financial sources
 - They get lower interest rate on loans
 - They have better cash-flow
 - They are likely able to convey more information to banks/creditors, lowering the typically high risk assessment for SMEs.

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Innovation Effort Characteristics, Frequency (in %) of SMEs Participating and Not Participating in Production Networks

Characteristic	In Production Networks	Not in Production Networks	Statistically different
Met international standards (e.g. ISO, etc.)	44,4	36,5	Yes*
Introduced information and communication technology	35,5	36,0	No ²
Established new divisions or plants	27,0	18,8	Yes*
Involved in business network activities	52,6	47,1	No ³
Bought new machinery with new functionality	58,4	47,9	Yes**
Improving the existing machinery	72,5	59,1	Yes**
Introduced new know-how in production method	49,6	40,7	Yes*
Recently introduced new products	63,4	55,1	Yes*

Policy implications

- Developing SMEs and Promoting SMEs to Engage in Production Networks
 - A multi-pronged approach is needed to tackle the issue of access to finance (found to be the most serious barrier for participation in IPN).
 - Credit reporting agencies
 - credit guarantee schemes
 - Microfinance institutions
 - Non-banking financing
 - Capacity building to help SMEs to access formal credit

Policy implications

- Promoting SMEs to Participate More Effectively in Production Networks
 - Successful development of clusters
 - Inviting more FDI (to create more tech spillovers)
 - Firm technological and innovation capability
 - Availability of infrastructure, including infra for ICT
 - IPR.

Policy implications

- Strengthening the Regional Institutional Arrangements for Supporting SMEs
 - Make sure that economic partnership include various forms or areas of cooperation and capacity building.
 - Very important so that SMEs are able to benefit from various trade facilitation measures.

SME Access to Finance

- SMEs in general face a number of obstacles in accessing finance; mainly related to their limited resources and perceived risks by lenders.
- Classic issue: credit rationing for SMEs, because of greater opaqueness and risks.
- Access to finance seems to be the biggest problem.

SME Access to Finance

- Key findings from ERIA study:
 - Start-up and expansion mainly from internal finance.
 - However, external finance becomes more important for domestically owned, smaller, making lower profit, as well as for SMEs in less-developed economies.
 - There is evidence of credit rationing, or risk premium exercised, by financial institution on SMEs. Again, stage of development seems to matter.
 - Networth, collateral, business plan, and cash flow matter.
 - Financial access significantly affect innovative capability of SMEs.

Final Remarks

- Promoting SME development in ASEAN is a very difficult task
 - Complex; depends not only on policy or external condition, but also on SME's characteristics and how SME perform/behave
- No reason to be pessimistic, however:
 - At least ASEAN has its mechanism, ie. ASEAN SME Blueprint and its strategic action plan.
 - The blueprint and strategic plans are not without weaknesses; but the process in ASEAN allows for continuous refinement.

Final Remarks

- One way to accelerate SME development in ASEAN: improving monitoring mechanism for the implementation of the SME Blueprint.
- ASEAN may consider to adopt the similar (monitoring) process taken by Western Balkan countries through their (OECD) SME Policy Index.

Final Remarks

- **‘Scorecard Plus’**
 - **Guard** the policy implementation within a robust policy framework;
 - The process (self- plus independent evaluation) ensures policy makers to **realize** their weaknesses.
 - The process (involves public consultation and discussion of the evaluation results at regional level) allows countries to always **learn** one from the other;

Final Remarks

- Having SME policy index in ASEAN facilitates and harmonize policies, strengthens coordination of policy and programs, and serves as instrument for capacity building.
- Of course, the (OECD) version of SME policy index need to be **tailored** according to priority and situation in ASEAN.
- The two issues mostly need immediate attention are perhaps: **start-up** and **financial access**. Promoting **innovation** is also important considering IPNs and sustainable development (ie. green tech adoption).

Thank you..!

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