

# Prologue

## Overview of the ASEAN SME Policy Index

### 1. Introduction

Small and Medium Enterprises (SMEs) play an important role in ASEAN economic integration because between 89-99 percent of the firms in ASEAN Member States (AMSs) are SMEs. Together, they create between 52-97 percent of employment, and contribute between 23-58 percent to the Gross Domestic Product (GDP), and 10-30 percent in total exports (Table 1).

**Table 1: Significance of SMEs in the Economy in Selected Years**

| Country                  | Share of Total Establishments |      | Share of Total Employment |      | Share of GDP |      | Share of Total Exports |      |
|--------------------------|-------------------------------|------|---------------------------|------|--------------|------|------------------------|------|
|                          | Share                         | Year | Share                     | Year | Share        | Year | Share                  | Year |
| <b>Brunei Darussalam</b> | 98.2%                         | 2010 | 58.0%                     | 2008 | 23.0%        | 2008 | -                      | -    |
| <b>Cambodia</b>          | 99.8%                         | 2011 | 72.9%                     | 2011 | -            | -    | -                      | -    |
| <b>Indonesia</b>         | 99.9%                         | 2011 | 97.2%                     | 2011 | 58.0%        | 2011 | 16.4%                  | 2011 |
| <b>Lao PDR</b>           | 99.9%*                        | 2006 | 81.4%                     | 2006 | -            | -    | -                      | -    |
| <b>Malaysia</b>          | 97.3%                         | 2011 | 57.4%                     | 2012 | 32.7%        | 2012 | 19.0%                  | 2010 |
| <b>Myanmar</b>           | 88.8%**                       | -    | -                         | -    | -            | -    | -                      | -    |
| <b>Philippines</b>       | 99.6%                         | 2011 | 61.0%                     | 2011 | 36.0%        | 2006 | 10.0%                  | 2010 |
| <b>Singapore</b>         | 99.4%                         | 2012 | 68.0%                     | 2012 | 45%          | 2012 | -                      | -    |
| <b>Thailand</b>          | 99.8%                         | 2012 | 76.7%                     | 2011 | 37.0%        | 2011 | 29.9%                  | 2011 |
| <b>Viet Nam</b>          | 97.5%                         | 2011 | 51.7%                     | 2011 | -            | -    | -                      | -    |

*Note:* \* Asian Development Bank (2013), \*\* Registered numbers.

*Source:* Country Reports.

SME development is embedded in the third pillar of the ASEAN Economic Community (AEC) Blueprint, namely, equitable economic development, and its development would directly contribute towards achieving the implementation of the third pillar. SMEs in the region, however, are reported to have difficulties in access to finance, technology, and competitive markets. Entrepreneurship, compliance with

standards, marketing and management are also some of the other problems faced by SMEs in ASEAN.

Usually, SMEs are in a much weaker position than large firms to deal with the vicissitudes of economic volatility. They will be forced to respond to these developments by implementing risk management strategies, speeding up customer payments, focusing on the retention of skilled staff where possible and critical for high tech SMEs, cutting costs, diversifying into new markets, and improving their corporate governance. These, however, are not likely to be an adequate response and will need to be supplemented by appropriate policies aimed at addressing these vulnerabilities.

As such, an appropriate SME policy framework is fundamentally important for the growth of the private sector, in particular, SMEs, as is the need to ensure that the adverse consequences of external or exogenous disturbances emanating from regional trade partners have a minimal disruptive impact on domestic and regional economies.

The strengthening of ASEAN SMEs requires improvement of human resources, provision of access to finance, technology and innovation, and market as well as internationalization through policy support measures, supplementary activities and appropriate communication. In particular, providing access to finance for start-up SMEs is important for strengthening the SME development in ASEAN.

The AEC Blueprint has focused on SME development through the ASEAN Policy Blueprint for SME Development (APBSD) 2004-2014. It is expected that by 2015, ASEAN SMEs would form a major part of the regional and global supply chains. The Strategic Action Plan for ASEAN SME Development (SAPASD) 2010-2015 has been devised to engage the businesses on issues of access to finance, technology development, and human resources development, among others, in order to enhance the resiliency and competitiveness of SMEs. The post 2015 AEC needs to define a clear strategy for involvement of the private sector, especially SMEs, to achieve an inclusive economic growth in the region.

Because the region's business players are preponderantly SMEs (including micro enterprises), the pursuit of SME development is in fact not just for equitable development in the region under the third pillar of the AEC Blueprint; it is also for the strengthening of the competitiveness and robustness of the region's economies which depend, to a large extent, on the competitiveness and robustness of the region's SMEs.

And precisely because SMEs are critical for the robust growth of the AMSs and the whole region itself, it is important for the policy regime in the region to be facilitative of the growth and development of the SME sector in the region. Such policy regime is determined by both ASEAN initiatives and agreements, and national policies and programs. Towards this end, it is necessary to have a consistent SME policy framework in the ASEAN at both the national and regional levels. Additionally, there needs to be a comprehensive and effective monitoring tool like the ASEAN SME Policy Index to see whether the policies, programs and institutions are supportive of the development of SMEs in the region.

The ASEAN SME Policy Index derived from the OECD SME Policy Index and was further adapted to the ASEAN specific context. The SME Policy Index was originally developed by the European Commission, the European Bank for Reconstruction and Development, and the European Training Foundation. It has been successfully used in South East Europe (Albania, Bosnia and Herzegovina, Croatia, Kosovo, the Former Yugoslav Republic of Macedonia, Montenegro, Serbia and Turkey) as a monitoring tool as well as an instrument for facilitating policy dialogue, program coordination and the promotion of good practices in the region since 2006. The OECD SME Policy Index has also been applied to North Africa and the Middle East region (Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestinian Authority and Tunisia) and the Eastern European countries (Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine).

## **2. The Importance of an ASEAN SME Policy Index**

The development of the ASEAN SME Policy Index starts with the APBSD (2004-2014) which laid out strategic programs and policy measures that focus on five main priorities: (i) Human resource development and capacity building; (ii) Enhancement of SME marketing capabilities; (iii) Access to financing; (iv) Access to technology; and (v) Creation of a conducive policy environment. Concrete and detailed policy measures, implementation time frame, and indicative outputs have been identified.

The APBSD was later replaced by the SAPASD (2010 – 2015) which outlined the framework for SME development as a key measure for equitable economic development in the ASEAN region. The latter laid out policy measures to address: (i) Access to finance; (ii) Facilitation; (iii) Technology development; (iv) Promotion; and (v) Human resource development.

Both the APBSD and the Strategic Plan focus primarily on regional initiatives and have less emphasis on consistent national SME policies. The development of SMEs in the region though is affected by both national and regional policy regimes and program initiatives. In addition, there seems to be no systematic mechanism to track the progress and effective implementation of the APBSD and the Strategic Plan.

In this regard, the ASEAN SME Policy Index would improve on the APBSD and the Strategic Plan by incorporating dimensions and initiatives at both regional and national levels. Drawing from the OECD SME Policy Index and insights from the studies done at APEC (Asia-Pacific Economic Cooperation), the ASEAN SME Policy Index will have more policy dimensions than what are indicated in the APBSD and the Strategic Plan to attain the goals of ASEAN SME Development.

The ASEAN SME Policy Index can be expected to have useful functions for the ASEAN SME Working Group and the AMSs, similar to the functions of the OECD SME Policy Index (OECD, 2009) which include: (i) an analytical and dynamic tool to review SME policy developments on a number of policy dimension and across countries; (ii) a process by which a group of countries sharing common policy goals agree on to develop a joint framework for monitoring and comparing SME policy developments; and (iii) a framework to exchange experiences and good practices, and foster policy dialogue.

### **3. Objectives of the SME Policy Index**

The SME Policy Index is a tool that systematically and analytically tracks policy development and identifies gaps in both policy elaboration and implementation at the

national and regional levels (OECD, 2009, p.34). Similar to the OECD SME Policy Index, the objectives of the ASEAN Policy Index are as follows:

- Structured evaluation
  - Evaluate progress in SME policy reform on a comparative basis
  - Assess countries' performance, corresponding to the various dimensions of reform
- Targeted support for improvement
  - Prioritize regional and country level policy priorities and support needs
- Regional collaboration and peer review
  - Encourage more effective peer review through a common evaluation framework
- Public and private sector involvement
  - Offer a simple and transparent communication tool for potential entrepreneurs or investors
  - Establish a measurement process that encourages public/private consultation
- Planning and resource allocation
  - Facilitate medium-term planning, particularly for dimensions that require multi-year programs
  - Provide a tool for resource mobilization and allocation, following the identification of strong points and areas for improvement

#### **4. Framework for ASEAN SME Policy Index**

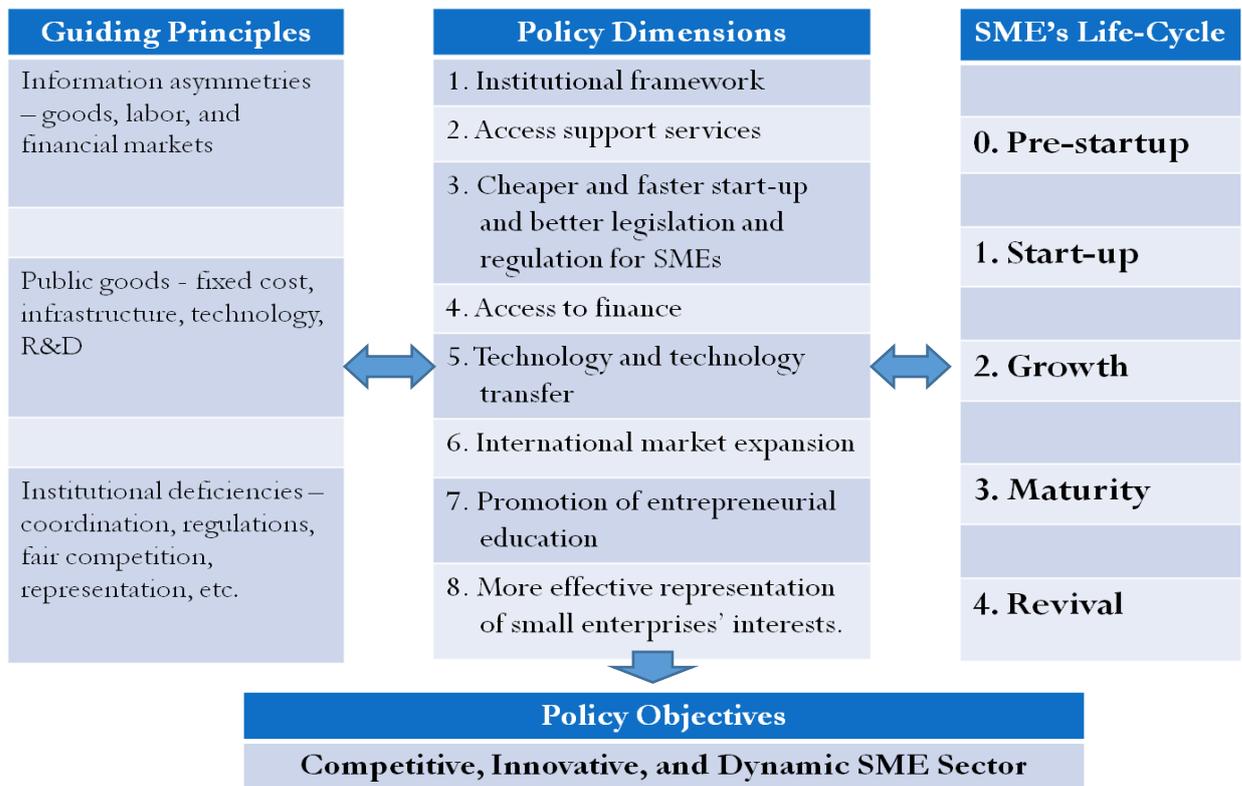
It has been widely recognized that both government and market failures such as excessive regulations, red tapes, monopoly power, asymmetric information, coordination failures, poor contract enforcement, free riders and other externalities, exist. These problems could hinder growth prospects and put SMEs in a more disadvantageous position compared with larger firms. Governments that pursue policies for public interest correct these failures by providing level-playing fields for all businesses and protecting the public from business abuses through regulations and appropriate policies.

In order for SMEs to become more competitive, innovative, and dynamic, the ASEAN SME Policy Index is designed to improve the business environment that must

be relevant to SMEs in any of the five stages of their life cycles (pre-start-up, start-up, growth, maturity, and revival). Being a comprehensive and effective monitoring tool, it also facilitates policy dialogues and connects the regulatory and policy environments towards the achievement of good practices (Figure 1).

Following the approach of the OECD SME Policy Index, the ASEAN Index is composed of several policy dimensions, each of which is subdivided into a number of sub-dimensions. Each sub-dimension in turn is composed of a number of indicators, with each indicator having a number of levels of policy reform or a set of policy reforms.

**Figure 1: SME Development Policy Framework and Firm Life-Cycle**



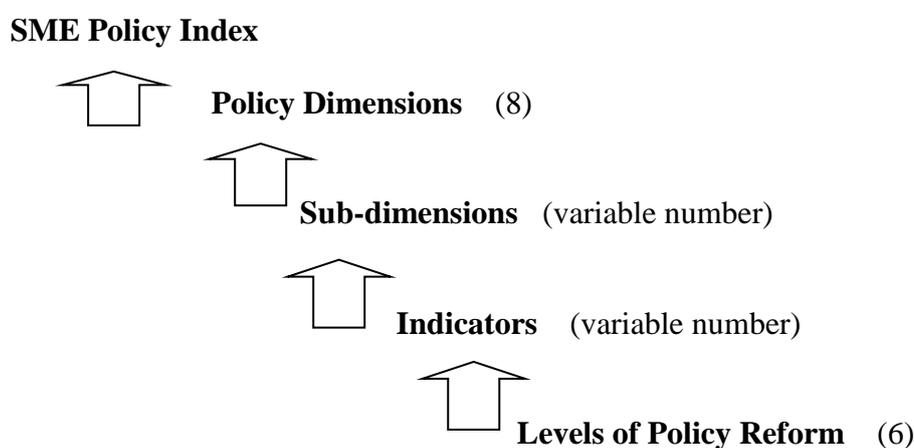
The following is a list of eight policy dimensions of the ASEAN Policy Index based on the ASEAN SME Blueprint, the Strategic Plan, and the OECD:

1. Institutional framework;
2. Access to support services;
3. Cheaper and faster start-up and better legislation and regulation for SMEs;
4. Access to finance;

5. Technology and technology transfer;
6. International market expansion;
7. Promotion of entrepreneurial education; and
8. More effective representation of SMEs' interests.

To reflect more the specific circumstances of the ASEAN region, the ASEAN SME Policy Index differs from the OECD SME Policy Index in its policy dimensions, sub-dimensions, indicators and levels of policy reform.

**Figure 2: Process in Constructing the ASEAN SME Policy Index**



*Source:* Adapted from OECD (2009).

Figure 2 shows each of the policy dimensions, sub-dimensions, indicators, and the six levels of policy reform around which the indicators are structured.

In total, there are 58 sub-dimensions/indicators, each of which has 6 levels of policy reform, starting from 1 for no specific policy measure or institution (poor) to 6 for a well-functioning institution or effective implementation of each policy measure (good practice).

For example, in order for business registration, as one of the indicators in policy sub-dimension 3 (cheaper and faster start-up), to qualify as best practice, level 6 of policy reform or the registration process must take less than five working days, require only one administrative step, and cost less than USD50.

The elaboration of the framework, list of sub-dimensions, indicators and levels of policy reform draws from the inputs of experts, stakeholders, and concerned government and ASEAN officials as presented in Appendix 2<sup>1</sup>.

## **5. Methodology**

The policy assessment in the SME Policy Index is conducted by an independent research team from each AMS through a questionnaire survey and in-depth interviews. The assessment draws inputs from government agencies, private sector and other SME stakeholders. The results of the assessment from each country are put together for consultations with government agencies, and compared and discussed in a workshop for refinement. The results are then internally reviewed by a panel of experts from the OECD and ERIA to ensure their consistency between countries and across the region.

The process of coming up with the SME Policy Index is therefore participatory in nature and offers a fair evaluation of policy implementation through an independent and peer-review process.

The method measuring policy implementation by means of the indicators offers flexibility for a country to choose policies that suit its situation well. This flexibility also means that the SME Policy Index is adaptable to different policy processes and institutional settings, given a wide difference in development and political settings of the AMSs.

## **6. Summary of the Assessment Results**

The results from the Policy Index suggest uneven levels of performance in the implementation of SME development policy at the national level between the two traditional groups of the AMSs, namely, (a) the less developed members or the CLMV

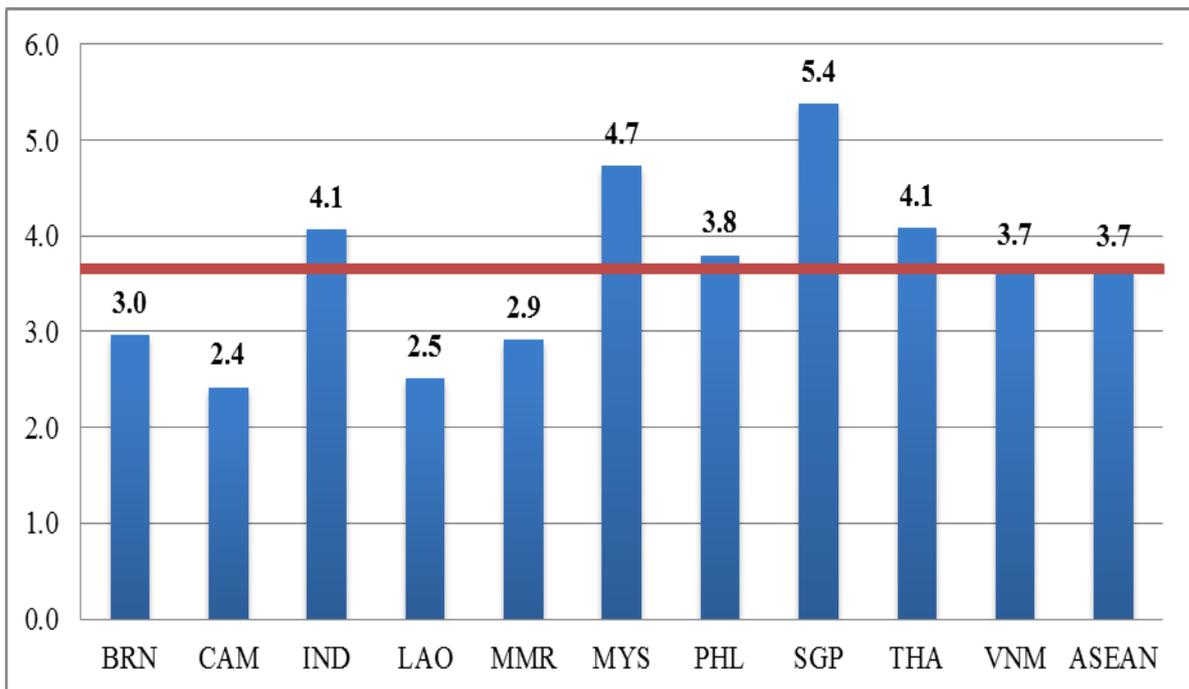
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<sup>1</sup> There are substantial suggestions from the Thai member of the ASEAN SME Working Group to improve the assessment framework. The suggestions will be incorporated in the next round of the assessment by making some modifications in the framework.

countries – Cambodia (CAM), Lao PDR (LAO), Myanmar (MMR), and Viet Nam (VNM), and (b) the more advanced members or the ASEAN-6 which include Brunei Darussalam (BRN), Indonesia (IND), Malaysia (MYS), Philippines (PHL), Singapore (SGP), and Thailand (THA). An exception should be mentioned in the case of Brunei Darussalam, which has a relatively lower score in comparison with Viet Nam (Figure 3).

Higher index scores reflect better performances and practices. On average, Singapore, Malaysia, Indonesia, Thailand, and the Philippines are in the top order of the index score, above the ASEAN average, followed by Viet Nam, Brunei Darussalam, Myanmar, Lao PDR, and Cambodia, whose aggregate index scores are below the ASEAN average.

**Figure 3: ASEAN SME Policy Index – By Country**



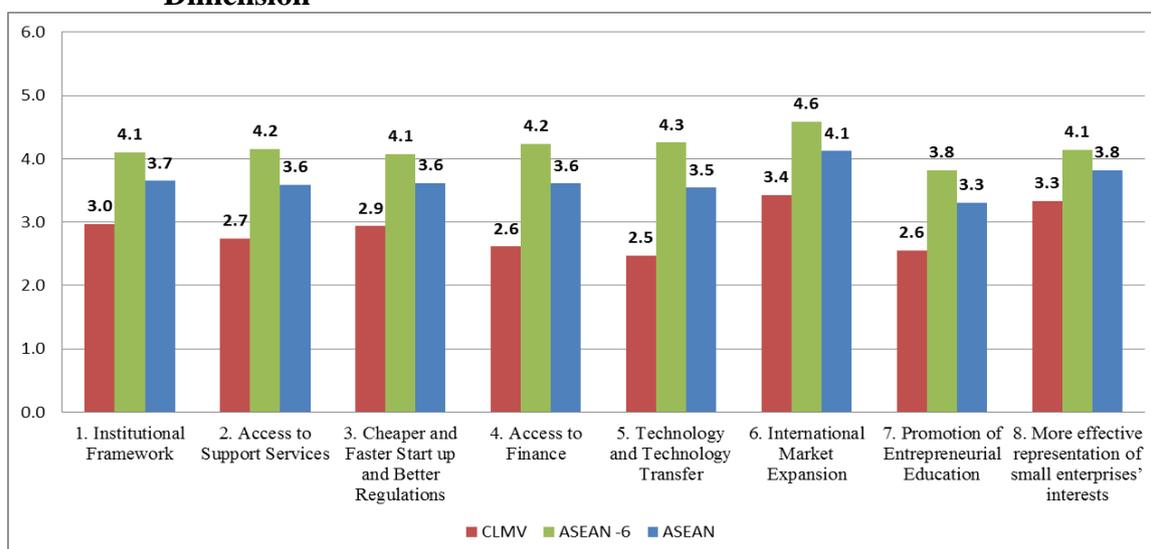
As seen in Figure 4, across the eight policy dimensions, there are big gaps between the ASEAN average, ASEAN-6 and the CLMV countries, with the most significant gaps and low regional standing found in five policy dimensions, namely: (5) *Technology and Technology Transfer*, (4) *Access to finance*, (7) *Promotion of*

*entrepreneurial education, (3) Cheaper, faster start-up and better regulations, and (2) Access to support services.*

Underlying the gaps in performance between the AMSs in these key policy dimensions are the status of legal frameworks and institutional arrangements as well as the elaboration and implementation of specific policy measures in each AMS (see Policy Sub-dimensions and Indicators, Tables 2-9 and the Appendix).

- The biggest gap in policy, i.e., to promote *technology and technology transfer*, is due to the lack of strategic approach to innovation policy for SMEs, poor provision of information on innovation support services, limited access to standard certification services, lack of technology support in universities, and little linkages between SMEs and R&D labs and incubators. Poor protection and promotion of intellectual property rights (IPRs), lack of broadband infrastructure, underdeveloped science/industrial parks, lack of competitive clusters, and insufficient financial incentives in technology development and R&D activities are also reasons for the gap.

**Figure 4: ASEAN SME Policy Index – By Group of Countries and Policy Dimension**



- The gap in *access to finance* is exacerbated by the poor functioning of the cadastre system, stringent collateral requirements, and inadequate protection of creditor rights. Credit risk guarantee schemes and a central bureau for credit information, which are essential to promote collateral-free finance, are not well established and well-

functioning. There is also a lack of a legal framework/policy to promote alternative finances and diversified financial markets, ranging from microfinance, leasing, factoring, venture capitals, equity funds, business angels, to stock markets.

- *Access to support services* is severely hampered for SMEs in the CLMV countries due to the lack of action plan for the provision of support services, poor services of business development service centers (BDS), lack of legal framework for and underutilization of e-commerce and e-government services, and unreliable online portal for SMEs.

- *Promotion of entrepreneurial education* exhibits both gaps between the two groups of AMSs and a very low standing at the ASEAN level because most AMSs have not clearly articulated an entrepreneurial promotion policy nor have integrated it into their national development plans with adequate budget, monitoring and evaluation system. Key competencies of entrepreneurship learning programs are not well introduced in the general and higher education system and there is lack of active collaboration with the private sector to develop curricula, research, customized training, coaching, internship, business awards and scholarships. Non-formal education in entrepreneurship and management of SMEs is also not well promoted.

- There are also variations between AMSs in the policy on making *cheaper, easy start-up, and better legislation and regulations* for SMEs. Procedures for business registration and overall process for SMEs for entry into operation are, in general, simpler, faster and cheaper in more advanced AMSs than in the CLMV countries. Most of the ASEAN-6 can provide online registration, one-stop-shop services, and varieties of financial support for start-ups. Both existing and new legislations and regulations are routinely and systematically reviewed using the regulatory impact analysis (RIA) framework in these advanced AMSs.

- The gap in the capability to provide facilitating support for *international market expansion* is relatively wide between the two groups of AMSs. It is because export

promotion programs, provision of advice and high quality information are better structured in the ASEAN-6. They have also developed and run export capacity building programs nationwide in a well-coordinated manner. More financial facilities such as trade credits, grants, and insurance schemes are also in place in the ASEAN-6 to encourage SMEs to expand their market overseas, with a faster and cheaper custom clearance.

- The overall development of *institutional framework* is not even among AMSs. A common SME definition has been applied in relevant government agencies in the implementation of the SME development strategies in most of the ASEAN-6. In addition, these AMSs have a multi-year SME development strategy which has been adopted by a single institution responsible for SME policy formulation and implemented by a designated executing agency with an effective coordinating role. Moreover, their mechanism for review, monitoring, and evaluation of the strategy is clearly in place, and programs/measures to facilitate the movement of SMEs from the informal to the formal sector are adopted.
- The gap in promoting an *effective representation of SMEs' interest* is the smallest in the region due to the active role of industrial, business or SME associations in setting up structured consultation mechanisms with government agencies in policy formulation and advocacy process in order to represent SMEs' voice and interests domestically and internationally. However, most SME associations still lack resources, and technical and research capacities to provide high quality services and access to regional and global production networks.

In order to get a better understanding of the results, the succeeding chapters – Chapters 1 to 8 – describe in detail the performance of each AMS with respect to each policy dimension at the sub-dimension and indicator levels so that both strengths and weaknesses of each AMS can be thoroughly discussed.