

Executive summary

In the Asia-Pacific region small and medium-sized enterprises (SMEs), and microenterprises, constitute a significant majority of the economy and play a central role in enhancing economic dynamism, innovation and job creation. Development of this sector has been widely acknowledged as a crucial strategy for growth both in developed and in developing economies of the region. This is not an easy feat, as a number of challenges and barriers need to be understood and overcome. It demands comprehensive policies to address a variety of connected issues while also working with, and meeting the needs of, a range of local, national and global stakeholders.

This publication offers comprehensive and practical policy interventions to facilitate SME development in the region. While proposed interventions are designed to be general and adaptable to individual contexts, they are also as specific as possible to maximize practical application. Within this context, throughout the publication four key guidelines are repeatedly emphasized and all policy interventions are based on them. These four factors are far from exhaustive; however, this guidebook deems the guidelines to be the most integral to SME development in the Asia-Pacific region today. They are:

- (a) The reduction of entry barriers (and related costs) for new businesses;
- (b) The importance of sufficient and smooth cash flow to SMEs;
- (c) The need to strengthen entrepreneurship through education and training; and
- (d) The strengthening of networking and information dissemination.

Chapter I provides an introduction to the importance of the SME sector in the global economy. A substantial percentage of enterprises in the world are SMEs, and they require a number of supportive structures, provisions and policies to facilitate development. The development prospects of this sector are promising; however, there are a number of key challenges that must be addressed with a comprehensive approach. The six key areas that such an approach should cover are: (a) a business enabling environment; (b) the promotion of an entrepreneurial culture; (c) business financing; (d) business development services; (e) innovation and technology development; and (f) market access. These six key areas are the focus of the main chapters in this publication.

Governments have a key role to play in SME policy development, which also requires cooperation among multiple actors and especially multilateral institutions and the private sector. Policymakers can facilitate the smooth implementation of policies by employing tactics such as establishing a national steering committee. They may also focus on given sectors by providing direct support to firms. The methodology employed by the policy guidebook consists of an analytical review of existing policy measures, studies, documents and other secondary materials. Academics and industry experts were invited to provide insights and comments. Expert group meetings were held, and feedback from stakeholders was incorporated.

Chapter II on Contributions, challenges and prospects of SMEs offers the background context for the key terms, concepts and subjects discussed throughout the guidebook. Defining SMEs is a problematic task, as different criteria are used by individual countries and even between industries within countries. There is no universal definition; however, the most commonly used indicators are number of employees, business turnover and capital investments. SMEs are also divided according to various typological indicators including: (a) registered or unregistered; (b) the stage of economic development; (c) market orientation; (d) pace of innovation; (e) use of technology; and (f) the stage in the corporate life cycle. Despite the varying definitions and typologies, SMEs do share a number of common characteristics. For example, they tend to be born out of individual initiative, possess greater operational flexibility and high aspiration for innovation and suffer from financing and market access shortages. Microenterprises are a subcategory of small enterprises that are sometimes distinguished as a separate category, although the issues that have an impact on SME development also generally apply.

While SMEs have made significant contributions to national economic development in the region, the sector remains underdeveloped in many countries and requires greater support. SME development involves four key stages (start-up, growth, maturity and exit), and each of them has differing needs in terms of policy interventions. The barriers to SME development can be divided into external and internal. External barriers generally comprise those beyond entrepreneurs' control (e.g., policy environment). Internal barriers are those within their control (e.g., managerial experience). SME competitiveness can be enhanced with strategies such as industrial clusters, which offer advantages including proximity to resources and suppliers, shared infrastructure and knowledge exchange. Furthermore, social considerations such as culture and gender issues influence SME development. Women entrepreneurs are an undersupported sector of most Asia-Pacific economies, and targeted policy measures for their inclusive development are strongly recommended. Policy interventions should be aimed at: (a) increasing the number of SME start-ups and survival rate; (b) encouraging formalization; (c) fostering graduation to become larger firms; (d) facilitating smooth exits; and (e) enhancing market access.

Chapter III on Business Enabling Environment explores the issue of the business enabling environment (BEE), the first of the six key areas for SME development. The business environment provides the fundamentals for all private sector development, and favourable conditions form the foundation of SME growth, survival and competitiveness. The basic BEE components include, but are not limited to, economic policies, factor endowment, regulatory framework, infrastructure, entrepreneurship culture and technology. The chapter analyzes the results of four key international BEE surveys to determine the state of business environments in the Asia-Pacific region. The surveys are: (a) World Bank "Ease of Doing Business" rankings; (b) the Fraser Institute's "Economic Freedom of the World" exercise; (c) the World Economic Forum's Global Competitiveness Index; and (d) Transparency International's Corruption Perception Index. These surveys assist in determining what types of BEE reforms are necessary in an economy.

Governments have a central role to play in making BEEs more conducive to SME development; however, governments in many developing countries are challenged by a lack of skills and knowledge to develop and implement effective policies. To assist the reform process, a number of toolkits can be utilized. Chapter III highlights the value of four in particular by the International Finance Corporation (IFC), International Labour Organization (ILO), Japan International Cooperation Agency (JICA) and the Asian Development Bank (ADB). Effective BEE reforms must cater to individual national needs; however, they all benefit from some common considerations. BEE surveys are a valuable source for identifying and prioritizing specific reforms. A strong political will to commit to undertaking changes is needed, coupled with a genuine receptiveness to learning from existing best practices. It is also important to assess the needs of the target sector regularly, e.g., SMEs, in the policy development and implementation process. Finally, BEE reforms and improvements must be conducted in an accountable and transparent manner.

Chapter IV on Entrepreneurship development explores this challenge. SME development is driven by entrepreneurs, and a dynamic entrepreneurial environment is essential for growth. While the understanding of entrepreneurship varies, this publication defines it as an individual or team process of doing something new or different, with calculated risking-taking behaviour for future gains to add value to society. A number of key factors influence the success of entrepreneurs, and these elements can generally be classified under five categories: (a) internal traits of the entrepreneur; (b) adequate resources; (c) a solid business plan; (d) a favourable external environment; and (e) the wider political, social and cultural contexts. Another key consideration is the existence of entry barriers, especially the “fear of failure”, which discourages many potential entrepreneurs in Asia-Pacific countries.

To help overcome potential barriers, governments and relevant agencies can promote awareness about the importance and value of entrepreneurship with strategies such as education and training. It is particularly recommended that certain strategies be aimed at undersupported segments of society such as women, youth and rural entrepreneurs. In recent years, an emerging trend is social entrepreneurship involving businesses that are aimed at addressing important social issues or that operate in environmentally sustainable ways. Many social enterprises are SMEs, and policy interventions should pay close attention to this new subsector. The chapter also highlights a number of key policy recommendations. Offering “single window” assistance to support entrepreneurs, especially for new business registration processes, is crucial to increasing efficiency. Formal property rights must be protected as property is a common form of collateral for bank loans to new businesses. Furthermore, with regard to credit, accurate and timely credit information is essential for entrepreneurs and credit providers alike. Investors must also be protected to help companies raise capital, especially in times of financial uncertainty. Taxation must also be easy to understand and follow. Simplifying tax collection procedures is one method of increasing corporations by decreasing the time needed and the costs involved. More resources for education and training are also recommended, not only to increase awareness and

knowledge about entrepreneurship but also to foster more positive attitudes in the wider community.

As access to sufficient and sustained finance is essential for all SMEs, this aspect is the focus of chapter V. Different stages of the business life cycle have varying needs for cash with the start-up, growth and transition stages being particularly important. There are a number of different instruments and sources of SME financing, which can be classified into seven general categories: informal, internal, debt, equity, asset-based, leasing and government grants or subsidies. The major instruments within these seven categories are elaborated in this chapter to provide better understanding about how they work and what type of actors offer such instruments. In general, informal financing such as personal savings and loans from family and friends, and internal financing including retained earnings, are particularly important for small businesses. Commercial banking also plays an important role, particularly in the European Union, Japan and the United States of America where the banking sector is highly developed. The multiple financial instruments are administered by a variety of financial institutions, and there are many associated advantages and challenges that need to be understood in order to introduce effective policy interventions. One example of favourable government intervention to strengthen the connection between financial institutions and SMEs is the implementation of credit rating schemes. This facilitates loans by providing accurate and timely credit information about SMEs, which instills more confidence in financial institutions to provide loans. During an economic downturn, SMEs are generally more vulnerable and in greater need of government financial support, both directly and indirectly.

Chapter V on Financing Business offers a number of key policy considerations. Working capital is essential for the functioning of all businesses, and this needs to be maximized to help SMEs survive and flourish. A balance between the development of debt and equity markets would benefit SMEs, as debt markets tend to assist the early stage of SME development. Equity markets are, however, more conducive to entrepreneurial and innovative ventures. Another important policy consideration is the need to provide adequate and timely information both to SMEs and to financial institutions. The public sector also has an important role to play in facilitating connections between SMEs and sources of equity funding. Financial services, while essential, are not the only determinant of SME success, and they should be combined with business development services for more comprehensive support. Policy interventions should also focus on strengthening the relationship between bankers and small business entrepreneurs in order to facilitate greater understanding and trust. Finally, it is strongly recommended that policymakers consider introducing a four-tier financial system for a clear division of labour and improved institutional coordination.

Chapter VI on Business Development Services considers the importance of comprehensive, affordable and high-quality business development services (BDS), which consist of three core segments: operational, advisory and advocacy. The most sophisticated of the three segments is operational services, which assist with the daily functions of a business. Advisory and advocacy services are currently underdeveloped or

short-lived, and these areas should be more fully explored. The delivery of BDS has transformed over the years, shifting from the traditional approach where governments and related agencies engaged in direct provision, to a market-oriented approach where private providers are engaged to deliver services. The latter approach is generally preferable, although this is only a viable option once a certain level of economic development has been attained. Prior to this, the public sector is needed to provide direct support. Cooperation is necessary between the different BDS actors, with varying priorities, capabilities and mandates. Coordination of interventions at the micro, meso and macro levels also increases effective BDS delivery to SMEs. One form of BDS, i.e., business and technology incubation, has proven to be a particularly effective strategy and is explored in greater detail in this chapter. Incubators provide valuable assistance to SME start-ups, and the growing number of incubators worldwide attest to their effectiveness. BDS can ultimately help SMEs join regional or global supply chains, which bring new knowledge, skills and networks. The key policy recommendations for BDS development are: (a) enhancing public-private partnerships; (b) raising awareness about the importance of BDS; (c) creating an enabling environment; and (d) encouraging participation by the private sector.

Chapter VII on Innovation and Technology examines how innovation and technology contribute to SME development. There are four key components of innovations – product, process, marketing and organizational – which can be further divided into incremental or radical innovations. While the benefits of innovation are widely known, SMEs in developing Asia-Pacific economies experience difficulty in building their capabilities. Policymakers need to analyze the key innovation strategies that SMEs can adopt in order to gain a better understanding of what interventions are most effective. This chapter discusses some of these strategies and issues. Research and development (R&D) has shown positive movement in the Asia-Pacific region recently, with countries such as Singapore, Japan and the Republic of Korea investing significant amounts of GDP into R&D activities. SMEs, with their limited capabilities and size, are not often associated with strong R&D; however, effective activities can be simple and affordable.

Another popular strategy for innovation is technology acquisition and transfer. Domestic factors such as institutional structures, supportive policies and regulations and financial assistance have a significant impact on technology acquisition and transfer. New products, processes or services need to be introduced into commercial markets, and successful technology commercialization is most efficient when there is strong and diverse collaboration between multiple actors. Policy interventions should facilitate the creation of these linkages with a national innovation system (NIS), and a related subnational innovation system (SIS). The four key pillars of a strong and effective NIS are human capital, infrastructure, innovation culture and funding. Innovation related to NIS and commercialization can be greatly facilitated by adopting an open innovation model. Under such a model, firms are able to commercialize innovations through a variety of means. While this is primarily driven by enterprises, policy interventions can assist enterprises to pursue such strategies with subsidies,

favourable regulation or networking opportunities. Another innovation strategy for SMEs is reverse engineering, which can be effective in reducing product development costs, improving the quality and functionality of products and compensating for limited R&D capabilities. It is important that this method be carefully applied and monitored, as this tool could violate intellectual property rights (IPRs) if used for direct duplication. The protection of IPR has become an increasingly visible issue and it is beneficial for SMEs to receive education and guidance on the issue. This is advantageous not just to avoid violating IPR; SMEs can also use these rights to protect their own innovations.

The final strategy discussed in this chapter is the use of tax incentives, particularly for R&D activities, to help stimulate innovation. Tax incentives can take different forms and be delivered in a variety of ways. The specific needs of SMEs and local conditions must be taken into account when formulating tax strategies. The chapter highlights a number of national initiatives undertaken in Asia-Pacific economies. Five central principles were common to the success of all these initiatives. A comprehensive technology development policy within a strong but simplified institutional framework produces an enabling environment for SMEs. Government-subsidized funding for innovation activities helps reduce financial barriers for SMEs and other key players. Development of an NIS (and SIS) to increase connections, linkages and coordination is especially beneficial to SMEs. The provision of support for open-market policy will facilitate a greater degree of technology transfer and outsourcing among SMEs and other stakeholders, such as large enterprises and research institutions. Finally, officials should offer tools such as business and technology incubation and training for technology-focused SME development.

Chapter VIII focuses on the importance of market access, particularly in regional and global markets. SMEs must continually generate new business; however, this can be challenging when the domestic market is either small or large but highly competitive. SMEs generally face difficulties in accessing new markets as they have limited resources, expertise and market information. This chapter identifies four critical factors in enhancing market entry capability. First, knowledge about business opportunities, customers, competitors, distribution procedures, local rules and regulations and taxation is essential. Second, the policy and regulatory framework must be well-organized, and must provide the necessary trade business infrastructure and other facilitation services. Third, trade barriers, both tariff and non-tariff, can hinder SME access, and this issue needs to be addressed at the national, regional and international levels. Fourth, networking and cooperation between SMEs and larger firms provides an important source of information, knowledge and skills.

The trade environment in which SMEs operate influences the ease of market access, and this chapter explores some of the most pertinent issues in this area. Trade policy and trade investment agreements have a significant impact on SMEs. A policy that lowers trade barriers brings benefits to firms seeking access to foreign markets as well as advantages to local firms in the form of cheaper imported inputs. Investment agreements increase security, stability and predictability, and this creates more investment inflows.

A key player in international trade issues is the World Trade Organization (WTO), and some of the most relevant agreements and rules under this body are highlighted in the chapter. Another factor in facilitating SME market access is the improvement of export product identification, pricing and competitiveness. SMEs would benefit from training in how to control costs and effectively use their competitive advantage. SMEs must also be informed about quality standards and certificates, and trained to meet these standards. Furthermore, with regard to trade logistics in business transactions, the transport system is a central factor and policy interventions should focus on improving the relevant infrastructure. Customs procedures are another area in which policy interventions should be aimed at increasing clarity and efficiency for easier trade across borders.

The chapter also discusses the importance of trade promotion tools and highlights trade fairs, buyer-seller meetings and trade missions. These are important strategies which require careful planning and assistance to ensure that follow-up activities are executed to maximize the benefits. The various actors in trade promotion have their own strengths and policymakers need to understand these to enable cooperation. A useful tool for promoting market access is the use of information and communication technology (ICT), particularly through the Internet, and policy should be aimed at raising awareness about the benefits, strengthening literacy and capacity, and helping ICT firms develop. The chapter also explores the important issue of trade finance. It focuses on the main forms of trade finance, various trade finance instruments and the actors who help facilitate trade finance. Special economic zones (SEZs) have proven to be a particularly useful tool for SME development; there are a number of examples in the Asia-Pacific region.

Foreign direct investment (FDI) should also be facilitated as SMEs can either become direct suppliers or they can participate in global supply chains, both of which are beneficial to their development. The multifaceted issue of market access requires a variety of policy interventions; while the chapter offers a comprehensive set of recommended actions, it is important to adapt these to local needs and conditions as appropriate.

Chapter IX presents a Policy Framework that draws together all the preceding recommendations. A summary of the major constraints to SME development is provided. National policy planning must involve a process for selecting and prioritizing the policies that best fit local conditions and address the most pressing problems. In each of the six key areas (i.e., business environment, entrepreneurship, financing, business development services, innovation and market access), the recommended actions at the national and regional levels are recapitulated. These recommendations are designed not only to be comprehensive but also to enable adaptation to local needs. Every country in the diverse Asia-Pacific region must assess the status of their SME sector and consider the local conditions before embarking on policy reform or implementation. This assessment should inform the plan of action, which should also involve consultation with experts, academics, entrepreneurs and other stakeholders. While the policy frameworks might differ between countries, the ultimate objectives for the entire region are uniform: build SME capacity, increase competitiveness, partner for economic development, generate employment and increase the well-being of all the people in the region. The chapter ends with an annex on the concepts and major frameworks of monitoring and evaluation (M&E) exercises. M&E can be used to ensure proper governance, transparency and accountability of SME development programmes.