

# Chapter 10

## Small and Medium Enterprises in Cambodia, Laos, and Vietnam

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## Chapter 10

# SMALL AND MEDIUM ENTERPRISES IN CAMBODIA, LAOS, AND VIETNAM

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### Abstract

Small and medium enterprises (SMEs) are categorized into four groups: supporting industries, export-oriented industries, domestic market-oriented industries and cottage industries. Supporting industries are defined as having backward linkages with the machinery industry. The creation of such linkages may accelerate industrialization, create more employment, and diversify economic activities.

Apparel and footwear are the main export industries in Cambodia, Laos, and Vietnam (CLV). Domestic market-oriented SMEs and cottage industry SMEs enjoy close linkages with distributors through informal financing. Although it is not easy for domestic market-oriented SMEs to enter supporting industries because they require technology and management skills, some SMEs invest in high-technology equipment and improve management methods. Taking a cue from cottage industries that have started exporting, proponents of SME policies can promote such shift and diversification.

Expansion of demand and competition encourages the entry of local SMEs. Policies cannot control demand but facilitate imports of components and capital goods and exports of products. It is important to develop local SMEs to accumulate skill and know-how. There are two possibilities for new entrants. First, domestic-oriented SMEs like replacement parts manufacturers can join supporting industries. Second, employees in existing factories of MNEs can set up their own enterprises to supply components to them. In both cases, there are bottlenecks in low technology, unskilled management and unskilled workers. Strengthening SME finance and training management and workers are can solve these bottlenecks.

Most SMEs in CLV belong to domestic market-oriented and cottage industries. As they are not registered, they are operating illegally. Tax concessions may encourage them to register. Most cottage industries depend on middle persons to procure materials and sell their products. These middle persons play an important role in improving informal financing that benefits households.

Distribution of cottage industries should be modernized. Public organizations can replace middle persons only in marketing promotion in domestic and export markets. Therefore, microfinance and cooperative society should support crafts manufacturers.

## **INTRODUCTION**

Policy framework that sought to foster small and medium enterprises (SMEs) was introduced in Cambodia, Laos, and Vietnam (CLV) from 1990s onwards. These countries shared some things in common. First, although they had foreign direct investments, the linkage between foreign companies and local enterprises were weak. Second, private enterprises could not thrive under a socialist regime. Although state enterprises, foreign companies and private companies, mainly SMEs, were operating, existing economic policies were biased in favour of state enterprises. Private companies could not secure production promises. And while the governments were encouraging registration of SMEs through reduced registration costs, many SMEs were still operating illegally. Third, cottage industries accounted for a large share of SMEs.

Cottage industries are important from the social policy and rural development perspectives, yet many of them are losing their base as industrialization progresses. Others are increasing exports. This means these industries still have a chance to survive.

Notwithstanding their current state, SMEs are expected to promote industrialization and to generate employment. SMEs have potentiality to become large enterprises. SME policies must encourage the establishment of new manufacturing enterprises, boost the growth of the private sector, and develop market access.

As SMEs refer to size of enterprises, their markets, technology, and financial source are heterogeneous. In this paper, SMEs are classified into four groups and their development examined. Finally, policy recommendations are given at the conclusion of this paper.

### **1. FOUR CATEGORIES OF SMES**

SMEs are categorized into four groups: supporting industries, export-oriented industries, domestic market-oriented industries and cottage industries. They can shift from one category to another in the process of development, or belong to two categories at the same time in the course of diversification. Since they cater to the domestic market, they

can get contracts from multinational enterprises (MNEs). Those in cottage industries start exporting through contracts with foreign buyers.

### **1.1 SMEs in Supporting Industries related with Machinery Industry**

Supporting industries are defined as industries with backward linkages with the machinery industry, including electric machinery and transport equipment. They supply parts and components, capital goods such as die and machine tools, and materials like steel and plastics. Although MNEs create employment and facilitate management transfer to employees, their effects are limited without backward linkages. The creation of such linkages accelerates industrialization, creates more employment, and diversifies economic activities.

When MNEs set up assembly factories of final products in developing countries to take advantage of cheap labour, some of them start production from complete knockdown of imported components. Others bring to their host countries their related companies back home as suppliers. As production volume increases and reaches the minimum level where economies of scale work for suppliers, suppliers can start production. In some cases, local replacement parts manufacturers become suppliers to MNEs. In other cases, employees of MNEs establish their own enterprises and subcontract with the MNEs. As a result, MNEs can procure parts and components at lower prices, since they do not have to pay for transportation costs and tariffs.

As supporting industries develop, a cluster of SMEs is formed around the factories of MNEs. SMEs have production linkages with MNEs through a multi-tier supply chain. MNEs occupy the top tier. First-tier suppliers, which mainly consist of large enterprises that include foreign enterprises, supply parts and components to MNEs. Second-tier suppliers, comprising mainly of SMEs, supply parts and components to first-tier suppliers.

Suppliers must meet customer demand at three points: (1) price reduction by some targeted percentage within a certain time span, reflecting efforts to reduce costs; (2) high reliability in quality assurance; and (3) high reliability in keeping up the delivery schedule. The contract is not necessarily rigid and exclusive. Electric machinery and automobile companies produce many models. They change models regularly. Specifications for each part of the new model as well as the price thereof are

determined during development period prior to the model change. Once a supplier receives an order for a part when the commercial production of the new model is launched, his delivery normally continues. There is a tendency for each large enterprise to assign responsibility for the supply of part of a model to a single supplier to avoid duplicate investment. But when the life cycle of a given model ends, there is no guarantee that the concerned supplier can receive an order for the same model part. On the other hand, customers support improvement of production efficiency among suppliers by providing technical assistance like training of suppliers' employees and dispatching engineers to suppliers' factories.

Moreover, learning through constant interactions with a particular customer facilitates skills formation around basic technological capability that suppliers have accumulated. Asanuma defines accumulated learning acquired through transactions as relation-specific skill. The effect can be expected from competitive spot bidding if the transaction is repeated for over a certain period (Asanuma 1989)<sup>1</sup>. Such multi-tier supply system is not formed in all industries. Supply systems on the basis of specializations are selected when the upstream production requires specialized technology (Kimura 2001). Although the multi-tier supply system is typically observed in Japan, a similar system is working in developing countries in Asia.

The linkages between local enterprises and MNEs increase value added in CLV, promote technology transfer to local enterprises, and bring market information to local enterprises. The involvement of local enterprises in international production network promotes industrialization. In some developing countries, many foreign SMEs operate as first- and second-tier suppliers. Foreign SMEs have the same impact on production and employment. Yet, those that are based in developing countries withdraw quickly when they face problems. Lessons from experience, including failure, do not accumulate in their host countries. Japan's experience, for example, shows that SMEs with accumulated skills can change products and customers, thus adjusting themselves to market conditions.

The development of supporting industries may lead to the next stage of industrialization. In this sense, it is important to develop local SMEs to accumulate

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<sup>1</sup> Asanuma focuses on the relations between typical LEs that manufacture the final products of automobile and electric machinery industries and their suppliers of parts.

skills and know-how without excluding foreign SMEs. There are two ways to do this. First, domestic market-oriented SMEs like replacement parts manufacturers can join supporting industries. Second, employees in existing factories of MNEs can set up their own enterprises to supply components to them. Both schemes, however, are faced with low technology, unskilled management, and unskilled workers.

## **1.2 SMEs in export-oriented industries**

Labour-intensive industries for exports such as apparel and footwear industries have developed in CLV. As the Multi-Fibre Arrangement (MFA) restricted export quantity from developing countries to the U.S. and European markets, exports from factories in China had been regulated by quota. This encouraged foreign direct investments in CLV from Taiwan and Korea. Apparel manufacturers in CLV could take advantage of cheap labour and utilize export quotas for CLV under the MFA before 2005. Even after the MFA was withdrawn, they maintained exports due to the advantage of generalized system of preferences and quantitative regulations on exports from China based on safeguards by the European Union (EU) and the United States.

In Vietnam, foreign companies as well as local public and private companies set up factories and started exports under contract with foreign buyers. The apparel industry developed rapidly beginning in the 1990s. Cambodia and Laos followed suit. Its apparel industry has promoted industrialization and contributed to employment creation. Most apparel manufactures in CLV depend on buyers from the US and Europe for material, design, and marketing. Foreign buyers procure textiles, distribute them to manufactures, and take inventory risks under a cut-make-trim (CMT) contract. The former extends technical assistance and management guidance to the latter. Manufacturers must meet international standards on quality control. As such, they need to invest in machinery, which only medium- or large-scale enterprises are capable of doing.

Footwear is another product manufactured under contract with foreign buyers. Foreign and local private enterprises are set up and begin exporting, taking advantage of low-wage labour and utilizing the Generalized System of Preferences (GSP). As export manufacturers must invest in machinery to maintain international standards on quality control, they mostly comprise medium- or large-scale enterprises.

Although apparel and footwear are main export industries in CLV, their share in SMEs are low. In addition to apparel and footwear, some industries are increasing exports to CLV. In Vietnam, these include the wood products industry.

### **1.3 SMEs in domestic market-oriented industries**

As the economy grows and quality of life improves, demand for daily needs such as food, apparel and household goods may expand as well. SMEs manufacture these products for the growing domestic market. This market does not require international quality standards, so its entry barrier is low. As such, household and small enterprises can enter the market easily.

Although many SMEs have closed down due to lack of funds, their operations are dynamic. Some of them have grown to become medium and large enterprises. Domestic market-oriented SMEs are characterized by the following:

- Low investment in equipment and low technological level
- Dependence on cheap labour
- Limited access to bank loans and dependence on informal and traditional financial markets
- Close linkages with distributors through informal financing

In some cases, domestic market-oriented SMEs have been affected by trade liberalization due to low competitiveness. In fact, cheap goods from China are flooding the CLV markets. On the other hand, SMEs enjoy close ties with distributors through informal financing. This is the case of the Vietnamese apparel market. While Chinese apparel are selling fast in the northern region, cheap but low-quality apparel produced by SMEs are being sold in the southern region.

### **1.4 Cottage Industries**

CLV's cottage industries make essential items and supplies using traditional production methods. They include food processing, cane and bamboo work, ceramics, lacquer ware, embroidery and textiles. Those SMEs create non-farm employments and raise rural income levels. Rural households in Cambodia and Laos operate handlooms as a sideline to growing rice. Most of them cater to local markets near production sites.

Because the national market is divided into local markets, cottage industries can survive in spite of their low productivity. But as the local economy gets integrated into the national economy and foreign trade through improved transport infrastructure, cottage industries may suffer due to their low productivity, unable to match products made in large factories in the same market. But cottage industries can still develop. One way this can happen is to secure outlets through marketing. This means that SMEs must get accurate market information and meet demand. In many cases, however, middle persons withhold market information like those on design for cottage industry SMEs.

SME policies can support marketing. One possible method of marketing promotion is the “One Village, One Product” movement. As cottage industries have the potential to cater to tourists in CLV and export markets, products made by cottage industries must have value added so they can stand out. Some cottage industry SMEs could get orders from foreign buyers. In fact, Vietnam was able to increase exports of products made in cottage industries in the 2000s (Table 1).

	2000	2001	2002	2003
Cane, bamboo and rush works	78.6	93.9	107.9	136.1
Ceramics	108.4	117.1	123.5	135.9
Lacquer ware and handcraft	36.2	34.0	51.0	59.6
Embroidery	50.5	54.7	52.7	60.6
Carpet and textiles	13.9	9.2	5.3	5.1

*Source:* Idei (2006:161)

*Original Source:* Tong cuc Thong ke (2005) Tu lieu kinh te-xa hoi 64 tinh and thanh pho Viet Nam (Economic and Social Material of 64 Province and Cities in Vietnam), Ha Noi, NXB Thong ke.

### 1.5 Characteristics of SMEs

Table 2 shows the characteristics of four SME groups. There is a huge technological gap between supporting industry SMEs and domestic market-oriented SMEs even across the same products. In the supporting industry, suppliers are required to supply parts and components with consistent quality and on schedule. But many local SMEs do not have quality control and production capability to meet buyers' requirements.



**Table 2. Characteristics of Four SME Groups**

Category	Main player	Main Customer	Technology	Possibility of backward linkage
Supporting industry	Foreign SMEs Local SMEs	MNEs	High	High
Export-oriented	Foreign SMEs Local SMEs	Foreign buyers	High	Low
Domestic market-oriented	Local SMEs	Domestic market	Low	Low
Cottage industry	Local SMEs	Local market	Low	Nil

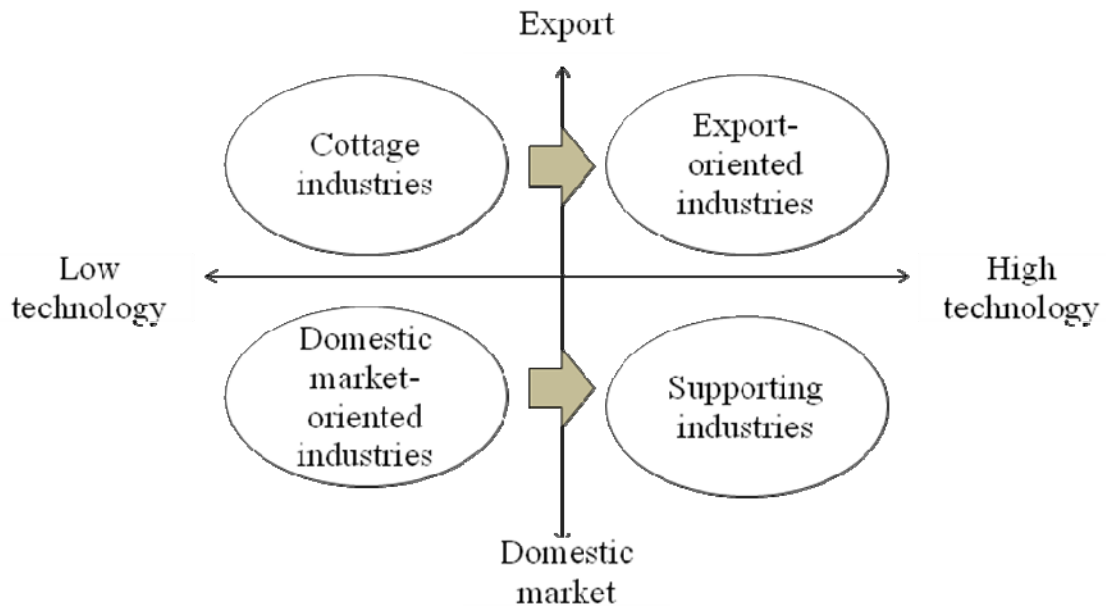
The Vietnamese motorcycle industry is an exception, though. Some SMEs catering to the domestic market have grown and are currently supplying parts to large enterprises as suppliers. By the late 1990s, three Japanese and one Taiwanese MNEs had set up assembly factories for motorcycles. A crucial turning point was the inflow of cheap knocked-down components from China in 2000 and 2001. Many local assembly factories were established to avoid import prohibitions on assembled vehicles. Prices of motorcycles made of cheap and low-quality imported components were one-fourth to one third those made by Japanese MNEs. These motorcycles have been able to penetrate medium- and low-income consumer markets in urban and rural areas that have remained unexploited by Japanese and Taiwanese enterprises.

A remarkable market expansion created by the entry of Chinese [*pls. check as edited*] components caused structural change in the industry structure. A Japanese MNE launched a new cheap model to compete with products made of imported components. It hiked procurement from local first-tier suppliers to reduce production costs. Soon the model became popular among local consumers. In January 2001, the Vietnamese government began more strictly implementing selective import tariffs for components with the right local content ratios. These encouraged Japanese and Taiwanese first-tier suppliers to replace imported components with locally sourced ones. They also replaced components sourced from Japanese second-tier suppliers with components from Taiwanese or Vietnamese second-tier suppliers. The majority of second-tier local suppliers were SMEs located near the first-tier suppliers. Some of them were originally manufacturers of replacement parts (Fujita 2008b). This was a rare but welcome

development for the domestic market-oriented SMEs. Without structural change in the domestic market, SMEs would not have the incentive to change their business style dramatically.

Although it is not easy for SMEs to enter supporting industries because they do not have the required technology and management skills, some domestic market-oriented SMEs are investing in equipment to introduce high technology and improve management methods. Cottage industries have started exporting. SME policies can promote such shift and diversification. (Figure 1 shows the direction of development and diversification.)

**Figure 1 Relation of Four SME Group**



## **2. SMES IN VIETNAM**

### **2.1 Policy Framework**

The SME policy framework came about gradually. The Enterprise Law that came into effect on 1 January 2000 abolished many licences and simplified enterprise establishments. As a result, the number of newly registered enterprises from 2000 to 2004 grew 3.5 times higher than the last nine years.

The central government Decree 90/2001/ND-CP, issued on 23<sup>rd</sup> November 2001, defines SMEs as “independent production and business establishments which make business registration according to the current law provisions, each with registered capital not exceeding 10 billion dong or annual labour not exceeding 300 people.” SMEs with less than 300 employee made up almost 100 per cent of all business establishments and over 77 per cent of all non-agriculture labour force in 2002. The decree covers the direction of SME policies such as SME finance, guarantee fund for SMEs, construction of industrial park for SME, among others. The Agency for SME Development was set up under the Ministry of Planning and Investment in 2003.

The New Enterprise Law and Investment Law came into effect on 1 July 2006. Foreign and domestic investments had been governed by two separate laws: the Law on Foreign Investment in Vietnam and the Law on Domestic Investments. As part of Vietnam’s efforts to meet the criteria for accession to the World Trade Organization, the principles relating to investment by foreign and domestic investors were unified in the new law. The New Enterprise Law is also intended to apply equally to domestic and foreign enterprises. The establishment of legal frameworks improved business environment and encouraged the entry of new businesses into the private sector and inflow of foreign direct investment.

The SME Development Five-Year Plan 2006-2010 was published in 2006. The plan assessed the development of SMEs in Vietnam and pointed out their weak points: (1) lack of skills, (2) lack of information on input markets, (3) limitation of market access, (4) low technology, and (5) non-transparent financial management, etc. The plan suggested four policy directions to develop SMEs, namely, (1) improvement of business

environment, (2) creation of access to land and production premises, (3) creation of access to finance, and (4) improvement of competitiveness (ASMED 2006).

Bias of policy implementation for state enterprises and unstable policies had discouraged investment in the private sector under the transitional period. As expected, low investment kept competitiveness of private sector low. The establishment of legal frameworks and improvement of infrastructure have enhanced the business environment of the private sector, including SMEs.

The development of SME finance happened when donors provided large funds to SME finance through Oversease Development Aid (ODA). Yet, there are still three major problems confronting SME finance. First, reliable information for credit assessment is not available from SMEs. Second, because the definition of non-performing loans became restrictive, banks tended to contain credit risk through cautious lending practices and dependence on collateral. Third, banks have pursued a business model which focuses on lending to state enterprises rather than SMEs (NRI 2008). As a result, only some SMEs can secure loans from banks and other formal financial institutions. Most household enterprises are getting traditional and informal finance.

## **2.2 SMEs in Supporting Industries**

After hearing from 32 Japanese assemblers and part suppliers of electric machinery, electronics, motorcycles and automobiles, Vietnam Development Forum (VDF 2006) concluded that overcoming the demand side problem is the most important condition for the development of supporting industries. Supporting industries require large minimum orders to enter the market. Consider what happened in 2004: When domestic demand for motorcycles reached 2 million units in 2004, market size was enough to cause the rapid development of supporting industries.

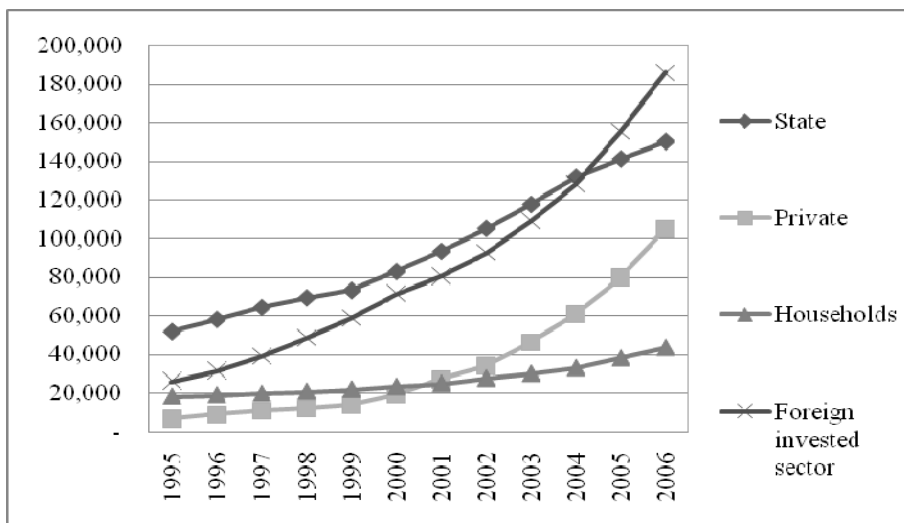
On the other hand, the market size of consumer electronics, including exports in Vietnam, is smaller than that in Thailand and Malaysia although domestic demand is growing. Japanese parts of electric machinery and electronics suppliers prefer to export parts from their existing factories in Malaysia or Thailand to Vietnam, rather than taking the risk to invest in Vietnam. The VDF has proposed the reduction of parts tariffs to zero to improve the cost competitiveness of electric machinery and electronics. It

assumes that expansion of production by final assemblers could generate larger orders for existing parts suppliers and encourage more foreign parts suppliers to invest in Vietnam.

Ohno, a member of VDF, has stressed the need for policies to focus on specific stages of promoting the supporting industries. According to Ohno, the first stage is to invite many assemblers among MNEs. The second is to invite foreign parts suppliers or foster local part suppliers to supply parts and components to them. The third and final stage is to enhance technology transfer and learning. Vietnam is currently in the first stage (Ohno 2003). In electric machinery and electronics industry, some MNEs concentrate on assembling—a labour-intensive process—importing most of its materials and exporting most of its products.

The focus of this three-pronged strategy is to accelerate industrialization in the short term and to establish industrial clusters in the long term. In fact, the foreign investment sector has led the manufacturing sector. Figure 2 shows that the private sector has increased its industrial output, next to foreign investors. In this context, the strategy could take advantage of the production network of MNEs, thus successfully promoting industrialization. This strategy, however, gives priority to large enterprises in the first tier.

**Figure 2 Industrial Output Value at 1994 Prices (Billion Dongs)**



Source: General Statistics Office of Vietnam <http://www.gso.gov.vn/>

As has been pointed out, a supporting industry has been developing in motorcycle industry. Some local second suppliers have grown from small enterprises to middle or large enterprises. This shows that local SMEs have the potential to become suppliers. SME policies should thus encourage the entry of local SMEs in supporting industries over the long term to create backward linkages.

### **2.3 SMEs in Export Oriented Industries**

In Vietnam, main manufactured export goods are apparel, footwear, wood products and electronics. In 2007 they accounted for 16.0 per cent, 8.2 per cent, 5.0 per cent and 4.4 percent, respectively, of total exports (JETRO 2009).

Private and foreign investment sectors significantly increased exports of apparel from 2000 onwards. Yet, both sectors depend on contract production with foreign buyers. Goto (2003) pointed out the difficulty to create backward linkages with the textile industry. Although Vietnam has many textile factories, they do not have the ability to meet the demand for high quality by apparel export manufacturers. More investment in equipment is necessary to improve the quality of locally manufactured textiles.

Beginning in 2000 the private sector raised footwear exports to EU dramatically. This eventually prompted the EU to impose anti-dumping duties on footwear from Vietnam in 2006. Such an action did not bode well for the country's footwear industry, which depends on contract production with foreign buyers. It did not help that Vietnam was getting low margin since it imports material.

The wood products industry began to develop in 1990. Ten years later its exports started to grow dramatically. Vietnam has two kinds of wood product manufacturers. One group consists of newly set up private enterprises and foreign enterprises. They are located near major ports in the southern region, exporting products under contract from foreign buyers. Another group consists of SMEs located in traditional art and craft villages in the northern region.

SMEs are based on household enterprises, an example of which is Dong Ky village. Craft makers set up companies and expand production, thus increasing exports. In 2003, 79 companies were registered, each of which had less than 50 workers. The local government has supported the development of cottage industries by establishing

industrial estates for cottage industries.<sup>2</sup> Dong Ky village has benefitted from the establishment of industrial estates that in turn led to the development of the wood products industry (Ishizuka and Fujita 2006).

#### **2.4 SMEs in Domestic Market Oriented Industries**

SMEs have been mushrooming in domestic market-oriented industries. Entry barrier is low because large amounts of investment are not necessary. When government protection was withdrawn, the domestic market-oriented industries, which had no international competitiveness (Ohno 2003), were expected to decline. Today, this sector is growing.

Fujita (2006a) surveyed 19 plastic moulding companies in Ho Chi Minh in 2003. Sixteen of these were SMEs, which employed less than 300 workers. Three large companies started production before 1990 and are producing household goods and other products. Twelve SMEs, which were set up after 1991, produce packing materials, specifically motorcycle parts. Products have been diversified in the plastic industry but SME technology has not reached the level required by MNEs.

Based on the 2002 and 2003 field survey conducted by Goto (2005) in Ho Chi Min City, there is a difference between exporting enterprises and domestic market-oriented enterprises. The former consists of medium and large enterprises that use modern sewing-related equipment, pre-sewing equipment and systems, and finishing equipment and systems to meet high-quality standards and complex specifications from buyers. They partly depend on bank loans to buy machinery. On the other hand, the latter are small enterprises employing less than 50 workers and using secondhand machinery. They must depend on their own funds or informal loans to buy equipment.

Goto points out two characteristic features of apparel SMEs catering to the domestic market. First, they utilize subcontracting based on blood and shared territorial bonds while exporting apparel manufacturers do not rely on them due to the difficulty of maintaining quality control. He compares workers' wages in SMEs as parent companies and those in their small enterprises, or their subcontractors, who employ less than 20

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<sup>2</sup> As land is owned by the state, the private sector cannot secure production premises without the local government's cooperation.

workers. The former's wages are 1.3 to 1.5 times higher than those of the latter. SMEs take advantage of cheap labour through subcontracting and provide sawing machines for small enterprises during the contract period at no cost to the latter. Second, SMEs extend informal loans to wholesalers through "goi dau," or the traditional system of sale on credit. Part of the payment is paid in cash at the time of the transaction and the remainder forms part of the credit. SMEs transact with wholesalers every four days on the average. The return on the loan is 3.76 per cent per month. Wholesalers can avoid inventory risks by paying high credit to SMEs. This means apparel SMEs catering to the domestic market can benefit from low wages through subcontracting and high return through traditional finance system.

SMEs can secure outlets under the present market conditions and distribution system. They can survive before the distribution system changes dramatically even if tariff rates are reduced.

## **2.5 SMEs in Cottage Industries**

Cottage industries are mainly located in the northern region. The Japan International Cooperation Agency (JICA) had a survey on cottage industries and found 2,017 arts and crafts villages in 2002. Arts and crafts villages are defined as having more than 20 per cent of the total village households engaged in the cottage industry, or where the industry accounts for more than 20 per cent of total village income. Of the 2,017 arts and crafts villages, 80 per cent are located in the northern region, particularly in the Red River delta. As some villages have plural industries, 2,971 industries were listed in the survey. Cane and bamboo work, textiles, wood products and embroidery accounted for 24 per cent, 15 per cent, 12 per cent, and 12 per cent, respectively, of the industries. The survey did not include the food industry, which produces traditional foods (Idei 2006).

In 1986 the Vietnamese government initiated economic reforms, which came to be known as the doi moi reforms. These reforms have had an impact on the cottage industry. Kojin (2006) conducted a survey at the Bat Trang village in Vietnam in 2004. Of the 1,625 households surveyed, 796 were engaged in ceramic manufacturing. Most of them were full-time manufacturers and employed workers from the neighbouring villages. Before the reforms were implemented, state and collective enterprises had been mainly producing ceramics for the domestic and export markets in socialistic countries.



Beginning in the second half of the 1990s, household enterprises increased exports rapidly, diversifying products to meet demand from Asian and European markets.

Kojin identifies the common characteristics of growing exporters following the *doi moi*. First, they looked for export outlet by themselves at the beginning of the reform period. Second, they could get valuable information on markets through foreign buyers. Third, they invested in equipment to improve the quality of their products. Although state and collective enterprises could not adjust themselves to market conditions, SMEs could do it well.

The central government started promoting cottage industries in 2000. Decision No. 132/2000/QĐ-TTg, dated 24th November 2000, of the Prime Minister on some policies which encouraged the development of rural trade was one of the first decisions the state promulgated with specific priority regulations for home craft production and handmade products (MARD 2009).

In spite of the promotion policies, cottage industry SMEs expected some policy assistance: (1) expansion of SME finance to encourage investment in equipment, (2) guidance of technology, including introduction of information on production technology, (3) establishment of a stable supply system for materials like agricultural products, and (4) marketing support, including participation in exhibition (Idei 2006). This shows that local governments must play an important role to promote cottage industry SMEs in addition to the establishment of industrial estates in arts and crafts villages.

### **3. SMES IN CAMBODIA**

#### **3.1 Policy Framework**

In Cambodia, the economic policy framework was formed when in July 2004, the government announced the Rectangular Strategy for Growth, Employment, Equity and Efficiency. As a component of the strategy, SME promotion is further delineated into 13 policies, which are as follows:

- Encourage the development of SMEs, especially through the provision of medium- and long-term finance.
- Suppress smuggling.
- Reduce registration procedures and start-up processing for companies.
- Facilitate export-import activities by simplifying procedures such as those for licensing and obtaining letters of permission.
- Support newly established industries for an appropriate period.
- Promote linkages between SMEs and large enterprises.
- Assist SMEs to enhance their productivity and reduce production costs.
- Ensure the quality of domestic products to meet regional and international standards.
- Establish national laboratories to quality tests and product testing.
- Strengthen the mechanism for the protection of industrial intellectual property rights.
- Promote vocational/skills training, both domestic and overseas.
- Expand and accelerate the “one village, one product” programme.
- Strengthen the legal framework by creating appropriate laws.

The focus of the strategy is to promote SME registration to facilitate tax collection and collect statistical information. Many SMEs choose to remain informal since the cost of incorporating outweighs the benefits (SMES 2005).

Cambodia became a member of World Trade Organization (WTO) on 13 October 2004. Although it has reduced import tariffs on agricultural goods and non-agricultural goods, it has enjoyed the benefits of a GSP at export markets in

developed countries. WTO requires member countries to adjust their laws according to WTO conditions.

In 2005, the Small and Medium Enterprise Development Framework was announced by the government. It was a medium-term strategy with two phases. In the first phase (from 2005 to 2007), the emphasis was on establishing a framework for an enabling environment for SME development. The second phase (from 2008 to 2010) sought to enhance and expand the framework for an enabling environment. It was intended to serve as the government's road map for the development of the SME sector.

The framework focuses on developing three kinds of industries to encourage diversify production, increase range of exports and improve productivity. They are agribusiness, labour intensive industries such as garment, toys and footwear, and industries based on processing existing natural resources such as fish, meat, cement production, brick and tile. It mentioned two ways to promote agribusiness. The first way was to strengthen the legal framework for longer-term land management. The second way was to provide tax incentives for establishing factories to process agricultural products, such as cotton, jute, sugar, palm oil, cashew nuts, rubber, cassava and fruits.

The framework identifies four key issues: (1) regulatory and legal framework, (2) access to finance, (3) SME support activities, and (4) policy coordination. SMEs in Cambodia are facing high costs and uncertain business. In particular, the legal framework has missing key legislation dealing with contracts, bankruptcy, and mechanisms for dispute resolution. Law on the Amendment to the Law on Investment, Law on the Amendment to the Law on Taxation, Sub-Decree No.148 on the Establishment and Management of the Special Economic Zone and Law on Management of Factories and Handicrafts were enacted in 2003, 2003, 2005, and 2006 respectively. But important laws such as Civil Code, Law on Commercial Contract, Law on Secured Transaction and Law on Insolvency had not been enacted yet (CDC 2006). Legislation for dealing with secured transactions or sharing credit information amongst banks is either inadequate or does not exist. Such missing components raise the cost of doing business and discourage entry. These, alongside an appropriate audit system, need to be established first before a responsive and reliable framework can be achieved.

### 3.2 Domestic Market oriented Industries

The domestic market is expanding due to the rise in living standards. Among others, increased urbanization has created new business opportunities like making bottled water, resulting in the setting up of more SMEs. In 2006, the Ministry of Industry, Mines and Energy determined that there were 31,149 small industrial establishments with fewer than 50 employees. Table 3 shows the highlights of the ministry's findings. First, half of the small enterprises were not registered. The share of licensed establishments in 2006 approximated that of 2002 at 50 per cent. There were 1,689 small textile and garment enterprises, of which over 90 per cent had no operating permits. These were mostly weaving enterprises in the cottage industry. Second, agro-industry accounted for 81.7 per cent of small industry establishments. Most of them were into rice milling. Agro-industry and cottage industries are major SMEs in Cambodia.

**Table 3. Small Industrial Establishments in 2006**

	Number of establishments	Labour	Licensed establishments
Food, beverages and tobacco	25,455	58,512	12,350
Rice milling	23,103	47,887	10,922
Textile and wearing apparel and leather industries	1,689	6,347	167
Paper products, printing and publishing	33	351	25
Chemicals	159	1,448	155
Non-metallic mineral products except products of petroleum and coal	797	8,932	652
Fabricated metal products, machinery and equipment	2,380	8,243	1,613
Other manufacturing industries	636	3,239	435
Total Manufacturing	31,149	87,072	15,397

*Source:* SMES (2007) "Technical Report: SME Statistics in Cambodia," p. 11.

Hatsukano (2006) conducted a survey of small enterprises in the food processing industry in 2005. Among nine SMEs surveyed, only two got bank financing while the remaining seven depended on their own funds or informal finance such, including funds from relatives and friends.

In 2007 the New Zealand Institute of Economic Research (NZIER 2008) conducted a survey of SMEs employing less than 100 workers. The survey covered 20 SMEs in the food processing industry. There were two major constraints to doing

business. First, 14 SMEs complained about either the cost or supply of electricity. Compounding the poor power supply was the fact that the tariff rate of electricity in Cambodia remained the highest in the region. In 2004, the average production costs of electricity per kWh in Cambodia, Laos, Thailand and Vietnam were 15.2 US cents, 2.7 cents, 3.2 cents, and 4.6 cents, respectively (Yim 2007). Second, SMEs were faced with competition from imported goods, which seven of the 20 SME owners considered difficult. It did not help that the competitiveness of Cambodian SMEs was already low due to the inferior quality of their products. The perceived superior quality of imported items made consumers prefer them to local ones.

### **3.3 Cottage Industries**

Silk handlooms have a long history in Cambodia and Laos. Middle persons play an important role in promoting the handloom industry. Kojin (2004) interviewed 13 weavers of silk handlooms in a village in Takaev state in December 2002 and July 2003. All weavers were women who wanted to help augment their family incomes. Based on the survey, handloom weavers had close linkages with middle persons. The latter would go to markets in Phnom Penh to buy materials like silk yarn and dye and sell the end products. Silk yarn and dye imported from Thailand and Vietnam are distributed in the market. The middle persons supplied materials on credit to weavers at an interest rate of \$1 to 3 per one kilogram of silk yarn. When middle persons purchased products, they deducted the cost of material and the corresponding interest from the payment. The same middle persons gave out cash and household goods on credit without interest to weavers. Weavers used the loan for their daily needs. Informal financing from middle persons helped make their relations with weavers stable.

It is doubtful whether the middle persons can develop new outlets. Distribution of textiles should be modernized to promote the silk textile industry. But as long as these middle individuals play an important role in informal financing to help improve the household budget, formal institutes like One Village One Product National Committee cannot readily take their place. The development of the cottage industry should be argued in the context of rural development. Thus, policies should have three purposes: (1) improvement of income of weavers, (2) marketing promotion in domestic and export

markets, and (3) financing of households. The establishment of a cooperative society is an idea that could be pursued to support weavers' households.

## 4. SME IN LAOS

### 4.1 Policy Framework

The promotion of SMEs in Laos gained legal ground with the enactment of the Decree on the promotion and development of SMEs in 2004.<sup>3</sup> The Small and Medium-Sized Enterprise Promotion and Development Office (SMEPDO) was established under the Ministry of Industry and Handicrafts in 2005 to serve as the secretariat to the National Small and Medium-Sized Enterprise Promotion and Development Committee.<sup>4</sup> However, broader policy frameworks aiming at SME development came into existence decades before 2004. The government signaled its official transition to a market-oriented economy when it adopted the “New Economic Mechanism Policy” in 1986. Privatization was one pillar of this transition alongside opening up to foreign direct investments (Keola 2006). Between 1990 and 1995, the government promulgated a series of economic laws and administrative decrees to turn private enterprises into a major engine for economic growth. While the word “SME” had not been used explicitly around that time, the Enterprise Law promulgated in 1994 made it possible, for the first time since 1975, to establish private SMEs legally in the country.

According to the Decree on the promotion and development of SMEs, either of three following criteria would define SMEs in Laos. These are (1) number of employees, (2) total assets, or (3) annual turnover. Based on these criteria, small enterprises are those with no more than 20 employees, or with total assets no exceeding 250 million LAK (Lao Kip. 1 USD = 8000 LAK, as of December 2008), or generating an annual turnover not exceeding 400 million LAK. Medium enterprises are those bigger than small enterprise but employing up to 99 employees, or with total assets not exceeding 1.2 billion LAK, or an annual turnover of a maximum of 1 billion LAK. Since information on total assets as well as annual turnover of enterprises can be largely erratic as well as

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<sup>3</sup> Decree on Promotion and Development of SMEs, no. 42/PMO, 20/04/2004.

<sup>4</sup> SMEPDC was established in accordance with the Prime Minister's Decision No. 23/PM, 8 March 2005. It is chaired by the Minister for Industry and Handicrafts and consists of 26 members, 17 of whom are from the private business sector. (SMEPDO 2009)

difficult to obtain, and for purposes of analysis, this report chooses a relatively stable number of employees as a prime criterion.

Though government's policy to promote SMEs is clear and defining them is simple enough if it is only based on number of workers, there is yet single survey in Laos that covers all SMEs by this definition. SMEs in cottage industries which are said to be the largest in terms of number have not been targeted by any nationwide survey, partly due to their unique business model. As will explained later, many small groups of people, usually within the same family or village, that produce handicrafts are generally scattered throughout the country and linked to local and foreign consumers through retail shops and middle persons. While retail shops are generally required to be registered with the Ministry of Finance for tax collection purpose, many of them are not registered with the other economic ministries directly engaging in promotion of SMEs. As such they may not be accounted for in general surveys of SMEs. Moreover, middle persons who link these craft persons to foreign market, mostly across borders in Thailand, are not likely to appear in any formal documents.

However, there have been several nationwide enterprise sample surveys since 2002. Based on the Business Establishment Survey 2004, there were 1,192 SMEs<sup>5</sup> in 2003 which increased to 1,478 in 2004 (Table 4). There were only 55 SMEs employing just 1,289 persons in food related industries in 2004. Laos is certainly among the countries with least developed SMEs in Southeast Asia. It is still highly depended not only on import of industrial goods but also on agricultural products from Thailand. Lao's major cities along the Mekong River still rely on Thai products ranging from rice, vegetables, eggs, noodles, salt, sugar to fish sauce and cooking oil, among others. Policy frameworks and measures in broader sense to promote SMEs were in place for years, and while progress has been made, it is obvious that much still need be done.

This section seeks to describe the current situation of SMEs in Laos based on available data and information gathered from various sources. It will also try to identify some of the obvious determinant bottlenecks that hinder faster development of SMEs in the country. This section also divides SMEs in Laos into four categories based on the framework discussed in the succeeding section.

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<sup>5</sup> Categorization by size of employment in Business Establishment Survey is not exactly the same with categorization of SMEs by law.



**Table 4: Number of Business Establishments by Main Activities**

Main Activities	2003			2004		
	Number of Employee			Number of Employee		
	1-9	10-99	from 100	1-9	10-99	from 100
Mining	3 (129)	24 (779)	3 (282)	7 (164)	27 (841)	3 (2304)
Food, Drink and Tobacco	12 (211)	31 (850)	6 (1688)	25 (252)	30 (1037)	8 (2150)
Garment and Leather	1 (87)	15 (1094)	38 (18350)	2 (208)	18 (1041)	48 (30482)
Wood Products	6 (370)	58 (3921)	25 (3392)	24 (560)	76 (4120)	21 (4414)
Paper Products, Printing, Chemical and Rubber Products	9(118)	30 (1141)	4 (530)	12 (286)	49 (1451)	6 (1242)
Non-metal Products	13 (234)	35 (764)	5 (1740)	14 (286)	39 (1009)	5 (1338)
Metal Products and Machinaries	15 (192)	32 (1040)	7 (1479)	18 (380)	35 (1079)	10 (1914)
Furniture	23 (254)	18 (420)	1 (297)	8 (113)	10 (219)	1 (294)
Electricity and Water Supply	(70)	22 (1180)	10 (4525)	4 (116)	19 (1108)	13 (5890)
Construction	51 (2900)	286 (6108)	14 (2456)	90 (1977)	297 (5806)	9 (2234)
Sale and Repairing Service of Transport Equipments	11 (99)	13 (303)	2 (1062)	29 (330)	31 (738)	3 (1216)
Wholesale and Retail	84 (833)	91 (1647)	3 (715)	117 (1161)	110 (2185)	4 (843)
Transportation	25 (268)	35 (1031)	5 (1161)	34 (406)	53 (1122)	4 (1272)
Post and Telecommunication	3 (72)	25 (893)	3 (2039)	5 (96)	25 (1095)	4 (1998)
Real Estate	20 (263)	37 (856)	3 (1205)	36 (405)	40 (1128)	6 (1685)
Hotel, Restaurant, School and Hospital	68 (828)	96 (2105)	5 (1194)	85 (978)	109 (2744)	6 (4386)

Source: Business Establishment Survey 2004. National Statistical Center.

## 4.2 SMEs in Supporting Industries

In Laos, very few enterprises, let alone SMEs, take part in the transnational production network if the garment industry is not included. Some transnational supporting factories were set up in 1997 or about a decade after the first wave of export-oriented garment factories came about in Laos. After starting out as SMEs, or with less than 100 workers, some these supporting factories grew to become large enterprises over the years. As it would be impossible to determine whether an SMEs belong to supporting industries from publish statistics, figures and discussions in this section would be mostly based on interviewed information.

**Table 5: Supporting SMEs in Laos (As of October 2008)**

Factory (Es. Year)	Products	Number of Labors	Source Countries	Export Destinations
A (1992)	Motorcycle parts	70*	Thailand (Japan)	Vietnam, Cambodia (Japan)
B (1997)	Trigger coils, transformers of camera flash	72→700	Japan	Thailand (Japan)
C (2002)	Electric resistors	100→200+	Japan	Thailand (Japan)
D (2002)	Wire harness for automobile	20→226	Laos	Thailand (Japan)
E (2008)	USB	80	Japan	Thailand (Japan)

*Source:* Based on interviews by authors.

*Notes:* \* Covers only factory workers.

One common characteristic of Lao SMEs in supporting industries is their interconnectedness with Japan and Thailand. The large agglomeration of Japanese supporting industries in Thailand and relatively low cultural barriers between Laos and Thailand (Hiratsuka, Keola and Suzuki 2008) may partly explain this. Firstly, all SMEs, including former ones that are listed in Table 5, participate in the transnational production network of Japanese products. Secondly, four out of five were established in Laos to support the main factory in Thailand by either Japanese investors or Thai subcontractors from Thailand. Factory D, which is wholly-owned by a Lao investor and takes part in the manufacture of wire harness for Japanese cars, was also established with full support by the main Japanese factory in Thailand. Thirdly, all but one factory import all the necessary materials and ship back semi-finished products to the main factories in Thailand. Factory A imports raw material from the main factory in Thailand, and ships processed motorcycle parts to assemblers of the same Japanese motorcycles in Vietnam and Cambodia. Factory B imports all necessary materials from Thailand by land and air, and sends back processed electronic parts to the main factory in northern Thailand by air. Factory C manufactures electronic resistors using raw materials from main factory near Bangkok Thailand where it also ships processed products back to. Factory D imports electric wires from a second-tier automotive parts supplier in Thailand and sends back processed wire harness to the same company. Factory E goes through the same process but for USB and other computer related components.

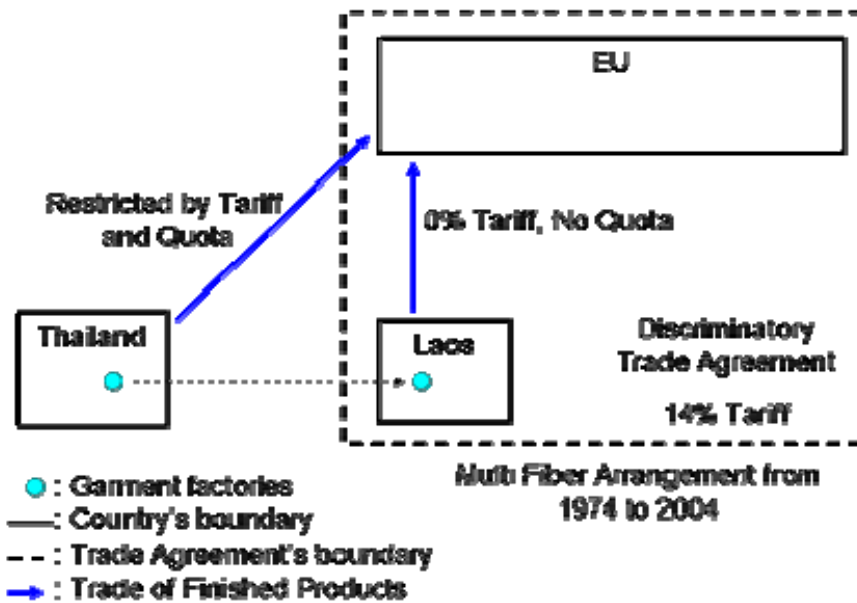
Though SMEs in supporting industries are few, they have demonstrated some positive trends with promising prospects. For instance, the number of workers in many

of these factories has grown significantly over the years. Factories A to D started as medium enterprises, with less than 100 workers, and then expanded to become large enterprises a few years later. Furthermore, the products made by transnational production networks which Lao factories either participate in or support are mostly connected to very large global market. For instance, trigger coils and transformers produced by the whole group of factory B<sup>6</sup> account for 60 to 70 per cent of markets for the same products worldwide. Motorcycles and automobiles into which parts produced or processed by Factory A and D would be used are also first-tier internationally well-known brands.

### 4.3 SMEs in Export Oriented Industries

Garment factories dominated SMEs in export-oriented industries in Laos. The first wave of garment factories relocated or established in Laos almost immediately after it re-opened itself to foreign direct investments in 1988. Export-oriented garments factories comprise the largest number among factory-based enterprises in Laos. Their

**Figure 3: Preferential Trade Arrangements between EU and Laos**



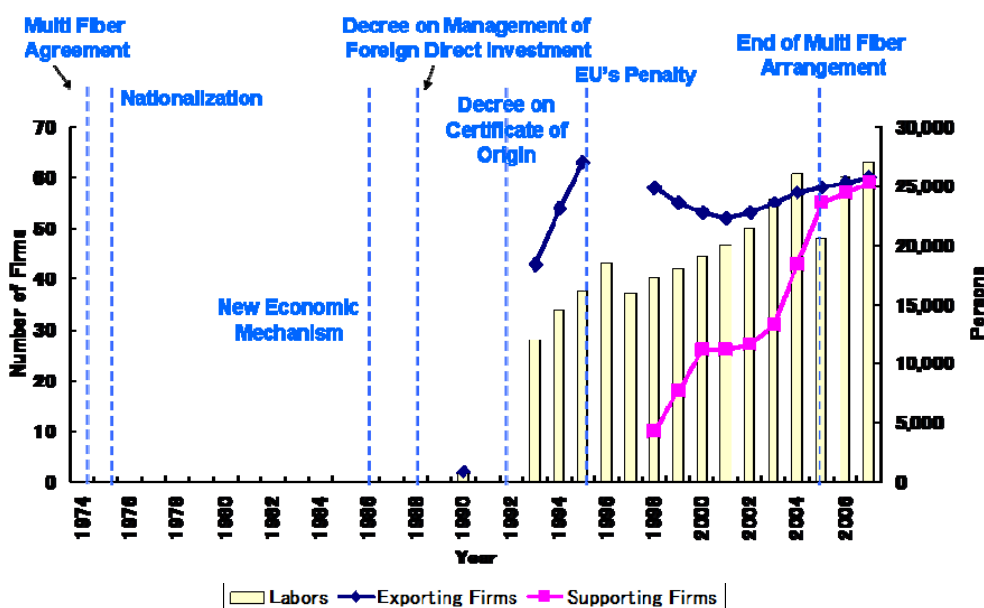
<sup>6</sup> As of late 2008, this group currently has factories in China, Thailand and Laos, employing approximately 3000, 1000 and 700, respectively

share of labor force is also the largest and accounts for more than 60 per cent of the total employments in the manufacturing sector.

Puga and Venebles (1997) showed that discriminatory or preferential trade arrangements can force firms to relocate to countries within preferential arrangements. In Laos's case, it is obvious that most of these garment factories relocated to Laos in order to enjoy preferential trade arrangements given to the country, mainly by the EU. Figure 3 depicts the business model of these factories. The merit of relocating garment factories to Laos was evident, because in general it would be very difficult for any private enterprise to cut costs by a magnitude as big as 14 per cent of the shipment's prices. Garment factories in Thailand can achieve this relatively easily by crossing borders to neighbouring Laos.

Many garment factories were established in Laos through direct investment in the early 1990s (Figure 4). The developments that led to this are as follows: Garment factories emerged in developing countries such as Thailand in the 1970s to supply cheaper apparel. The Multi-Fiber Arrangement was for industrialized nations a tool to protect domestic producers from, or soften the impact on them, of much cheaper imported clothes from developing nations. The exceptions from the MFA, however,

**Figure 4: Development of Garment Industry in Laos**



Source: Author. Number of Firms and Lavors are based on Boutsyongsak (1996) and Phommalay (2007).

were least developed nations such as Laos. Some of the garment factories in Thailand then chose to relocate to neighbouring Laos to overcome these discriminatory trade arrangements.

Laos imports materials needed to be manufactured into finished garments from countries that are relatively closer to home and exports finished products to relatively far developed nations. The main destinations of garment products from Laos have been limited to the EU and other European countries—the only major global markets that for decades have virtually accorded Laos preferential trade status. Exports to the US, which granted Laos Normal Trade Relations (NTR) status in 2005, was equivalent to only 2.5 per cent of what goes to the EU member states and other European countries. Such proportion was considered too low, given the size of the US market. This, however, must be viewed from a vantage point that Laos had not received preferential treatments from the US until February 2005, when it ceased being one of the few states under economic sanctions by the US. Still, preferential treatments under NTR are significantly less compared to those under the Most Favored Nations (MFN) status. To this day, Laos's efforts to get the MFN status from the US have not yielded fruit.

Japan's Generalised System of Preferences has also proved beneficial for Laos, judging from increased cumulative number of applications and the establishment of garment factories since 2006. While Japan granted preferential tariff rates to garments products from the least developed countries for years, garment manufacturers had to contend with a two-step manufacturing process that proved difficult for least developed country such as Laos, where hardly any supporting industries existed. In fact, Japanese garment makers did not show much interest in either Laos or Cambodia until Japanese authorities could ascertain that a one-step process was sufficient for finished garment products to gain 0 per cent access status.

#### **4.4 SMEs in Domestic Market-Oriented Industries**

Factories exporting 100% of its products are literally called “closed circuit factory” in Laos, and almost all dozen foreign invested garment factories in the country fall into this categories. About the same number of supporting garment factories which do not export directly exist, but should rather categorized as export oriented because most of their products are indirectly exported. There are some that supply to both local and

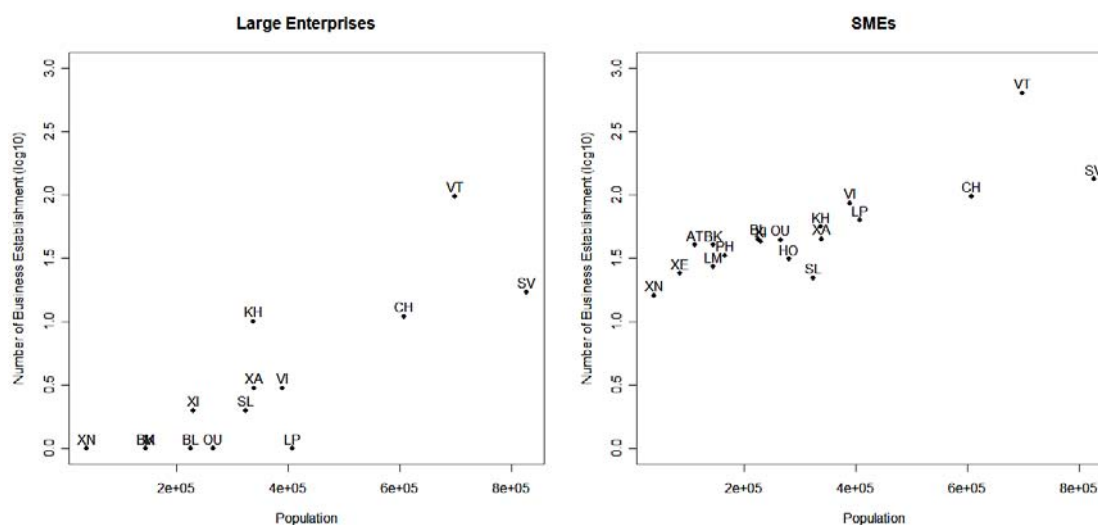
foreign markets, such as those in mining, wood processing industries. The rest are thus domestic oriented ones. These included small workshops that supply drinking water, ice, meat, noodles, assembled motorcycles, and electronic and transport equipments repairing services to local customers.

The domestic oriented business establishments are mostly SMEs. As is clear from Table 4, in 2004, only 8 out of 63 in food related industries, 9 out of 396 in construction industry and 4 out of 231 in wholesale and retail industries, the obvious domestic oriented, were large enterprises. The same hold for sales and repairing services of transport equipments, transportation, hotel and restaurant services which have local markets as the main ones. The numbers of employments were also extremely small. Only about 3,500 were employed by all enterprises, including large ones, in food related industries. There were less than 2500 persons providing transportation service in country with nearly 6 million local residents.

This is obviously different from export oriented garment industry where 48 out of 68 were large enterprises. 20 SMEs and 68 large enterprises in garment industry employed 31,731 persons, more than 3 three times bigger than 10,017 persons employed in construction, or second largest industry by size of employment. Hotel, restaurant and education; Wood related industry as well wood related industry had employed from between 7,000 and 9,000 while the rests employed less than 5,000.

In Laos, there is obvious tendency showing that the bigger the population, the larger the number of SMEs as well as large enterprises in the province (Figure 5). Every province has SMEs, with bigger provinces having more and Vientiane Capital having most. Some of small provinces do not however have large enterprise. Large enterprises concentrate in Vientiane Capital (VT), Savannkhet province (SV), Champasak province (CH) and Khammouan province (KH) or four of five largest provinces which are also comprise most of non mountainous areas in the country. While these four provinces are bordering Thailand or having population concentrated in areas nearby to border with Thailand, the rest that have some large enterprises such as Xayyabouly province (XA), Vientiane province (VI), Xiengkhouan province (XI) are either nearby areas to border with Thailand or Vietnam.

**Figure 5: Population Scales and Number of Business Establishments**



*Source:* Population and Housing Census 2005 and Business Establishments Survey 2004. National Statistical Center.

*Note:* AT:Attapeu, BK:Bokeo, BL:Bolikhamxay, CH:Champasak, HO:Houaphanh, KH:Khammouan, LM:Louangnamtha, LP: Louangphabang, OU:Oudomxay, PH:Phongsaly, SL:Salavan, SV:Savannakhet, VI:Vientiane, VT: Vientiane Capital, XA: Xayyabouly, XE: Xekong, XI: Xiengkhouang, XN: Xaysomboun.

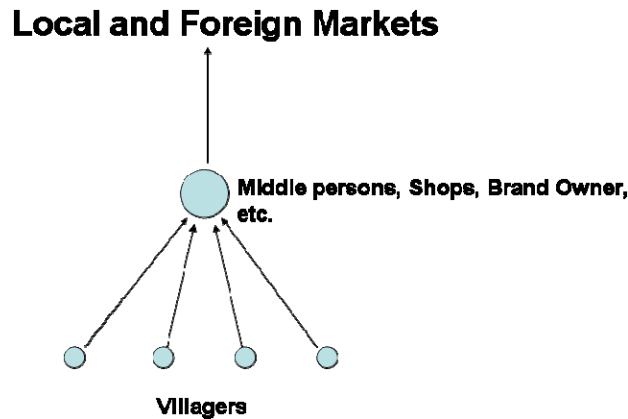
Tentative conclusion that may be drawn here is demand factor seem to play determinant role in development of SMEs. While local or nearby demand seems to determine whether SMEs came into existence, accessing to foreign larger and generally more distant markets may determine whether or not they would grow to be large enterprises.

### 5.5 SMEs in Cottage Industries

The cottage industry undoubtedly makes up the biggest number of SMEs in Laos. They mainly manufacture items that are not being imported as well as those with price competitiveness. These include traditional handwoven clothes, which are still widely used as well as traditional farming equipments.

Figure 6 shows the business model for cottage industries in Laos. Generally, many villagers sell their handicrafts to middle persons and retail shops, particularly brand owners, who will then re-sell them directly, or refashion them into other products for distribution, to local, regional, or international markets.

**Figure 6: Business Model of SMEs in Lao Cottage Industries**



*Source:* Based on interviews by the author.

Villagers selling handmade handicrafts are not likely to be registered as enterprise owners, since their products are mostly for home or family consumption. This makes it difficult to determine their precise number. In 2000 the Japan International Cooperation Agency (JICA) conducted inventory surveys of district-level local handicraft makers who could qualify for the “One District, One Product (ODOP) project.

The ODOP movement was introduced in Laos on November 14, 2002 through a dramatic presentation of the “One Village, One Product” (OVOP) movement by Morihiko Hiramatsu, the founding father of the movement and former governor of Oita Prefecture in Japan before a huge audience of Lao government officials. The movement came to be known as ODOP when it was adopted as the formal name for this movement in Laos in the Macroeconomic Policy Support II, a cooperation project between JICA and the Lao government.

JICA conducted an inventory survey in Phonghong district in Vientiane Province under MAPS II in early 2004. Phonhon District is about 70 km north of the capital and consists of 80 villages with a total population of 54,542. The survey, carried out by an ODOP working group under MAPS II, identified rattan chairs, rice boxes, dining tables, fishing gear, tablecloths, jar alcohol, bags, among others, as potential ODOP products. In 2006 a study was conducted to gather more information in five provinces along the East West Economic Corridor (namely, Savannakhet, Saravane, Champasak, Sekong and Attapeu) as part of the preparations for a planned pilot project .



Tourism had been added and nearly 300 potential ODOP had been identified in 31 districts in five Southern provinces (Souvannavong 2007).

**Table 6: Inventory Survey of Potential ODOP (2006)**

Province	No. of District	No. of Village	Agriculture	Food	Forestry	Handycraft	Tourism	Culture
Savannakhet	15	96	21	17	3	33	7	1
Saravan	8	50	15	3	6	14	17	5
Champasak	9	64	6	11	3	27	9	5
Sekong	4	30	19	5	3	14	8	7
Attapeu	5	25	8	4	2	14	4	8

Source: Souvannavong, Mixai Techno Engineering & Consulting Co. (2007).

As have been said, one of the biggest problems confronting SMEs in cottage industries is the lack of information despite their large size and assumed impact on national economy. While it may be unrealistic to expect most of them to grow or even continue to exist in the process of industrialization or modernization of the country, it would be a big loss if those with potential to grow disappeared due to lack of coordinated support, as some handmade handicrafts depicting modern designs have actually found their way into international markets. ODOP will help, but a broader scheme to identify and promote those with potential is certainly needed.

## **5. POLICY RECOMMENDATIONS**

In general, the establishment of legal frameworks and improvement of infrastructure enhanced the business environment for the private sector, including SMEs. Following are more specific policy recommendations for four SME groups:

### **5.1 SME Policies for Supporting Industries**

Vietnam's experience in the motor cycle industry shows that the expansion of demand and competition will encourage the entry of local SMEs. Policies cannot influence demand but can facilitate the importation of components and capital goods and exports of products. Thus, it is important to develop the local SMEs to accumulate the necessary skills and knowhow. There are two possibilities for new entry. First, domestic-oriented SMEs like replacement parts manufacturers can join supporting industries. Second, employees in existing factories of MNEs can set up their own enterprises to supply them with components. In both cases, there are bottlenecks in low technology, unskilled management and unskilled workers. Here are some policy recommendations that can to solve these bottlenecks.

- Facilitation of imports of components and capital goods through reduced import duties
- Strengthening SME finance to support entry
- Training for management staff in training centres
- Training for workers either in training centres or on the job

### **5.2 SME Policies for Export-oriented Industries**

In addition to apparel and footwear, other industries are increasing their exports to CLV (Cambodia, Laos, and Vietnam). To sustain their efforts, they need support in marketing and information gathering. To promote exports, governments need to enforce policies that will foster the following:

- Inviting more foreign buyers of SME products
- Dispatch SME owners to participate in trade exhibitions in foreign countries

### **5.3 SME Policies for Domestic Market-Oriented Industries**

Most SMEs in CLMV (Cambodia, Laos, Myanmar, Vietnam) belong to domestic market-oriented industries and cottage industries. They are commonly unregistered and are therefore operating illegally. This is the most serious problem confronting them. Granting these SMEs tax concessions could be an incentive to registration. Japan is a case in point. After the Second World War, SMEs were found to have inadequate bookkeeping, brought on by fears of over taxation. To resolve this situation, Japan began the Blue Returns system in 1949, allowing certain tax merits if a tax return was made with a “certain formula of quick bookkeeping,” according to Japan’s Small and Medium Enterprise Agency. This improved the financial accounting and financing systems of SMEs (SMEA 2009).

- Allowing certain tax merits if a tax return is made with a “certain formula of quick bookkeeping”

SMEs in Laos must contend with limited demand, which is in part an offshoot of fragmented domestic markets. It does not help that major cities are located near the border, making SMEs more difficult to access them. Policies required to allow Laos to shift from the limited domestic market to the much larger foreign ones are recommended.

- Trade facilitation in border areas

### **5.4 SME Policies for Cottage Industries**

Most cottage industries depend on middle persons to procure materials and sell their products. The latter also play an important role in informal financing. Distribution of cottage industries should be modernized to the develop market. Public institutions can replace middle persons only in marketing promotion in domestic and export markets. Thus, microfinance and cooperatives should support household crafts manufacturers. Here are potential measures:

- Encourage microfinance and the establishment of cooperative society.
- Modernize the distribution of cottage industries by replacing middle persons with public institutes.

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