

SMALL AND MEDIUM-SIZED ENTERPRISES IN ASIA AND THE PACIFIC: CONTEXT AND ISSUES

A. Context

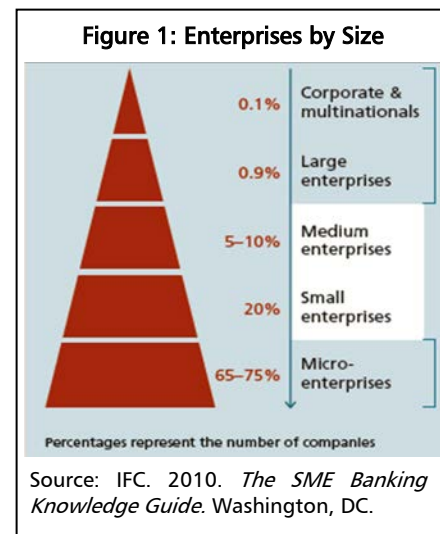
1. Small and medium-sized enterprises (SMEs) represent a significant proportion of enterprises, especially in developing countries. A study by the International Finance Corporation (IFC) in 2010 showed that, in an emerging economy, the majority of firms are microenterprises (65%–75% of total enterprises), followed by small enterprises (20%) and medium-sized enterprises (5%–10%), while large enterprises, corporates, and multinationals together comprise a minor 1% (Figure 1).¹

2. IFC estimated that there are some 25 million–30 million formal SMEs (those with 5–250 employees) in developing countries, including 2.7 million–3.3 million in Central Asia and Eastern Europe, 11.2 million–13.6 million in East Asia, and 2.0 million–2.8 million in South Asia.² A 2014 publication by Asian Development Bank (ADB) showed that, for the 20 countries in Asia and the Pacific with available data during 2011–2014, on average, SMEs represented 62% of national employment, ranging from 4% to 97%, and accounted for 42% of gross domestic product (GDP), ranging from 12% to 60% (Figure 2).³

3. SMEs are usually defined by the number of their employees, the value of their assets, and/or the value of their sales. However, specific cutoffs vary from country to country. There are also different criteria and different cutoffs for different sectors. For example, SMEs are defined as having up to 1,000 workers in some sectors in the People’s Republic of China (PRC), but the cutoff is up to 200 workers for some sectors in Thailand. Furthermore, government agencies within the same country may use different definitions. For example, a ministry may use one definition while the national statistics office uses another, and a lending policy may adopt yet another

4. Analysts have called for a standard definition across countries to make comparative analysis easier, but governments generally see no need to go beyond their own definitions.⁴ As a result, there is no universal agreement on what qualifies as an SME and definitions vary widely across countries.

5. Many factors, barriers and constraints influence the performance of SMEs and the development of a country’s SME sector. To identify major constraints facing SMEs in 25 countries supported by ADB during 2005–2017, the evaluation team reviewed project documents of all the operations under



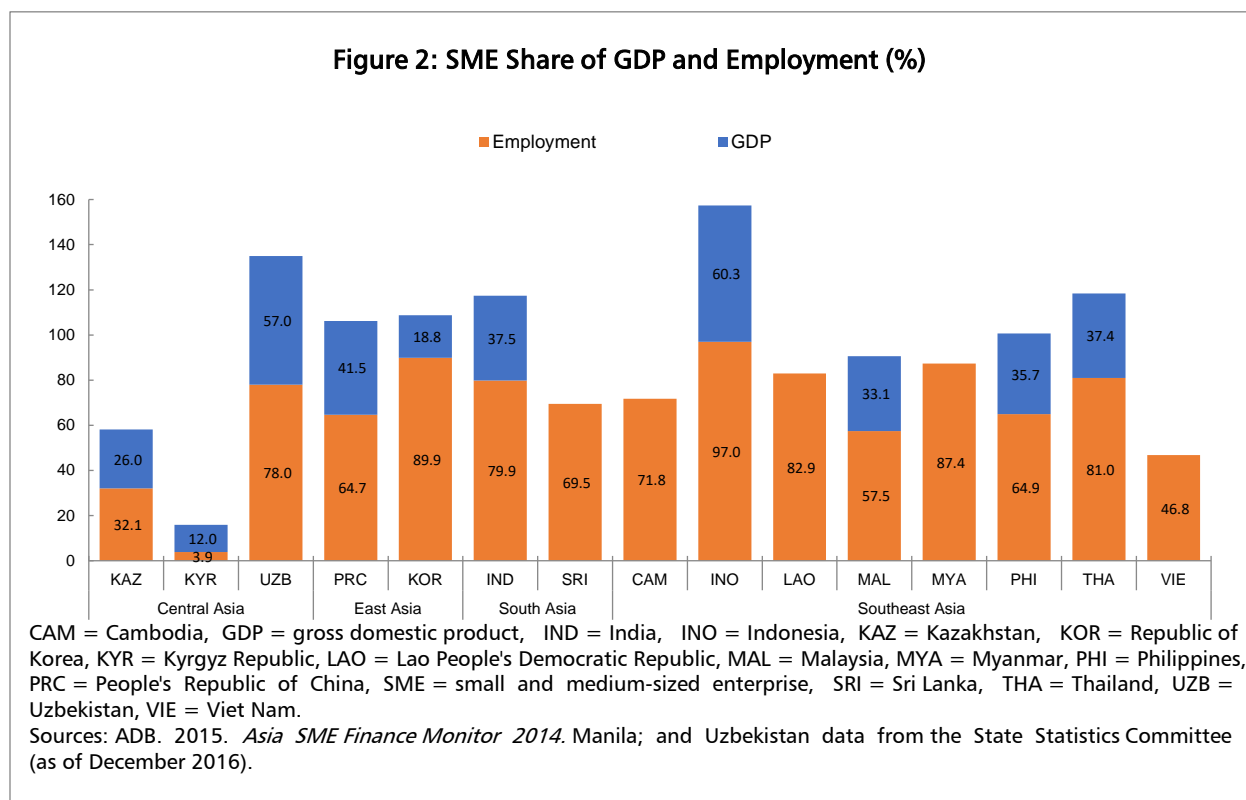
¹ IFC. 2010. *The SME Banking Knowledge Guide*. Washington, D.C.

² IFC. 2010. *Two Trillion and Counting*. Washington, D.C.

³ For Kazakhstan, Kyrgyz Republic, Lao People’s Democratic Republic (Lao PDR), Myanmar, and Thailand, data include only SMEs. GDP data for the People’s Republic of China (PRC) and Republic of Korea are proxied by data on the share of micro, small, and medium enterprises (MSME) exports, while GDP data for the Philippines is proxied by data on the share of MSME gross value addition. Employment data for India and Myanmar are proxied by data on the number of MSMEs or SMEs to total enterprises. No GDP data were available for Cambodia, Lao PDR, Myanmar, Sri Lanka, or Viet Nam.

⁴ ADB Institute (ADBI). 2016. *SMEs in Developing Asia. New Approaches to Overcoming Market Failures*. Tokyo.

evaluation,⁵ ADB’s SME-related documents and publications,⁶ and relevant literature on SMEs produced by other organizations,⁷ and the outcomes of the World Bank Enterprise Surveys conducted during 2013–2016.⁸ The key findings from the literature review are presented below.



⁵ These include reports and recommendations (RRPs) and technical assistance (TA) reports; self-evaluation reports for 45 completed non-TA operations, 25 TA completion reports, 33 project completion report validation reports, and 4 project performance evaluation reports.

⁶ Key materials included: ADB. 2015. *Asia SME Finance Monitor 2014*. Manila; ADB. 2011. *Financial Sector Operation Plan*. Manila; ADB. 2017. *Review of 2011 Finance Sector Operational Plan*. Manila; ADB. 2015. *Integrating SMEs into Global Value Chains. Challenges and Policy Action in Asia*. Manila; ADBI. 2016. *SMEs in Developing Asia. New Approaches to Overcoming Market Failure*. Tokyo.

⁷ Key publications included: United Nations ESCAP. 2012. *Policy Guidebook for SME Development in Asia and the Pacific*. Bangkok; World Bank. 2017. *Doing Business 2017. Equal Opportunity for All*. Washington, D.C.; IFC. 2011. *Strengthening Access to Finance for Women-Owned SMEs in Developing Countries*. Washington, D.C.; IFC. 2010. *The SME Banking Knowledge Guide*. Washington, D.C.; IFC. 2013. *IFC Jobs Study. Assessing Private Sector Contributions to Job Creation and Poverty Reduction*. Washington, D.C.; IFC. 2017. *Alternative Data. Transforming SME Finance*. Washington, D.C.

⁸ World Bank Enterprise Country Surveys 2013–2016 (www.enterprisesurveys.org). Enterprise surveys provide firm-level data in 139 countries. Each country is surveyed every 3–4 years.

B. Constraints on the Business Environment

6. The Donor Committee for Enterprise Development (DCED) describes the business environment as the complex interplay of policies, laws, and regulations that affect business development in a given place and the institutions responsible for their enactment at the international, national, regional, and municipal level.⁹ Mechanisms are established to implement government policies, as well as the institutional arrangements that influence the way key actors operate (e.g., government agencies; regulatory authorities, and business membership organizations, including businesswomen associations, civil society organizations, trade unions). A weak enabling business environment (legislation, policies, regulations, and support institutions) was often identified as a key constraint on the development of the SME sector.

7. The lack of a clear policy and legal framework hindered development of the SME sector across countries, albeit in varying degrees. Countries often lacked an effective policy, strategy, and institutional framework for SME development; diverse policies and programs were not integrated or coordinated; there was limited institutional capacity and resources; and most countries lacked a statistical database on SMEs. Often, development policies are more favorable to large enterprises and multinational corporations. In terms of the legal framework, the key issues were either a lack of enabling laws or existing laws (e.g., on secured transactions, property and land registration, leasing, commercial enterprises, insolvency, and unfair competition) or laws that were inadequate and outdated. As shown in Table 1, only about one-fourth of the 20 countries in Asia and the Pacific had some form of legislation for SME operations, and less than half had SME development policies.¹⁰

8. Inefficiencies in regulatory procedures and administrative processes have been the most often identified constraint on the business environment for SMEs.¹¹ In particular, SMEs found the processes and procedures for registration, licensing, and permits burdensome, resulting in a high cost of compliance and low productivity. Other key constraints on the regulatory and administrative framework were the high cost of tax compliance due to complicated tax administration, corruption caused by weak governance, lengthy customs processes, weak contract enforcement, and lengthy court proceedings. These regulatory and administrative inefficiencies translate into high costs of starting, operating, and closing a business (Table 2). Consequently, many businesses choose to operate in the informal sector, outside the ambit of the government.

Table 1: SME Legal and Policy Framework in Asia and the Pacific

Legal and Policy Framework	Number of Countries (n=20)
Legislation	
SME Law	5
SME Decree	1
SME Resolution	...
General Enterprise Law	2
Others	4
Policy	
SME Development Strategy	8
National Development Plan	5
Financial Inclusion Strategy	2
SME Sector Policy	6
General Enterprise Policy	...
Fund/Program	7

... = not applicable, n = number, SME = small and medium-sized enterprise.
Source: ADB. 2015. *SME Finance Monitor* 2014. Manila.

⁹ Established in 1979, DCED was known as the “Committee of Donor Agencies for Small Enterprise” until 2005. DCED is a forum of 22 funding and intergovernmental agencies for sustainable poverty alleviation through private sector development.

¹⁰ Legislation is the exercise of sovereign power that may be passed by a congress or parliament. It may be in the form of published laws, or cabinet or congressional or presidential decrees. Policies can be developed at the national, regional and local levels explicitly expressed in a policy document or white paper. In some countries, a presidential decree sets the framework for government.

¹¹ Regulations are used to implement the policies and legislation. Administration refers to the ways in which policies, laws, and regulations are enforced, managed, and monitored. Rules or procedural directives are issued by administrative or regulatory

Table 2: Cost of Starting and Closing a Business in Asia and the Pacific, 2016

Region	Starting a Business			Closing a Business		
	Average Number of Procedures	Average Number of Days	Cost (% of income per capita)	Time (Average Number of Years)	Average Cost (% of Estate)	Average Recovery Rate (%)
Central Asia	4.8	9.3	4.9	1.8	10.8	38.7
East Asia	7.0	17.5	1.1	2.9	18.5	27.0
Pacific Islands	5.5	9.0	14.5	1.0	38.0	12.2
South Asia	8.6	16.3	9.8	2.9	7.8	29.8
Southeast Asia	10.7	42.7	23.7	4.1	20.8	17.1
Developed Economies	4.0	4.7	2.8	1.0	5.2	86.0

Note: Developed economies are Australia, Japan, and New Zealand.

Source: World Bank. 2017. *Doing Business 2017: Equal Opportunity for All*. Washington, D.C.

9. The most common constraints concerning support infrastructure for SMEs were inadequate or absent financial infrastructure and business development services (BDS). Weaknesses in the financial infrastructure included the lack of a modern collateral registry and credit reporting system or credit bureau. An effective collateral registry and credit bureau makes more information available and hence reduces legal uncertainties and risks to lenders that often restrict the supply of finance to SMEs. On the demand side, weak SME skills and capacity, and their lack of access to markets, information, and technology have often been cited as common constraints. BDS in developing member countries are often inadequate to meet SME requirements, and SMEs have limited access to their services.¹²

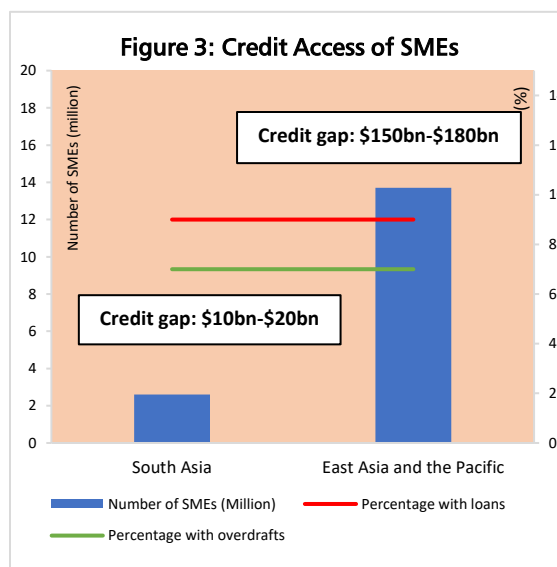
C. Constraints on Access to Finance

10. All documents reviewed highlighted limited SME access to finance as one of the most significant constraints on the survival, growth, and productivity of SMEs.

authorities to implement laws. Regulations and administrative mechanisms can enable and promote businesses, or they can restrict them.

¹² BDS are defined by IFC as non-financial services and products offered to entrepreneurs at various stages of their business development. These services are primarily aimed at capacity development, skills transfer, or business advice, to enhance the performance of businesses, increase access to markets, and improve competitiveness and profitability.

11. Limited access to bank credit continues to be the major constraint on SME access to finance in Asia and the Pacific. For countries with data available from ADB SME Finance Monitor 2014, SME bank loans comprised an average of 11.6% of GDP and 18.7% of total bank lending.¹³ IFC estimated that about 9% of SMEs had bank loans and about 7% had overdrafts. The formal credit gap for SMEs was estimated to be \$150 billion–\$180 billion in East Asia and the Pacific and \$10 billion–\$20 billion in South Asia (Figure 3).¹⁴



bn = billion, SME = small and medium-sized enterprise.
Sources: IFC. 2013. *Closing the Credit Gap for SMEs*; ADB. 2015. *Asia SME Finance Monitor 2014*. Manila.

12. Credit gaps result from both demand and supply side factors. On the demand side, many SMEs cannot access credit because of the financial documentation and collateral requirements for obtaining a loan; high interest rates; and long loan approval procedures, among others. On the supply side, banks often consider SMEs to be high-risk and high-cost clients to acquire, underwrite, and serve. Revenues per SME client are lower than those of large firms. Information on SMEs is also often opaque. These factors deter banks from lending to small SMEs and focus their attention on bigger SMEs or larger firms. The recent global financial crises and the resulting increased capital and liquidity requirements and new prudential regulations (including those under Basel III) have made banks even more risk-averse and made borrowing from them more difficult for SMEs.

13. SME financing from other sources remains very limited, given the bank-centered financial system in the region. Non-bank financial institutions (NBFIs) are smaller than banks and they account for less than 10% of SME financing in the region (Table 3). Only seven developing countries in the region have specialized capital markets platforms that SMEs can tap for growth capital financing. In total, the region has only 11 capital market platforms for SMEs with fewer than 3,000 listed companies and less than \$1.4 trillion in market capitalization (Table 4).

Region	SME Loans to GDP (%)	SME Loans to Total Loans (%)	NBFI Financing to GDP (%)	NBFI Financing to Bank Loans (%)
Central Asia	4.6	13.9	5.4	27.0
East Asia	17.3	25.5	1.4	2.4
South Asia	8.0	19.2	1.9	0.1*
Southeast Asia	17.3	20.2	3.7	13.9
Pacific	2.6	12.1	1.9	10.1
Overall	11.0	18.9	3.2	9.7

* 2013 data.
GDP=gross domestic product, NBFI=non-bank financial institution, SME = small and medium-sized enterprise.
Source: ADB. 2015. *Asia SME Finance Monitor 2014*. Manila.

Country	Number of Markets	Number of Listed Companies	Total Market Capitalization (\$ billion)
PRC	2	1,138	1,191.5
Korea	3	1,249	143.0
India	2	88	1.5
Malaysia	1	107	2.8
Philippines	1	4	0.8
Thailand	1	109	11.9
Vietnam	1	169	1.7
Total	11	2,864	1,353.2

PRC= People's Republic of China.
Source: ADB. 2015. *Asia SME Finance Monitor 2014*. Manila.

¹³ ADB. 2015. *SME Finance Monitor 2014*. Manila.

¹⁴ IFC. 2013. *Closing the Credit Gap for Formal and Informal Micro, Small, and Medium Enterprises*. Washington, D.C.

D. Constraints on Access to Value Chains

14. Limited access to product markets, both domestic and global, was frequently highlighted as a major constraint on SME operations and growth in all developing countries in Asia and the Pacific. The key obstacles that affect SMEs' ability to enter value chains include: (i) limited integration into domestic markets; (ii) lack of capacity to innovate and develop new products; and (iii) limited capacity to meet international standards (product quality, labor, and environmental standards).

15. Few reliable cross-country data on SME participation in value chains are available. However, a proxy for domestic value chain integration is the share of SME outputs in a country's GDP. Wignaraja found that the SME contribution to GDP in developing Asian countries ranged from 17% in India to 54% in Indonesia.¹⁵ As a proxy for SME participation in the global value he further estimated the SME share in total exports, which ranged from 11%–40%. In a survey of five ASEAN countries, he found that only 22% of SMEs took part in regional or global value chains, compared with 72% of large firms (Figure 4). Malaysian SMEs were the most active (46%), while Indonesian SMEs were the least active (6%).

Box 1: Value Chain

"A value chain describes the full range of activities through which a good or a service passes from its conception to its distribution and beyond. This includes several activities such as design, production, marketing, distribution and support to the final consumer. All these activities can be contained within a single firm or divided among different enterprises; they can be contained within a single geographical location or spread over wider areas."

Source: United Nations Conference on Trade and Development. 2010. *Integrating Developing Countries' SMEs into Global Value Chains*. New York and Geneva.

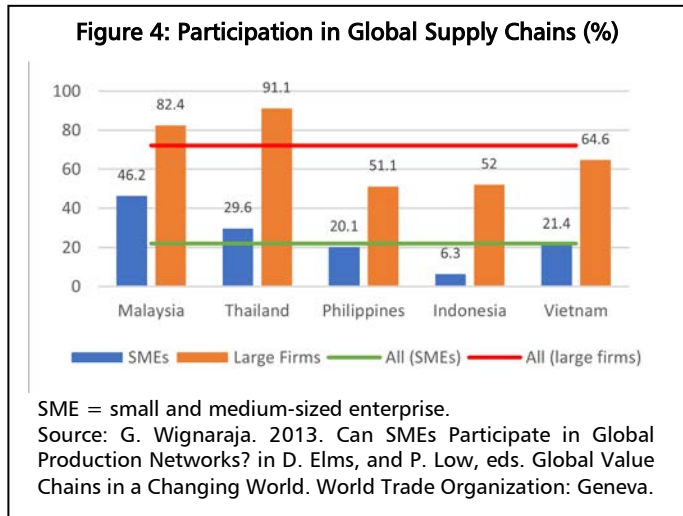
Illustration of a Value Chain in Automotive Industry

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graph TD
    CKD[Units CKD] --> AL[Assembly line welding, painting, assembling]
    EQ[Electrical equipment and installations] --> AL
    AP[Accessories Packaging and various] --> AL
    CEP[Control equipment and instrument panels] --> AL
    AL --> IF[Interior finish]
    AL --> AC[Air conditioning]
    AL --> D[Distribution]
    D --> OBW[Other body work]
    OBW --> C[Cars]
    
    subgraph Components
    C[Chassis]
    SBS[Steering, brakes and suspension]
    EL[Engine and lubrication]
    TNG[Transmission and gearbox]
    WRT[Wheels, rims and tyres]
    BW[Body work]
    end
    Components --> AL
    
    P[Panels] --> AL
  
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¹⁵ G. Wignaraja. 2013. *Can SMEs Participate in Global Production Networks?* in D. Elms, and P. Low, eds. *Global Value Chains in a Changing World*. World Trade Organization: Geneva.

16. Integration into domestic markets is the first and most important step in participating in global value chains. Most SMEs, especially from developing countries, participate in these through indirect channels by supplying inputs to other domestic companies that export their products, instead of becoming direct exporters themselves. However, SMEs are often excluded or isolated within the domestic market because of a large informal sector that poses unfair competition to SMEs;¹⁶ market disparities and segregation across sectors or between geographical areas that make it difficult for SMEs to participate in supply chains; and an unfavorable regulatory environment.¹⁷

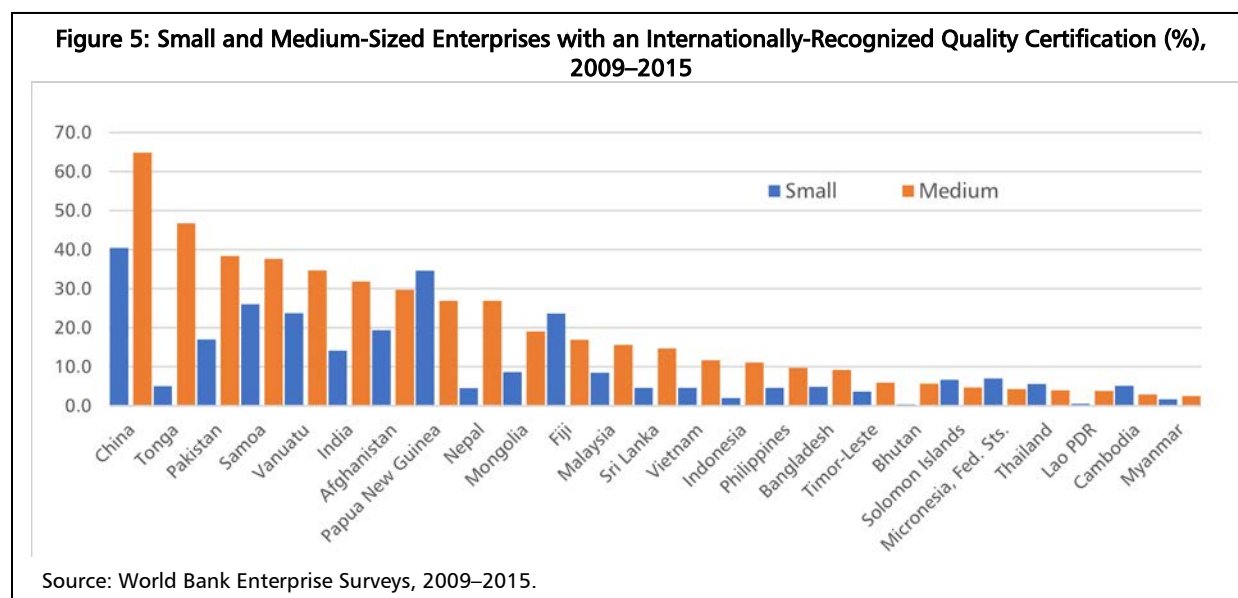


17. Lack of capacity to innovate and develop new products hinders SMEs' participation in value chains since this requires customization and integration of production facilities both domestically and internationally. Small companies in locations where large firms operate need to innovate to be included in the large companies' production chains but most lack the financial capacity to invest in research and development and new product development. They also lack information (on customers, competitors, prices, new products, and market opportunities); technical skills (e.g., computer software, product design); and business skills to manage the innovation process effectively and efficiently.

¹⁶ An Independent Evaluation Group (IEG) evaluation in 2014 found that 32% of SMEs with 10–19 employees and 31% of SMEs with 20–99 employees considered the informal sector to be one of the top five constraints on doing business. IEG. 2014. *The Big Business of Small Enterprises: Evaluation of the World Bank Group Experience with Targeted Support to Small, and Medium-Size Enterprises, 2006-2012*. Washington, D.C. World Bank.

¹⁷ These include unpredictable changes at short notice in laws and regulations and unclear regulations promoting rent-seeking activities and informal payments. For instance, a joint study by the Viet Nam Chamber of Commerce and Industry and USAID in 2016 reported that around a third of SMEs surveyed admitted that local officials used compliance regulations to extract rents, with informal payments amounting to 10%–13% of the SME revenues. VCCI and USAID. 2016. *Business Environment for Vietnam's Small and Medium-Sized Enterprises*. Hanoi.

18. Limited capacity to comply with national and international standards is another major constraint for SMEs. According to the World Bank Enterprise Surveys 2009–2015, on average only 11% of small and 20% medium-sized enterprises in Asia have an internationally-recognized quality certification (Figure 5). Standards include not only product quality—to which many SMEs in low-income countries still have difficulties to adhere to—but also environment and labor standards. Lack of quality assurance is another obstacle to SMEs participation in value chains. The high cost, both financial and opportunity costs, of obtaining certification is another common constraint faced by SMEs as well as lack of knowledge and awareness of market opportunities.



D. Gender-Specific Issues in SMEs

19. Despite the critical role of women-owned SMEs in promoting gender equality and achieving growth and development, such enterprises remain on the margins in many countries. Worldwide, about one third of SMEs are led by women (Box 2). Across Asia and the Pacific, the share of formal SMEs owned by women is 8%–9% in South Asia and 38%–47% in East Asia and Central Asia.¹⁸

¹⁸ ADB. 2013. *Women Entrepreneurs in Asia and the Pacific*. Manila.

20. In terms of size (based on the number of employees), women-owned SMEs are usually smaller than men-owned SMEs. About 73% of women-owned SMEs in member countries of the Asia-Pacific Economic Cooperation (APEC) employ 5–9 employees compared with 65% among men-owned SMEs. Meanwhile, 6% of men-owned SMEs in APEC economies employ 50–200 employees compared with about 3% for their female counterparts. Moreover, more women-led SMEs (85%) operate in the informal sector compared with men-owned SMEs (77%) across APEC region.¹⁹

Box 2: Women-Led Enterprises

According to the International Finance Corporation (IFC), women-led small and medium-sized enterprises (SMEs) account for 31%–38% (8 million–10 million) of formal SMEs worldwide.^a For Asia and the Pacific, it was estimated that about 35% of SMEs were led by women in 2010.^b These women-led enterprises were typically small businesses, employed fewer workers, operated in sectors characterized by low profit margins and productivity levels, and generally had access to fewer resources than men-owned SMEs.

Sources:

^a IFC. 2011. *Strengthening Access to Finance for Women-Owned SMEs in Developing Countries*. Washington, D.C.

^b United Nations ESCAP. 2012. *Policy Guidebook for SME Development in Asia and the Pacific*. Bangkok.

21. Women-led SMEs work under the same macro, regulatory, and institutional conditions as their male counterparts, so they face the same constraints as SMEs in general. In addition, women entrepreneurs face additional gender-specific barriers;²⁰ the World Bank report, *Women, Business and the Law 2014* found at least one discriminatory law or policy restricting women-owned enterprises in 128 economies of the 143 covered in the report, including women not being able to open their own bank account, sign a contract, or hold land titles (Box 3).²¹

Box 3: Legal Differences Between Men and Women Identified by The World Bank (various countries)

Areas where differences exist between men and women with the same marital status:

- | | |
|---|---|
| 1. Applying for a passport | 12. Having ownership rights over property |
| 2. Traveling outside the home | 13. Having inheritance rights over property |
| 3. Traveling outside the country | 14. Working the same night hours |
| 4. Getting a job or pursuing a trade or profession without permission | 15. Doing the same jobs |
| 5. Signing a contract | 16. Enjoying the same statutory retirement age |
| 6. Registering a business | 17. Enjoying the same tax deductions or credits |
| 7. Being “head of household” or “head of family” | 18. Having their testimony carry the same evidentiary weight in court |
| 8. Conferring citizenship on their children | 19. Absence of a gender or sex nondiscrimination clause in the constitution |
| 9. Opening a bank account | 20. Validity of customary law if it violates the constitution |
| 10. Choosing where to live | 21. Validity of personal law if it violates the constitution |
| 11. Obtaining a national identity card | |

Five other areas applicable only to married women:

- | | |
|--|--|
| 22. Being legally required to obey their husbands | 25. Having legal recognition for nonmonetary contributions to marital property |
| 23. Being able to convey citizenship to their non-national husband | 26. Having inheritance rights to the property of their deceased husbands |
| 24. Administering marital property | |

Source: World Bank. 2013. *Women, Business and the Law 2014: Removing Restrictions to Enhance Gender Equality*. London.

¹⁹ H. Zhu and C. Kuriyama. 2016. *Gender-Related Constraints Faced by Women-owned SMEs*. APEC Policy Support Unit. Policy Brief No. 15.

²⁰ For example, one by USAID <http://www.cipe.org/blog/2012/11/27/constraints-to-womens-entrepreneurship-in-emerging-economies/#.WXIMChGqpBd>.

²¹ World Bank. 2013. *Women, Business and the Law 2014: Removing Restrictions to Enhance Gender Equality*. London.

22. These gender-specific barriers include:

- **Social acceptability and gender biases:** In many developing countries in Asia and the Pacific, women do not fully participate in the labor force, nor do they run businesses.
- **Time constraints:** Competing priorities between running businesses and attending to domestic responsibilities (home care, child care, and elderly care).
- **Credit barriers:** Compared to men, women have less access to finance, because of their low access to, and control of, assets and financial resources, given customary inheritance practice. In many countries, property rights are attached to men, so women face legal challenges that prevent them from borrowing and starting enterprises. In addition, banks generally consider women-owned small businesses not attractive because they tend to borrow small amounts and banks cannot make much money from lending to them, or their businesses fail and expose the bank to credit risk.
- **Access to networks and infrastructure:** Patriarchal and protective approaches restrict women's capacity, ability and mobility to interact with the outside world. Hence, compared with men, women have poorer access to infrastructure, market information, networks of entrepreneurs, and business development services.
- **Lack of experience and capacity:** Compared with men, women in many developing countries have less access to education and are less likely to have gained relevant training or business skills. In addition, highly educated women mainly choose salaried work, thus less-skilled women are relatively more likely to be entrepreneurs.