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)

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

*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

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>In Production Networks</th>
<th>Not in Production Networks</th>
<th>Statistically Different</th>
</tr>
</thead>
<tbody>
<tr>
<td>Size (employees)</td>
<td>66.2</td>
<td>52.1</td>
<td>Yes⁺</td>
</tr>
<tr>
<td>Age (years)</td>
<td>10.6</td>
<td>13.8</td>
<td>Yes**</td>
</tr>
<tr>
<td>Share of foreign ownership (%)</td>
<td>18.2</td>
<td>7.2</td>
<td>Yes**</td>
</tr>
<tr>
<td>Labor productivity (sales/employee, thousand USD)</td>
<td>26.8</td>
<td>23.0</td>
<td>No²</td>
</tr>
<tr>
<td>Loan interest rate (%)</td>
<td>6.1</td>
<td>8.9</td>
<td>Yes**</td>
</tr>
<tr>
<td>Interest Coverage Ratio, ICR⁴</td>
<td>250.0</td>
<td>77.5</td>
<td>Yes⁺</td>
</tr>
<tr>
<td>Credit interest rate (%)</td>
<td>6.2</td>
<td>8.9</td>
<td>Yes**</td>
</tr>
<tr>
<td>Distance to industrial parks or EPZs (hours)</td>
<td>1.0</td>
<td>0.9</td>
<td>No³</td>
</tr>
<tr>
<td>Distance to port (hours)</td>
<td>1.3</td>
<td>1.2</td>
<td>No³</td>
</tr>
<tr>
<td>Skill intensity⁵</td>
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<td>Yes**</td>
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Firm characteristics of SME participating in production networks

• Innovative SMEs have better chance to participate in IPNs.
  – Mostly process innovation (e.g. 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

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<td>Met international standards (e.g. ISO, etc.)</td>
<td>44,4</td>
<td>36,5</td>
<td>Yes*</td>
</tr>
<tr>
<td>Introduced information and communication technology</td>
<td>35,5</td>
<td>36,0</td>
<td>No²</td>
</tr>
<tr>
<td>Established new divisions or plants</td>
<td>27,0</td>
<td>18,8</td>
<td>Yes*</td>
</tr>
<tr>
<td>Involved in business network activities</td>
<td>52,6</td>
<td>47,1</td>
<td>No³</td>
</tr>
<tr>
<td>Bought new machinery with new functionality</td>
<td>58,4</td>
<td>47,9</td>
<td>Yes**</td>
</tr>
<tr>
<td>Improving the existing machinery</td>
<td>72,5</td>
<td>59,1</td>
<td>Yes**</td>
</tr>
<tr>
<td>Introduced new know-how in production method</td>
<td>49,6</td>
<td>40,7</td>
<td>Yes*</td>
</tr>
<tr>
<td>Recently introduced new products</td>
<td>63,4</td>
<td>55,1</td>
<td>Yes*</td>
</tr>
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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.
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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