

BEYOND AEC 2015:

Policy Recommendations for
ASEAN SME Competitiveness

AUGUST 2014

Foreword by the Chairperson of
ASEAN SME Working Group



US-ASEAN Business Alliance for
Competitive Small and Medium Sized Enterprises



USAID
FROM THE AMERICAN PEOPLE



FOREWORDS

ASEAN SME Working Group

ASEAN is entering a new phase in its cooperation as members move towards building an ASEAN Economic Community (AEC) by 2015. The single market will open up unprecedented opportunities for businesses and citizens of ASEAN member states, allowing goods to flow freely and seamlessly within a market that has a population of over 600 million people. It will emerge and present itself as a stronger community on the global stage, bringing a multitude of opportunities for ASEAN small and medium enterprises (SMEs).

Accounting for more than 96 per cent of enterprises in ASEAN, SMEs are a significant engine of growth in the region and must seek to remain competitive. Nonetheless, SMEs face a variety of challenges in retaining their competitive edge, and in their quest towards becoming world-class enterprises.

In today's highly connected environment, ASEAN SMEs have to be equipped with the relevant competencies and sufficient resources to stay ahead of the curve. This calls for a multi-layered approach to capability and capacity building, technology transfer, and supply chain linkages to support their journey. The ASEAN SME Working Group (SMEWG) together with partners such as US-ASEAN Business Alliance for Competitive SMEs aim to foster an ecosystem of synergistic initiatives and infrastructure to catalyze their development.

The publication of this report is thus timely in providing fresh perspectives on the opportunities, challenges faced, as well as possible recommendations as the ASEAN SMEWG charts the direction of SME development post-AEC 2015.

I am heartened by the collaboration between the ASEAN SMEWG and the US-ASEAN Business Alliance for Competitive SMEs. This collaboration will drive ASEAN's growth to the next level and bring mutual benefits for businesses from the US and ASEAN to secure a future of hope, opportunity, and prosperity!

Ted Tan

Chairperson, ASEAN SME Working Group (2014-2015)

Deputy Chief Executive, SPRING Singapore

United States Agency for International Development (USAID)

Unlocking constraints to economic growth is one of the great challenges facing us today in our efforts to eradicate extreme poverty, and create a more secure and prosperous future for all. We know that entrepreneurship is one of the most powerful ways to unlock economic potential and lift people out of poverty. It promotes economic growth, job creation, and political stability and empowers youth and women. In the Southeast Asia Region, working to ensure that small businesses can start, grow and thrive in an integrated ASEAN Economic Community will be critical for the successful creation of a single market and production base in the Region, benefitting both the people of Asia and the United States (US).

USAID's Regional Development Mission for Asia is pleased to work with the ASEAN SME Working Group as it strives to create the right policy environment for inclusive business growth. By investing in sound SME policy, ASEAN Member States are working to ensure that no one will be left behind. We are also committed to our partnership with the US-ASEAN Business Council through the US-ASEAN Business Alliance for Competitive SMEs. Through training and mentoring of high-potential businesses, the Business Alliance will empower entrepreneurs, promote job creation and provide opportunity at all levels of society.

Dr. Michael Yates

Director

USAID Regional Development Mission for Asia

US-ASEAN Business Council

As the US-ASEAN Business Council marks 30 years of promoting US-ASEAN economic relations, we understand just how critical SMEs are to economic ecosystems where innovation and entrepreneurship can thrive. SMEs are great equalizers, in that they extend opportunity to all segments of society, including women and others without access to traditional employment. Promoting the development of SMEs is in the interest of all stakeholders in the region, including the U.S. business community.

In order for ASEAN to reach its full potential and fulfill the vision of the ASEAN Economic Community, all stakeholders must collectively work to ensure that we help ASEAN become a region which embraces entrepreneurs and creates a level playing field for all companies, especially SMEs. This is why the Council and USAID have come together to create the US-ASEAN Business Alliance for Competitive SMEs. This partnership combines the efforts of major U.S. corporations and USAID to develop the capacity and boost competitiveness of SMEs in the ASEAN region. American business has a huge stake in the success of ASEAN.

With \$190 billion in cumulative investment, U.S. companies have more invested in ASEAN than anywhere else in Asia. A strong base of SMEs will provide the future partners and customers of U.S. companies, and give ASEAN nations the economic strength and resiliency they need to continue to grow. As employers, taxpayers and partners, the American private sector in ASEAN sees the value in contributing resources to this endeavor and stands ready to ensure that this initiative continues well into the future, helping the ASEAN Economic Community become a reality.

SMEs are critical to ensuring Southeast Asia's growth continues to excel at creating jobs, opportunities and products of services for the people of ASEAN. This report offers specific suggestions for policy reforms and investments which will enable ASEAN to realize its considerable economic potential for its SMEs. As a proud founding partner

of the US-ASEAN Business Alliance for Competitive SMEs, we look forward to working with the U.S. Government and ASEAN to ensure our collective vision of a strong, prosperous, and dynamic region becomes a reality.

Alexander C. Feldman

President & CEO

US-ASEAN Business Council

ACKNOWLEDGEMENTS

This report has been a collaborative effort between the US-ASEAN Business Alliance for Competitive SMEs and the ASEAN SME Working Group. We would like to thank the staff of SPRING Singapore, the U.S. Agency for International Development, and the US-ASEAN Business Council for their strong support of this project throughout the process. In addition, we would also like thank the many individuals and organizations involved for their contributions to this publication, in particular: ASEAN Secretariat, Google, HP, MasterCard, Procter & Gamble, and UPS.

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EXECUTIVE SUMMARY

ASEAN's efforts to define a post-2015 ASEAN Economic Community (AEC) is an opportunity to address the competitiveness of its largest economic base – the small and medium enterprises (SMEs) sector – to achieve inclusive and sustainable economic growth for the region. We strongly support the ASEAN Leaders' vision of a highly competitive economic region of equitable economic development, and a region fully integrated into the global economy.

ASEAN and its Member States play a critical role in defining the policy and regulatory landscape in which SMEs operate. This landscape forms the foundation of a broader ecosystem that determines the scope and extent of benefits that will accrue to ASEAN SMEs in a post-2015 AEC. Together with the support of and investments made by a range of development and private sector actors, ASEAN and its Member States have a real and time-bound opportunity to change the structural dynamics that govern competitiveness of SMEs in the region. For the Leaders' vision of AEC 2015 to be fully realized and then translated into visible equitable economic development of the region, the goal of the post-2015 policy agenda must be to significantly strengthen the policy framework and infrastructure that enhance competitiveness for local enterprises.

To enable the competitiveness of ASEAN SMEs, it is recommended that ASEAN articulate a set of policy priorities that will enable the international market expansion and readiness of SMEs; facilitate the availability and application of technology; promote regulatory simplification, standardization and mutual recognition; and enhance accessibility of financing. Specifically:

- **Supporting international market expansion, integration into global supply chains and finding new customers:** Support modern manufacturing and supply-chain patterns to facilitate SME participation in global supply chains,

including policies supporting ethical business practices and corporate governance that will open up opportunities to work with US companies and other multinationals. In addition, to leverage the new growth in Business-to-Consumer (B2C) transactions, it is critical to pursue a conducive environment for cross-border e-commerce in the Asia Pacific Region.

- **Regulatory simplification, standardization, and mutual recognition:** The AEC 2015 Blueprint articulates a robust vision of regional integration that is grounded in the understanding that eliminating regulatory barriers to trade will provide the most opportunities for ASEAN SMEs to expand through the region, thereby realizing the potential of AEC. Today, in too many instances, SMEs with strong products and value propositions are unable to grow their business due to artificial constraints imposed by differential and complex regulatory requirements between ASEAN countries. ASEAN should continue to deepen this critical aspect of its reform agenda to ensure complete implementation of regulatory reforms, broader standardization across sectors, and expanded mutual recognition of standards and conformance.
- **Sustainability of business from startup to SME development via enhanced access to finance:** There is a substantial unmet demand for credit among ASEAN SMEs who cite the lack of financing as a major growth inhibitor. To support the sustainability and growth of SMEs, we recommend that ASEAN establish policies to promote product innovation in the financial market, considering alternative finances and diversified financial markets, ranging from microfinance, leasing, factoring, venture capital, equity funds, business angels, to stock markets. Policies supporting retail financing and e-payment systems such as debit and credit cards, mobile phone payments and online banking by individuals also support SMEs as a means to expanding reliable and verifiable financial transactions.

- **Facilitating and incentivizing the use of technology to enable SMEs to access markets and innovate:** Adopt policies supporting creativity, entrepreneurship, and the flourishing of technology, including the protection of intellectual property rights, and the free-flow of data across borders, needed by companies from all sectors including manufacturing, agriculture, retail, and banking who leverage technologies such as cloud computing to store and share data in an increasingly collaborative business world.

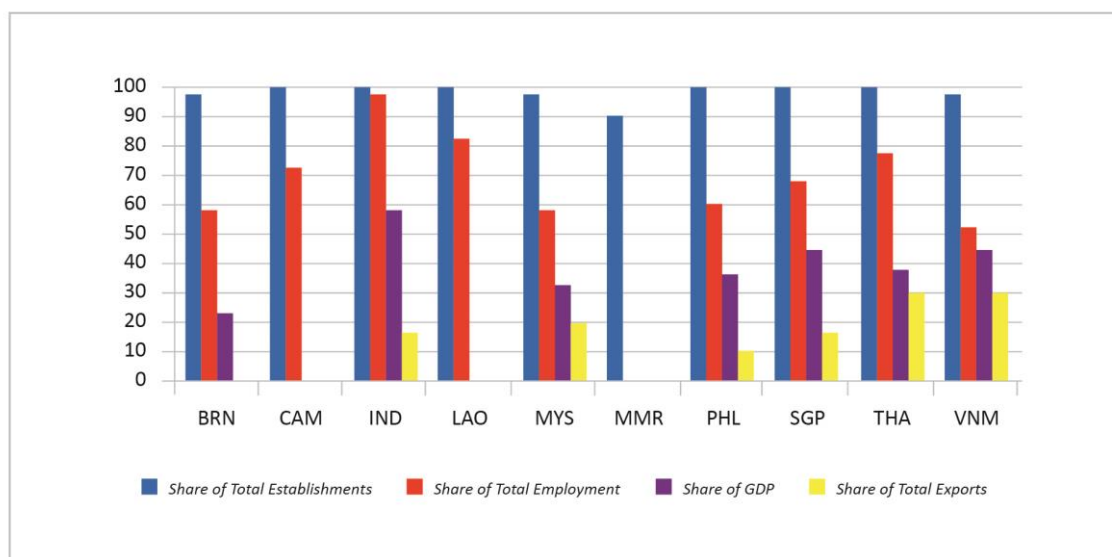
The private sector also has an important role in SME development. It is in this spirit that the US-ASEAN Business Alliance for Competitive SMEs (Business Alliance) was established, with the support of the United States Agency for International Development (USAID) and the US-ASEAN Business Council. Through the Business Alliance, US companies have actively engaged with ASEAN SMEs throughout the region to provide capacity building and share best practices to support global supply chain readiness and capabilities. Since March 2014, the Business Alliance has trained over 1000 SMEs in Indonesia, Malaysia, Myanmar, the Philippines, Singapore and Vietnam. In the lead up to 2015, the Business Alliance will continue its journey to help ASEAN SMEs become ready for the AEC and looks forward to growing its collaborative partnership with ASEAN Member States.

OVERVIEW OF ASEAN SME LANDSCAPE

SMEs are numerous and sector-diverse while employing many but SMEs could contribute much more

Within ASEAN, SMEs make up 92-99% of all commercial enterprises, employing 77-97% of the domestic work force in Indonesia, Thailand and Vietnam, and 58-62% in other ASEAN countries (*Figure 1*). It is expected by 2015, ASEAN SMEs will form a major part of regional and global supply chains. SMEs are also an important vehicle for gender empowerment with women-owned business constituting 38-47% of formal-sector SMEs in East and Southeast Asia.¹

Figure 1 Relative Economic Importance of SMEs in ASEAN (in various years and percentages)²



¹ Global Partnership for Financial Inclusion and International Finance Corporation, "Strengthening Access to Finance for Women-Owned SMEs in Developing Countries," October 2011.

² Economic Research Institute for ASEAN and East Asia (ERIA), "ASEAN SME Policy Index 2014," June 2014.

However, SMEs account for just 22-37% of gross domestic product of most ASEAN countries. Their export share is even lower: 10-20% in Indonesia, Philippines and Singapore, and around 30% in Thailand and Vietnam. Moreover, SMEs' export products are typically limited in variety and range, and are also highly resource-intensive and labor-intensive.

SME development is a critical part of the AEC Blueprint. The core of the Blueprint's pillar on Equitable Development focuses on SMEs. The ASEAN SME Working Group is implementing the AEC Blueprint for SMEs through its ASEAN Policy Blueprint for SME Development (APBSD) 2004-2014. The Strategic Action Plan for ASEAN SME Development (SAPASD) 2010-2015 has been devised to engage businesses on issues of access to finance, technology development, and human resources development, among others, in order to enhance the resiliency and competitiveness of SMEs.³

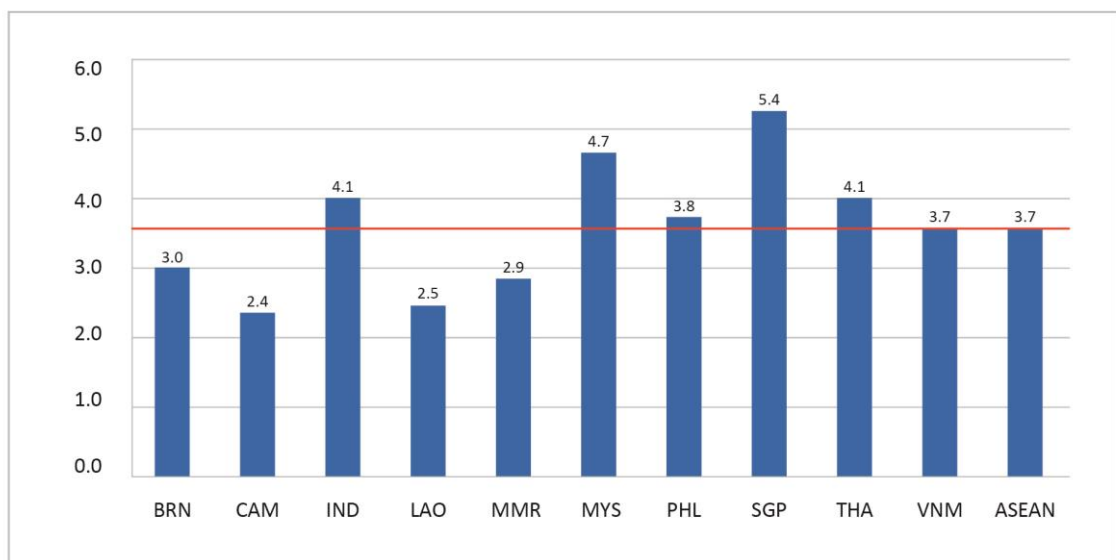
ASEAN SME Policy Index

It has been widely recognized that both government and market failures can hinder growth prospects and put SMEs in a more disadvantageous position compared with larger firms. The ASEAN SME Policy Index 2014, a joint research by the Economic Research Institute of ASEAN & East Asia (ERIA) and the Organization for Economic Cooperation & Development (OECD), was designed to measure the SME business environment in ASEAN. The index tracks SME development among ASEAN member states, and identifies gaps in both policy development and implementation. As stated in the index, the results from the Policy Index (*Figure 2*) suggest uneven levels of performance in the implementation of SME development policy at the national level between the two traditional groups of ASEAN Member States:

³ ERIA, "ASEAN SME Policy Index 2014 – Toward Competitive and Innovative ASEAN SMEs," June 2014.

- The less developed members or the CLMV countries (Cambodia, Lao PDR, Myanmar, and Vietnam) are below the ASEAN average
- The more advanced members or the ASEAN-6 (Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand) are on average in the top of the index score.

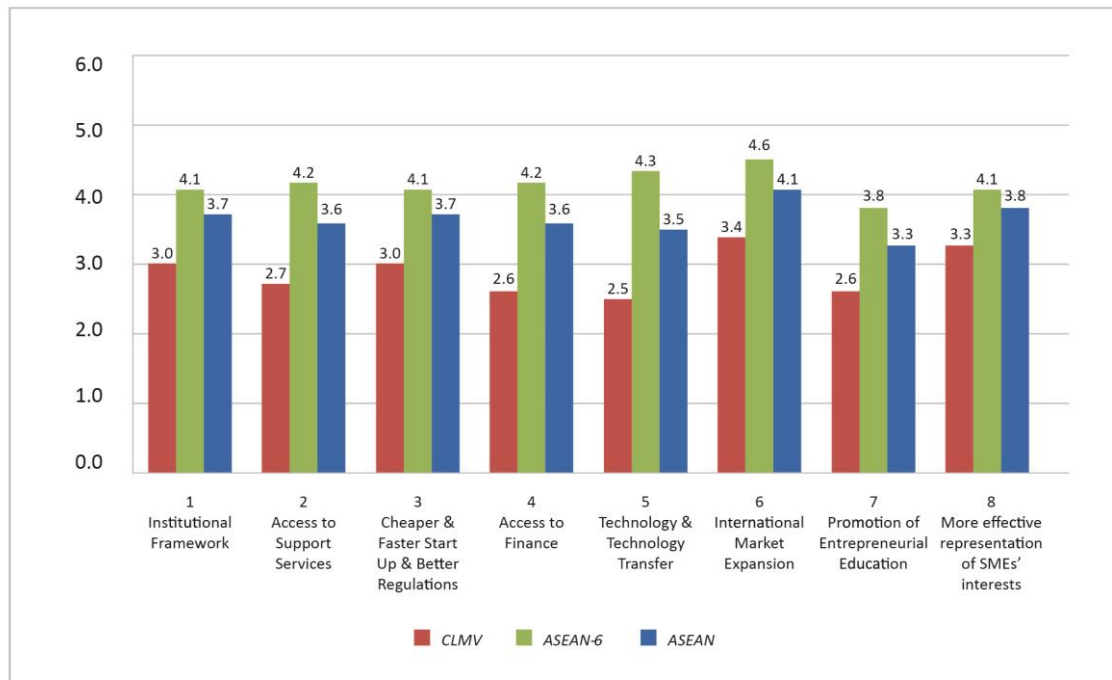
Figure 2 ASEAN SME Policy Index – By Country⁴



As seen in Figure 3 (next page), across the eight policy dimensions measured, there are big gaps between the ASEAN average, ASEAN-6 and the CLMV countries, with the most significant gaps and low regional standing found in five policy dimensions, namely: (5) Technology and Technology Transfer, (4) Access to finance, (7) Promotion of entrepreneurial education, (3) Cheaper, faster start-up and better regulations, and (2) Access to support services.

⁴ ASEAN SME Policy Index 2014, 9

Figure 3 ASEAN SME Policy Index – By Group of Countries and Policy Dimension⁵



The Challenges

SMEs face many challenges in ASEAN, which can be understood in three broad categories: regulatory barriers, lack of access to financing, and access to technology.

Regulatory barriers that inhibit growth

While complying with standards, technical regulations, and conformity assessment procedures can be costly for larger firms, it is potentially prohibitive for SMEs because many costs are fixed, regardless of a firm's size or revenue. The national level policy environments conducive for SME development vary across the region.

⁵ ASEAN SME Policy Index 2014, 10

Generally, SMEs have emphasized in Business Alliance activities the importance of administrative and procedural simplification, including the establishment of a single body for business registration, as well as adequate SME representation and voice in government policy making and administration processes. It is also important to provide tax exemptions and incentives, especially for research and development, to offset in part the costs to start-ups and to upgrade of products and processes.

The Asia Pacific Economic Cooperation (APEC) Business Advisory Council (ABAC) identified the following priority areas that represent challenges for SME development:

1. Laws, regulations and policies which:
 - Determine the ease of entrepreneurs to formally establish a business;
 - Constitute constraints on the ability of SMEs to access financial resources and related services;
 - Constitute barriers for SMEs to increase their access and utilization of information technology products and related services
2. Trade and customs policies that impact the ability of SMEs to participate in cross-border trade activities.⁶

In the ASEAN SME Policy Index 2014 report, Singapore, Malaysia, Indonesia, Thailand and Vietnam ranked higher than the remaining ASEAN member states in terms of the overall institutional framework. These countries have implemented multi-year SME development strategies with allocated budgets, policy targets, and review mechanisms for policy formulation and execution under a designated agency. Others lack proper legal framework, institutional capacity, development strategy, and resources to coordinate, formulate, and implement an SME development policy. Across ASEAN,

⁶ APEC Business Advisory Council letter to Chairman of the 2013 APEC SME Ministerial Meeting. July 18, 2013.

SMEs in certain industries (including food manufacturing, pharmaceuticals and customs) suffer due to a lack of harmonization in regulations.

Lack of access to finance

After achieving the hurdle of business start-up, often the next major challenge for SMEs is securing capital for business growth. SMEs at Business Alliance events regularly raise concerns about access to finance as a core problem that they face. Generally, about 85% of the SMEs in both the formal and informal sectors of developing countries suffer from credit constraints. The unmet need for credit is very substantial. Data from the International Finance Corporation show that some US\$900 billion to US\$1.1 trillion of SMEs' credit requirements are unmet in East and Southeast Asia. Importantly, the credit shortfall has a disproportionate impact on women entrepreneurs. The proportions of women-owned SMEs having good access to finance average 5-6% for micro-enterprises, 12-15% for small firms, and 17-21% for medium-sized undertakings.

According to ERIA, the gap in access to finance is exacerbated by a) the poor functioning of the cadastre system; b) stringent collateral requirements; and c) inadequate protection of creditor rights. Credit risk guarantee schemes and a central bureau for credit information, which are essential to promote collateral-free finance, are not well established and well-functioning. There is also a lack of a legal framework and policies to promote alternative financing and diversified financial markets, ranging from microfinance, leasing, factoring, venture capital, equity funds, business angels, to stock markets.

Another gap in financing arises from the lack of online crowdfunding alternatives. By some estimates, only 2.3% of new businesses receive private financing from sources such as venture capitalists or angel investors. The remaining 97.7% need to find other ways to raise capital, such as from family, friends and their community. Crowdfunding

sites are an emerging solution that allows companies to bring to life their ideas for film, art, albums and other projects. Examples of such crowdfunding sites are Singapore's Crowdnomic, which is a platform for entrepreneurs to gather contributions from supporters in exchange for products and services ('Rewards') using a 'Pay-as-you-Go' funding system. Securities laws and regulations need to allow for new, innovative ways of raising capital and existing regulations have proven to be complex barriers for small businesses.

Lack of access to technology

In today's digital economy, an SME without an understanding of available technology and innovation, and how to use it to reach customers, partners and new markets, is at a severe disadvantage. The lack of access to modern technology and tools, especially the Internet which is the greatest opportunity equalizer in modern business, is a severe constraint on SMEs' participation in e-commerce and on SME development in the less developed countries in ASEAN. In fact, online commercial platforms have enabled numerous SMEs and individuals worldwide to become micro-multinationals and to engage actively in micro-supply chains. Many SMEs in the CLMV countries would like to gain access to online marketing and electronic payments as well as the requisite skills to utilize these tools.

According to the ERIA, the biggest gaps in policy are due to the lack of a strategic approach to innovation policy for SMEs, poor provision of information on innovation support services, limited access to standard certification services, lack of technology support in universities, and little linkages between SMEs and R&D labs and incubators. Similarly, proposed restrictions on cross border data flows, support for the opportunities provided by the Internet for creators and protection of their intellectual property rights (IPR) through flexible exceptions, lack of broadband infrastructure, underdeveloped science and industrial parks, lack of competitive clusters, and insufficient financial incentives in technology development and R&D activities are also reasons for the gap.

SMEs in ASEAN also need to be able to harness the full benefits of the upcoming ASEAN Economic Community by having open access to the existing technology that they possess. Worrying regulations around the region threaten the open web that has provided a level playing field for many SMEs to compete. Requirements that companies store all their consumers' data locally will introduce large and unrealistic costs on SMEs looking to cater to a regional or global market and force them out of operation before they have even begun to compete.

Opportunities aplenty

The post-2015 AEC needs to define a clear strategy for involvement of the private sector, especially SMEs, to achieve inclusive economic growth in the region.

Comprehensive and effective monitoring tools—such as the ASEAN SME Policy Index—should also be implemented. The US-ASEAN Business Alliance for Competitive SMEs was launched to provide private sector support, and its focus is on improving access to the regional and international markets, access to information and information technology, and access to finance. Government initiatives are also helping, with many ASEAN Member States developing SME promotion programs that work to help SMEs in financing, capability and management development, technology and innovation, and access to markets.

Vision of AEC and opportunities contained within it

When achieved in 2015, the AEC will enable opportunities for trade and growth to all industries and enterprises in ASEAN and beyond. Trade, investment and skilled labor will move freely along with the freer capital movement in the AEC. Intra-ASEAN trade was valued at US\$602 billion or 24% of ASEAN total trade in 2012. It will be largely free of tariffs under the AEC, compared to an average tariff wall of almost 13% in 1993.

Extra-ASEAN trade was worth US\$1,874.3 billion in 2012. The region concluded five FTAs to further liberalize trade and investment relationships with Australia and New Zealand, China, India, Japan and Republic of Korea. Negotiation between ASEAN and its six FTA partners on a Regional Comprehensive Economic Partnership (RCEP) started in May 2013 and is to conclude by December 2015. RCEP covers 3.6 billion people with some US\$20 trillion in production value, both the world's largest.

Support from Development Partners

Looking forward, ASEAN is now planning for its post-2015 agenda. This will include a new SME work program. USAID and other donors are supporting ASEAN as it develops this plan. But more importantly, concern for SME development must infuse the entire post-2015 agenda. USAID is working closely with ASEAN to develop programs of support for women entrepreneurs and to expand SME finance. Regional efforts to foster SME development in ASEAN have received considerable support from other major donors and international organizations. Technical project support comes mainly from the Japan-ASEAN Integration Fund (e.g., the SME Service Center project) and Federal Ministry for Economic Cooperation and Development of Germany (e.g., the SME regional fund project). Meanwhile, ERIA and the OECD have provided research-based project support, with the latest project focusing on developing the ASEAN SME Policy Index.

Women entrepreneurs must be a special focus of development in the next plan. This will be assisted by the recent launch, with support of USAID and the US-ASEAN Business Alliance for Competitive SMEs, of the ASEAN Women's Entrepreneurs Network (AWEN), an important step in increasing the focus on women's issues in business. The Business Alliance will continue to support AWEN as it grows and takes a vital role at the center of discussions of economic policy.

The US-ASEAN Business Alliance for Competitive SMEs

The US-ASEAN Business Alliance for Competitive SMEs ('Business Alliance') is an example of private sector stakeholder support for SME development in ASEAN. Launched in Washington, D.C., on March 4 2014, the Business Alliance is co-implemented by USAID, through the ASEAN Connectivity through Trade and Investment (ACTI) project, and the US-ASEAN Business Council, through the Council's ASEAN Committee. The Business Alliance is committed to helping build the capacity of ASEAN SME entrepreneurs, particularly with respect to logistics, use of modern Information and Communications Technology (ICT) tools, use of payment systems, and marketing. Through a series of workshops and other events over the past five months, the Business Alliance has provided training to over 1000 SME owners. The Business Alliance is committed to providing this type of training and support to ASEAN SMEs through 2017. See Annex for more details on this initiative and its initial activities.

Support from ASEAN Governments

The SME focal agency in many ASEAN countries is embedded in the Trade or Industry Ministry. Yet, reality shows that it is well-coordinated efforts among multi-disciplinary actors combined with political will at the top that can create a real spur for SME development. Most of the ASEAN-6 have deployed effective SME promotion programs, ranging from credits/matching grants for innovative start-ups, export finance, export marketing, tax incentives, to technology consultancy/upgrading. The CLMV also have some programs up and running, yet the magnitude of efforts is less compared to those in the advanced group.

The AEC 2015 and trade agreements signed by ASEAN create opportunities for SMEs to expand their activities, but stronger and more concerted efforts at both the regional and national level are needed by ASEAN governments to enhance the competitiveness and flexibility of ASEAN SMEs. There are also opportunities for the private sector to

partner with ASEAN governments in public-private partnership (PPP) programs to enhance the competitiveness of SMEs, especially in financing and skills development.

The following box describes the innovative ‘SPRING SEEDS’ program in Singapore that successfully provides equity for local startups. Adapting this Singapore model based on the level of their development as well as resources available, the CLMV group can not only help promote SME development in their countries but also tap on the synergies between MNCs and local SMEs in the global supply chain, thereby spurring economic growth.

Best Practice Example 1

Singapore: SPRING Start-up Enterprise Development Scheme (SPRING SEEDS)

In partnership with the private sector, SPRING SEEDS provides an equity-based co-financing option for Singapore-based start-ups with innovative products and/or processes with intellectual content and strong growth potential across international markets. Together with third-party investors, SPRING co-invests and nurtures growth-oriented, innovative start-ups by matching dollar-for-dollar initial investment up to a certain limit.⁷

Countries can also begin to address the gender gap in SME ownership, which can help accelerate economic growth. The following describes Malaysia’s Get Malaysian Business Online (GMBO) scheme where the Government has set up a US\$16 million fund for an entrepreneur development program.

⁷ For more details: <http://www.spring.gov.sg/entrepreneurship/fs/fs/pages/spring-start-up-enterprise-development-scheme.aspx>

Best Practice Example 2

Malaysia: Get Malaysian Business Online (GMBO) scheme

This funding is for women between the ages of 18 and 65 who have a viable business product, and is aimed at encouraging female entrepreneurs to bring their businesses online. By recognizing the barriers to capital to grow technological competence, governments can play a role in accelerating SME growth.⁸

Procedural simplification, incubation support and start-up mentoring are widely considered of significant importance in fostering MSME development. Philippines has adopted an innovative and inclusive approach in these regards.

Best Practice Example 3

Philippines: Business Resource Innovation Center for Small and Medium Enterprises (BRICS) from the Department of Trade and Industry, Philippines.

Several Philippines' Business Resource Innovation Centers for Small and Medium Enterprises (BRICS) have been launched in major provincial cities in the Philippines. Basically, BRICS is an improved or leveled-up SME Center which provides a one-stop-shop with more proactive and user-friendly services in support of entrepreneurial start-up, early-stage enterprises as well as existing MSMEs themselves. BRICS' business development and support services range from facilitation of business registration, and the provision of market and other information to the facilitation of product development and investment, and of access to finance and technology transfer.⁹

⁸ For more details: <http://www.getmybusinessonline.com.my/>

⁹ For more details: <http://www.dti.gov.ph/dti/index.php/msme/brics>

POLICY RECOMMENDATIONS

Expanding the SME development pillar in the post-2015 AEC agenda represents a strategic opportunity for ASEAN to achieve its objectives of inclusive growth. Our specific recommendations for creating the best environment for SMEs in ASEAN center on:

- Supporting international market expansion, integration into global supply chains and finding new customers
- Regulatory simplification, standardization, and mutual recognition
- Sustainability of business from startup to SME development via enhanced access to finance
- Facilitating and incentivizing the use of technology to enable SMEs to access markets and innovate

Both the ASEAN and US private sectors recognize that AEC-deepening must be at the heart of the post-2015 regional economic integration agenda. The post-2015 agenda will be packed with initiatives to create a regionally integrated and globally connected ASEAN. We believe that among those initiatives there must be an SME development pillar, which provides targeted investment and initiatives to support specific segments of the SME sector. This would support more inclusive economic growth processes that take into account the aspirations and concerns of economic actors of all sizes. Our specific recommendations are outlined next.

Recommendation 1

Supporting international market expansion, integration into global supply chains and finding new customers

The implementation of the AEC and the FTAs with ASEAN's plus one partners (China, Japan, Korea, India, Australia, New Zealand) create great market expansion opportunities. Its effort to integrate within itself and with these trading partners must continue beyond 2015. The elimination of duties and opening of the services sector; harmonization and mutual recognition of standards which creates the much-needed scale for SMEs; simplification and integration of customs processes; and competition in cross-border transportation for cost-efficient travel and shipping are a critical part of these integration efforts.

Enhancing competitiveness requires understanding the patterns of modern trade that has evolved rapidly in the last few years and then formulating policies that will place ASEAN SMEs ahead of other global or regional partners, suppliers, agents, or vendors. For example, lean manufacturing practices and lower transportation costs have resulted in the global fragmentation of production networks. A smartphone sold in the US or EU can be designed in California, manufactured in China, with parts of components manufactured by suppliers in Singapore, Malaysia, Thailand, Taiwan, and Mexico. Similarly, a running shoe purchased by a European online shopper could be prototyped in the US, customized and designed online by the buyer, manufactured in Vietnam, with fabric, laces, uppers, in-soles and out-soles from Sri Lanka, US, Cambodia, and Vietnam, and packaging from Indonesia. The fragmentation of such production networks is an opportunity for SMEs who can now sell anywhere in the world.

Modern trade patterns have further evolved in the last couple of years with the onset of internet-based shopping and the explosion of e-commerce. This is also an

opportunity for SMEs who often do not have resources to establish a commercial presence in foreign markets to reach consumers there. Here, ASEAN SME retailers already have an advantage with the rise of the Asian consumer, as they are familiar with the patterns and preferences of their neighbors. Those that have ventured into foreign markets may also already have Asian networks.

The Business-to-Business (B2B) and Business-to-Consumer (B2C) trends described present significant opportunities for ASEAN SMEs. However, these trends demand a coordinated effort by individual ASEAN Member States and the entire region to ensure 1) the end-to-end speed, efficiency, and security of supply chains; and 2) a policy environment enabling e-commerce taking into account the role various parts of the e-commerce value chain play – from internet services; payment systems; cross-border and last mile transportation, to distribution and logistics.

- **Supporting B2B supply-chain practices and attaining global supply chain**

readiness: Global transportation networks and efficient border clearance processes enable the global production networks that provide opportunities to SMEs, without which, global buyers are limited to sourcing closer to market. It does not matter that a smart phone is manufactured in China for consumers anywhere as long as there is a way to efficiently bring components to the manufacturing site, samples to buyers, and the finished product to market. These efficiencies are even more critical today to meet the demands of global buyers and ASEAN must create the backdrop for which its SMEs can have access to global transportation networks, and can compete on lead times, customer responsiveness, and end-to-end visibility. Such a policy environment would entail:

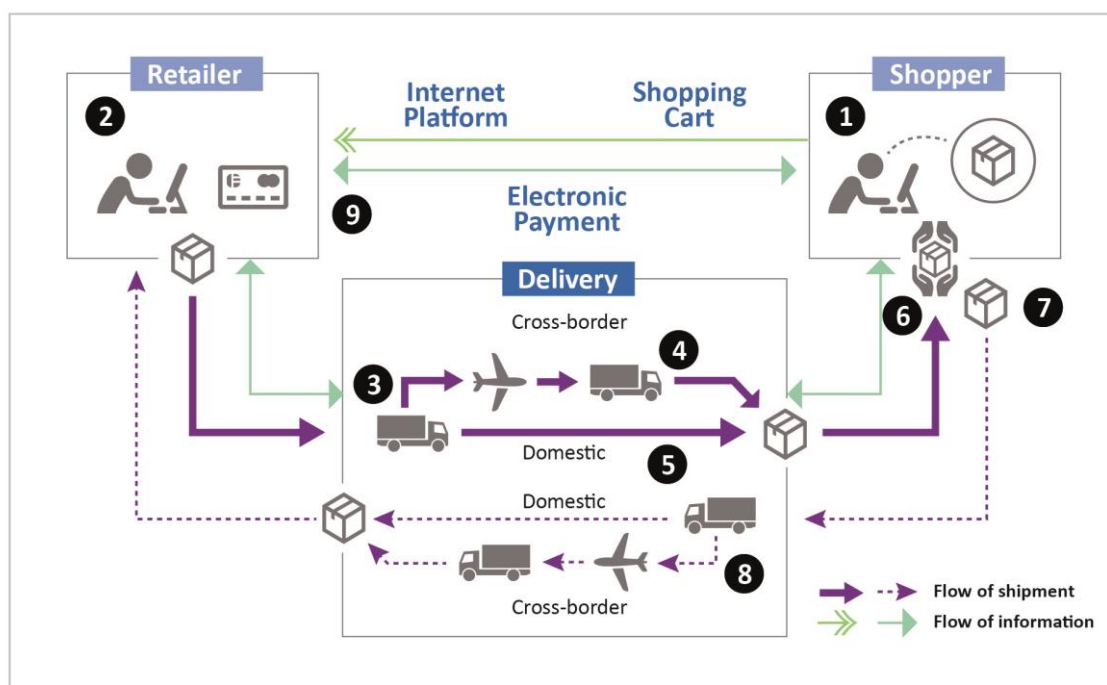
- An open transportation and logistics market to facilitate efficient door-to-door, and integrated air, cross-border land, ocean, and multimodal connectivity. Efficient transportation not only lowers costs and enhances

time-in-transit but also opens up additional opportunities for SMEs to serve international buyers looking to 'green' their supply chains.

- Efficient and coordinated border-clearance processes backed by electronic pre-arrival customs processing and clearance, risk management techniques supporting immediate release, account-based customs processing, and post-clearance payment of duties and taxes. Such modern customs practices as embodied in ASEAN's vision for the ASEAN Single Window support competitive lead times, enhancing time-to-market and impacting revenue gains.
 - The availability of technology to facilitate actionable visibility and collaborative decision-making among global buyers and their SME suppliers.
 - Compliance is of critical importance to global buyers who rely greatly on suppliers' compliance with strict laws and best business practices such as the Securities Exchange Commission (SEC) Act, the Foreign Corrupt Practices Act (FCPA) and other rules supporting ethical business practices and governance. Strong compliance among suppliers will no doubt open up additional opportunities to work with larger companies as partners, agents, suppliers, and vendors.
- **Supporting B2C e-commerce transactions to capture growth:** Much like in the US, e-commerce is opening up opportunities for ASEAN SMEs to reach new markets. However, unlike the US, where Internet shopping comprises a 7% boost to retail sales every year, B2C sales in Asia are an astounding 20-30% of total retail sales. B2C sales in the region are expected to outpace the US at 30% growth this year to over US\$433 billion, with China, Japan, India, and Indonesia leading the way. By

2017, analysts are predicting e-commerce in Asia to top US\$1 trillion.¹⁰ The power of online shopping is best illustrated by the sales generated on 11 November 2013 – China’s Singles Day – where Alibaba sales reached more than US\$5.75 billion on that day alone. The opportunities for ASEAN SMEs to tap into Asia’s growth and reach new customers are endless. To capture the growth, ASEAN governments must put in place the necessary policy framework to facilitate all parts of the e-commerce value chain, and enable the flow of data, funds, and goods across borders (see Figure 4 below).

Figure 4 Overview of Flows of Data, Fund and Goods in an E-Commerce Transaction¹¹



- **Facilitating the flow and distribution of goods across borders:** Much scrutiny is being placed on the fulfillment aspects of B2C transactions because this part of the value chain impacts overall customer satisfaction and experience. Indeed, many

¹⁰ e-marketer, 2013

¹¹ Copenhagen Economics, 'E-commerce and delivery: A study of the state of play of EU parcel markets with particular emphasis on e-commerce,' July 2013. (http://ec.europa.eu/internal_market/post/doc/studies/20130715_ce_e-commerce-and-delivery-final-report_en.pdf)

are attributing the success of e-commerce in Asia on the ability of logistics companies to keep up with the growth, handle increasing volumes, address geographic spread, all while guaranteeing service quality. Here, the online shopper is not only expecting choices, but also for his or her purchase to arrive quickly and on time, in good condition, with a built-in mechanism for seamless returns and refunds. Two policy aspects determine the success of logistics companies to fulfill online transactions efficiently:

- Policies that support efficient distribution and transportation networks internationally and domestically:
 - Restrictions in distribution are impediments on the growth of e-commerce. In a survey¹² done among 2000+ European SMEs in 2013, more than 60% of SMEs surveyed noted that they were impacted by ‘sales restrictions’; more than a quarter of those surveyed are not confident about their future; and more than half believe that innovation in e-commerce will decline and that consumers will not be able to find certain products online anymore. It is critical therefore that ASEAN and its major trading partners open up cross-border distribution channels in order for ASEAN SMEs to access new e-commerce opportunities.
 - In addition, to support last mile delivery capabilities, governments must work to open up the transportation sector to facilitate the growth of international and domestic transportation networks. Today, few logistics players offer the breadth of services needed at competitive prices across a broad global network to meet e-commerce demands. In China for example, where ASEAN SMEs and online retailers will have many opportunities for new customers, global and regional based

¹² <http://www.choice-in-ecommerce.org/news-press/press-information>

logistics players can reach customers concentrated in Shanghai and its top ten coastal cities, but eight out of the ten fastest growing markets are inland tier 2 and 3 cities - less reachable without international and domestic access. Without equivalent access and transportation connectivity to these inland cities, such as the ability of airlines to co-terminalize, or nationwide trucking capabilities, demand may fast outstrip the supply of critical affordable logistics services serving these emerging customer opportunities.

- Policies that support efficient border clearance especially those that support immediate release of low value shipments, simplified documentation, and returns.
 - SMEs throughout the world, including the more established SMEs in mature economies such as the EU and US often shy away from overseas customers because it is too burdensome to deal with cross-border transactions, as they simply do not have the resources to navigate the complexities of trade. To help SMEs overcome the administrative burden of trade, ASEAN must continue its efforts and encourage its trading partners to coordinate border agencies, simplify border procedures, and adopt meaningful risk management techniques at the border. These will be even more critical as e-commerce volumes grow in Asia, and customs and border clearance chokepoints start to develop, impacting overall time-in-transit and last mile delivery.
 - Beyond basic customs and border clearance efficiencies, ASEAN governments should also adopt the following practices to facilitate and support the growth of e-commerce:

- Establish electronic pre-arrival processing for express shipments and immediate release applying risk management techniques separating low from high value shipments.
- Establish commercially viable de minimis thresholds under which only simplified, informal import declarations are needed, and duties and taxes are waived. Seek to match de minimis levels to personal exemption thresholds for returning travelers. After all, why should goods meant for the same individual consumption be treated differently if it is ‘couriered’ rather than ‘carried’?
- Simplify importer/exporter registration and waiver of power of attorney requirements.
- Adopt service level commitment to goods release within specified period of time and flexible operation hours to support customs clearance round the clock.
- Establish efficient returns processes with no duty/tax levied during re-import.

Recommendation 2

Regulatory simplification, standardization, and mutual recognition

- **Establish a higher ASEAN SME body:** Given the stake of SME development in ASEAN and the fact that the success of the regional integration needs to have vibrant and competitive SMEs to fully benefit from a deeper regional integration

and narrow development gaps, we support the recommendation in the ASEAN SME Policy Index 2014 report that a higher ASEAN SME body should be established, elevating the ASEAN SME Advisory Board to an ASEAN SME Ministers Meeting level which reports to the AEC Council in coordinating regional efforts and mobilizing resources for SME development. These efforts will involve the integration of other regional initiatives (trade, investment, banking, and finance) in harmony with the SME development agenda.

- **Develop greater stakeholder participation, including the private sector, in the development of regional SME policies:** In the current inter-connected world where goods are often produced through linkages between many companies, it is important for SMEs to be able to take advantage of such linkages. Developing policies to support such linkages requires input from larger companies, on the types of support and training that can be most effective. We urge ASEAN to continue to embrace such linkages and we offer to be an active partner with ASEAN in this area. We would propose an annual symposium to both examine policy options for SME development as well as the success of past policy actions.
- **Launch regional and national legal, institutional and regulatory reform initiatives to reduce both online and offline barriers and create a favorable environment for SME exports:** The development of trade relations between SMEs in ASEAN as the lifeblood of the AEC is a driving force towards a common goal of integration and development of the economic potential of ASEAN. A seamless and coherent trading infrastructure, supported by the ASEAN Single Window, holds tremendous potential for SMEs. Undertaking regulatory harmonization efforts will also help to create a more integrated ASEAN SME ecosystem, in particular initiatives that support:
 - Alignment with internationally harmonized standards for goods and services as the basis for regulatory requirements. This will help to reduce

the number of country-specific requirements, which can otherwise create barriers or increase the costs of doing business for SMEs.

- Harmonization of regulatory requirements across countries to promote greater efficiency, supporting the development of intra-regional supply chains.
- Improvements to the quality and transparency of standards development and assessment, resulting in a reduction in the cost and complexity of conformity assessment procedures.
- **Assist SMEs in internationalizing operations so they can ‘go global’:** We believe that even the smallest of businesses can go global. Governments can therefore play a critical “triggering” role by enacting policies to boost SMEs' knowledge of overseas markets and their commitment to expanding abroad. This can be done by providing information services and raising awareness about the benefits of internationalization. Once enterprises have branched out beyond national boundaries, the process is likely to gain momentum on its own. It then becomes more important for the government to play the role of facilitator, for instance, by helping reduce entry barriers, lowering the cost of international expansion and ensuring access to the best inputs from a range of suppliers at global prices.

Recommendation 3

Sustainability of business from startup to SME development via enhanced access to finance

- **Retail lending infrastructure:** Policies that develop national lending infrastructures (credit information sharing systems and laws governing security interests) to

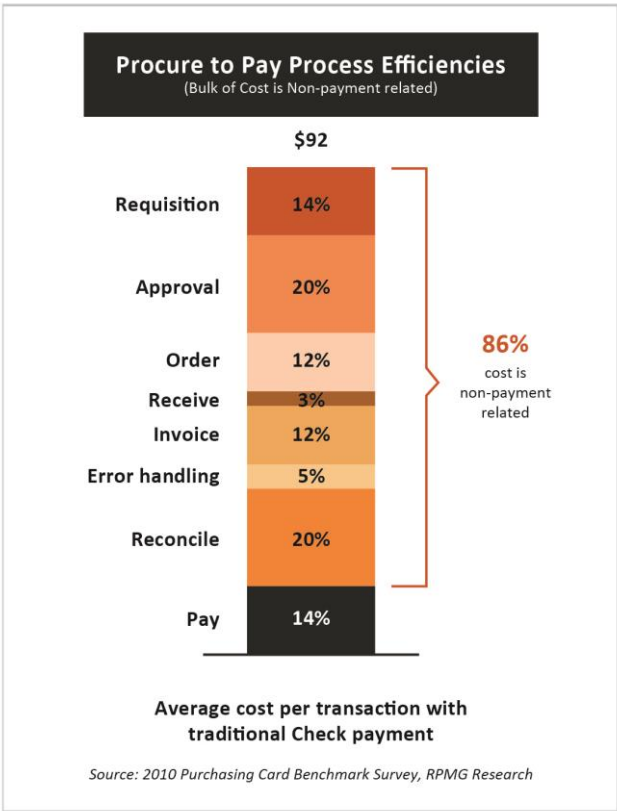
improve environments for SMEs to gain greater access trade finance, reduce the cost of finance and encourage lending/extension of credit to SMEs.

- **Wholesale lending infrastructure:** Regulatory reforms and public private partnership initiatives which incentivize angel and venture capital financing. In addition, public and private partnership investments in a regional “fund of funds” for supporting the growth of an ASEAN venture capital ecosystem.
- **Asset based lending:** Assist in capacity building for asset based lending (ABL) as a liquidity channel for SMEs, including best practices on clear legal rules for secured lending and factoring, transparent lien registries, broad definitions of eligible collateral, and enforcement of creditor rights. Concurrently, regional governments should develop and assist capacity building for modern, cross-border credit information systems to encourage prudent and competitive access to credit for consumers and SMEs, level informational playing fields, improved underwriting and market access. Unimpeded data flows are crucial to this process.
- **E-Payment systems in general:** Support the ongoing growth of e-payments systems such as debit and credit cards, mobile phone payments and online banking by individuals, SMEs and government entities as a means to expanding reliable and verifiable financial transactions. The use of electronic payments can increase efficiencies in individual ASEAN countries and in cross border transactions thereby promoting integration. Such payments speed up processing, reduce costs and enhance transparency and accountability.

In addition, e-Payments can facilitate efficiencies in B2B business processes. The bulk of cost in the procure-to-pay process is non-payment related (Figure 5 below). Better receivables management by converting complex manual processes to simple digital processes brings significant benefits to SMEs by reducing financial and processing costs from 3-7% to less than 2% of Cost of Goods Sold (COGS).

Electronic payments can drive supply chain efficiencies – working capital efficiencies; payment process efficiencies; business efficiencies; and global settlement efficiencies.

Figure 5 E-Payments Facilitate Efficiencies in B2B Business Processes¹³



- **E-Payment systems in e-Government:** Governments can lead the way. E-government tools improve efficiency, address challenges such as fragmentation across government agencies, centralize processes in shared service centers and optimize cash flows. The importance of financial inclusion rests on its potential value for the millions of individuals, households and microenterprises in ASEAN that are now either fully or partially excluded. A simple first step, such as opening a bank or e-money account for receiving salary or social benefits, can begin a

¹³ RPMG Research Corporation, '2010 Purchasing Card Benchmark Survey Results,' 2010. (http://www.rpmgresearch.net/product-view.php?product_id=32)

transformation that will ultimately enable them to manage their day-to-day life more productively, shield them against risks, and support them in achieving major life goals like education, home and business growth.

- **Launch national start-up programs across the region to inject funds into promising ASEAN-based startups:** While Silicon Valley startups have long enjoyed the benefits of the region's history of entrepreneurial mentorship, with a number of seed programs and incubators focused on helping to the next big idea, ASEAN startups have historically had to go it alone. ASEAN could launch national start-up programs across the region to inject funds into promising ASEAN-based startups and provide guidance over a set period by world-class mentors and venture capitalists. This can demonstrate an ASEAN 'spirit' to innovation. AMS could adopt relevant elements of the APEC Start-up Accelerator Initiative – a public-private sector collaboration and a platform that strengthens access to finance, investments and international markets.

Recommendation 4

Facilitating and incentivizing the use of technology to enable SMEs to access markets and innovate

- **Developing national policies that reduce barriers and costs for SMEs to utilize electronic commerce based platforms to participate in cross-border trade:** As a cost-free delivery channel, e-commerce has reduced the barriers to global trade. Many products and services can be sent effectively in the form of data. Electronic commerce platforms can facilitate cross-border business growth and should be promoted through reduction of administrative barriers.
- **Expand trade in digital goods, services and infrastructure:** The evolution and growth of the digital economy underscores a critical principle of the global trading

system: the importance of keeping all modes of international trade open. Despite progress in past agreements, significant impediments remain to trade and investment in areas critical to the digital economy. We recommend ASEAN countries actively support the expansion of the Information Technology Agreement (ITA) in the World Trade Organization (WTO).

- **Developing national policies and a regional framework to enable data and information to flow across borders:** Digital information, products and services, and the infrastructure that supports them, are the backbone of the modern global economy. Enterprises and individuals engage in digital trade in a variety of ways, including by conducting e-commerce, providing and accessing digital products, services and information, transferring data to run their global operations and utilizing ICT infrastructure. These activities enable organizations and entrepreneurs to innovate, create new products and services, enhance productivity, enable cost-savings, improve efficiency, protect consumers, facilitate trade, and create jobs.

A vibrant and unrestricted Internet is a key driver for international trade and domestic economic growth, and critical for in-country businesses and consumers to participate in the global information economy. The principle of openness is the best guarantor of national interest and economic growth. The Internet is a 21st century trading route, and so when it is impeded, the commerce that passes through it is impeded too. To realize the economic benefits of the Internet, countries are increasingly seeing the value in crafting trade policies that support innovation and competition, and avoid regulatory barriers that slow the adoption of modern technologies. Therefore, policymakers should consider the following:

- Governments that actively encourage and protect cross-border data flows will benefit from increased investment and economic growth.

- Data or server localization requirements have an impact on efficiencies, free flow of services and the ability of in-country businesses to grow.
- Economic growth in the Internet sector and beyond requires clear and balanced intellectual property rules and enforcement.

CONCLUSION

This report has sought to contribute to the overall vision of a post-2015 ASEAN Economic Community. The report focuses on the development of SMEs, which serve as both the backbone as well as the growth engine of the ASEAN economy. We were able to identify areas where opportunity abounds, but also areas where there are challenges, especially with respect to regulatory barriers as well as access to technology and financing. In line with these observations, the report includes recommendations on:

- Supporting international market expansion, integration into global supply chains and finding new customers
- Regulatory simplification, standardization, and mutual recognition
- Sustainability of business from startup to SME development via enhanced access to finance
- Facilitating and incentivizing the use of technology to enable SMEs to access markets and innovate

It is a joint responsibility of the political and business leadership in ASEAN to create the environment for every SME in ASEAN to grow to its full potential. We believe that doing so will lead to broad-based improvements in not just economic growth, but also to improvements in health and education, and alleviating overall poverty.

The report also recognizes, however, that identifying current problem areas and issuing policy corrections is not enough. We must seek to actively engage in the

formation of the AEC through ongoing initiatives such as US-ASEAN Business Alliance for Competitive SMEs and robust dialogue between all stakeholders. We look forward to deepening our partnership and working together to continue to develop a vision for a harmonious and inclusive ASEAN business environment.

ANNEX

The US-ASEAN Business Alliance for Competitive SMEs comprises US corporations offering their expertise and/or financial support for the Business Alliance include: ASEAN Committee leaders – P&G, UPS, HP as well as Baker & McKenzie, Cisco, eBay Inc., FedEx, Google, Hills Companies, IBM, MasterCard, Microsoft, Motorola, PayPal, Qualcomm, Seagate, UL, and VISA. Several other US corporates are expected to join the partnership later on or to incorporate Business Alliance activities as part of their own social outreach activities.

The Business Alliance focus areas are:

- Access to the regional and international markets;
- Access to information and information technology;
- Access to finance.

These focus areas are based on the availability of resources and expertise, the ASEAN SME Action Plan and findings from an SME needs assessment undertaken by USAID. The three focal areas have been endorsed by the ASEAN SMEWG.

The implementation of Business Alliance activities have endowed regional entrepreneurs with better understanding of the tools of modern commerce and greater competitiveness locally and within the ASEAN Economic Community. They also better understand the operational requirements of on-shore and off-shore value chains, especially as regards commercial, logistic, technology and legal aspects and dimensions, and so are better prepared and able to become suppliers to larger corporations.

Indeed, from their post-training survey responses, some 89% of these regional SME entrepreneurs plan to expand their business within the next 3 years. The major

business activities are trading (29% of the participating entrepreneurs), manufacturing (26%) and services (25%).

Current and future Business Alliance activities

Access to regional and international markets.

2014:

- Basic-level training on supply-chain readiness in Ho Chi Minh City, Jakarta, and Kuala Lumpur and Manila, involving some 712 SME participants (with 371 women). (April-July 2014). The next training workshop will be held in Myanmar in August.
- Business-leadership college for high-potential SME talents convened in Singapore with 50 participants (including 10 women). (June 2014)
- A series of ASEAN Insights Seminars to provide SMEs and their enablers with the most up-to-date information on major global and regional development trends, and their impact and implications on SME development (first meeting in Myanmar, November 2014)

2015:

- Three advanced level training workshops on supply chain readiness are planned across ASEAN. Participants include selected SMEs which had benefitted from the basic-level training plus high-performance SMEs in specific sectors suitable for supply-chain linkage.
- Two planned supply-chain networking visits under the ASEAN-helps-ASEAN approach, plus one business leadership college for high-potential SME talents.

Access to information and information technology.

A major initiative of the Business Alliance is to launch and establish the “ASEAN Online SME Academy” as a separate, dedicated and open access gateway. The Academy will: provide useful business information and training resources for start-up, development and internationalization, allow for the better provision of business development services (BDSs) by SME enablers, and serve as a platform for networking with regional and global communities of entrepreneurs, advisors and mentors, policy makers, and donors. Beyond this, work is being done to support ICT skill development among SME entrepreneurs in the region.

2014:

- “Train the Trainers” – Indonesia - 18 future trainers (with 5 women) and 77 entrepreneurs (with 37 women) received such ICT training in Indonesia (March-June 2014).
- The SMEWG and the Business Alliance will meet further plans for the “ASEAN Online SME Academy” in the last quarter of 2014. This will include discussions of configurations of the platform architecture, the content, gate-keeping and hosting, and other related issues

2015:

- Additional “train the trainer” opportunities in other countries in ASEAN
- Additional ASEAN Insights Seminars
- Launch the “ASEAN Online SME Academy”

Access to finance.

2014:

ACTI and the Business Alliance will provide the following support services in the regional conference on “SME Access to Finance: Moving Forward in Support of Women Entrepreneurs in the Less Developed ASEAN Countries”, planned for Ha Noi, Vietnam,

during 24-25 September 2014. This meeting considers, among other things, funding and capacity-building proposals from financial institutions plus the agenda to move forward in financing SME development, with a focus on women entrepreneurs.

Participants include SMEs, SME Agencies and enablers, financial institutions, donors and social investors.

- Work with stakeholders to identify and provide selectively the information, training and skills or tools. These are needed by (a) financial institutions for more efficient intermediation and operations on the (institutional) supply side; and (b) the borrowing entrepreneurs and SMEs for improved financial literacy, financial management and planning, and financial track record on the (loan) demand side. Women entrepreneurs will be the main target beneficiaries in these exercises.
- Provide a platform to bring new, additional and/or alternative funding programs and products, with women as the main target beneficiaries, to the attention of external donors and social investors. As needed, collaboration will be pursued with the donors and investors concerned in the follow-on development of the selected proposals to the pilot testing and fundable or implementation stages, or of cross-border replication of similar matchmaking activities on a sub-regional or regional basis.