

## **Zeti Akhtar Aziz: Connecting ASEAN SMEs through financial integration**

Speech by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the ASEAN SME Conference 2015 “Connecting ASEAN SMEs through Financial Integration”, Kuala Lumpur, 27 May 2015.

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It is my pleasure to be here this afternoon to speak at this inaugural ASEAN SME Conference. This conference takes place at a challenging and yet exciting time for the ASEAN region. While there continues to be uncertainty on the future prospects for the global economy, the ASEAN economies have demonstrated a high degree of resilience. The ASEAN economies have benefitted from the efforts for more than a decade to strengthen the foundations of our economies and financial systems. Our potential is now being further enhanced by steps to intensify regional economic and financial integration. In particular, ASEAN has taken the opportunity during our period of growth and stability within this decade to remain steadfast in advancing our efforts to forge greater economic and financial integration to unlock the immense opportunities for the region including for the SME business community.

My remarks today will touch on three areas; the significant intrinsic potential of the ASEAN economic bloc, how the SME sector would stand to benefit from these prospects, and on how greater financial integration can serve as a catalyst for the growth and development of SMEs.

### **ASEAN: A growth centre in the global economy**

ASEAN has emerged centre stage in the global economy and has been recognised as one of the most dynamic regions in the world. The region has sustained high economic growth with a long-term average GDP growth of 5.3%, higher than the global growth average of 3.6%. Currently, as a single entity, ASEAN is the 6th largest economy in the world with a GDP close to USD2.5 trillion. With a projected annual GDP growth of 5.4%<sup>1</sup> over the next six years, the region is poised to reach an economic size of USD3.7 trillion by 2020, four times the size it was a decade ago. The strong growth and dynamism of the region is supported by its favourable demographic structure. With a population of more than 630 million people and a burgeoning middle class, ASEAN is rapidly transforming into a thriving hub for consumer demand. By 2020, ASEAN is expected to account for more than USD2 trillion of additional consumption. This is being reinforced by rising incomes in the region, with per capita income almost trebling in this recent decade.

The rapid progress of economic integration in ASEAN has enabled the region to harness the benefits arising from the diversity and complementarities that exist across the ASEAN economies. Amid the strengthening of cross-border supply chains in the region, intra-ASEAN trade and investment activity have increased significantly over these recent 15 years. Intra-regional trade now accounts for almost a quarter of the region's total trade while intra-regional investment activity has quadrupled to 17% of total investment since 2000.

The vibrant SME sectors in the respective ASEAN economies have been an important part of this commendable economic progress. Indeed, going forward, the development and growth of ASEAN SMEs will have significant potential to contribute to the region's prospects and become a key source for the future growth of the region. It is estimated that SMEs would account for between 20 to 50% of GDP across the ASEAN economies, constituting more than 96% of enterprises in the region, and contributing 50 to 80% of total employment.

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<sup>1</sup> International Monetary Fund World Economic Outlook (April 2015).

While SMEs continue to contribute significantly to domestic economic growth, intra-regional trade in ASEAN remains driven by large multi-national companies with the SME sector mainly having a supporting role in the regional production network. The next phase of the ASEAN economic integration process should therefore be focused on enhancing the role of SMEs in contributing towards greater cross-border economic activity. To realise this, policy initiatives are being geared to ensure that SMEs in our region will be plugged into the regional and global value chains.

### **Leveraging on ASEAN's growth prospects**

The recent drive for the greater economic and financial integration of ASEAN has paved the way for SMEs to expand and thrive. Firstly, ASEAN has enabled SMEs in the region to **gain access to a larger and more extensive marketplace**. The realisation of ASEAN into an integrated economic community means that the potential benefits for SMEs in the region are no longer constrained by national borders. With easier cross-border flow of goods, services, capital and people, ASEAN offers significant market opportunities for SMEs. Given the large consumer base in ASEAN, SMEs can also utilise ASEAN as a platform to strengthen competitiveness before entering into the global market.

Secondly, the **lowering of regulatory barriers to trade** within ASEAN has further increased the potential for SMEs. The standardisation of trade procedures, the removal of tariff and non-tariff barriers and the improvement of regulatory frameworks across the region has been an additional enabling factor. This will not only provide SMEs with a level playing field in conducting businesses across the region, but will also maximise the competitive advantage of the individual ASEAN economies. This is evidenced by the emergence of regional supply chains, where reductions in tariffs on imported raw materials have resulted in lower production costs, while the removal of tariffs on a wide range of finished products for export within ASEAN will also benefit SMEs that trade within the region. Thus, the lowering of tariffs within the region and the large regional market will provide an environment for SMEs to grow and achieve the production scale and efficiency required to compete in the global marketplace. Additionally, an integrated ASEAN market will also serve to facilitate the meeting of global standards as SMEs upgrade to meet the more harmonised compliance requirements across the region.

Thirdly, SMEs will also benefit from the **drive to strengthen connectivity** in the ASEAN region. As highlighted in the Master Plan on ASEAN Connectivity, a comprehensive roadmap of strategies has been outlined to address connectivity challenges on three key areas, namely physical infrastructure, institutions and the people in ASEAN. Increased connectivity across all three dimensions will provide the physical and soft elements needed to create the enabling business environment for SMEs.

Fourthly, **various SME-specific policies by the ASEAN member countries** will also benefit SMEs in the region. This includes the establishment of a regional SME internship programme which has assisted SMEs in seven ASEAN countries to enhance the skills of their employees through structured staff exchanges and capacity building workshops. A further initiative is the recent launch of the online ASEAN Marketplace which aims to provide SMEs with information on the business environment in each respective ASEAN country and a business directory of SMEs to facilitate the access to the markets in the region as well as the potential for collaboration of SMEs across the region. To date, more than 1,000 SMEs across the region have registered with this online portal. It is expected to attract more than 20,000 businesses during the course of this year. Moving forward, the ASEAN Strategic Action Plan for SME Development 2016–2025 will also focus on promoting productivity, technology and innovation, access to financing, enhancing market access and internationalisation, while also enhancing the policy and regulatory environment, and promoting entrepreneurship and human capital development.

Fifth and finally, SMEs in the region will also benefit from **ASEAN's strategic economic linkages** with the greater Asia and with other parts of the world, including the advanced economies and other emerging regions. Several countries have entered into bilateral agreements, including trade agreements with ASEAN to enhance economic cooperation. These multilateral and bilateral engagements have the potential to create many new business opportunities for ASEAN SMEs.

### **Greater financial integration as a catalyst of growth for SMEs**

Let me now turn to the prospects for greater regional financial integration and its potential to support growth for the ASEAN SMEs. Given the region's high savings rate of approximately 30% of GDP, there is immense scope for greater financial integration in the region. An intensification of financial integration in ASEAN will serve to enhance the more effective intermediation of funds and thus the efficient allocation of resources in the region, thereby acting as a catalyst to achieve a growth that is mutually reinforcing for the economies in the region. This will allow for excess savings in one country to be channelled into productive investments in another country within the region.

The bulk of ASEAN's surplus funds, however, are currently intermediated mainly through the international financial markets before being reinvested back into the region. In particular, more than 90% of cross-border portfolio investment flows are channelled to the advanced economies. Given the USD 1 trillion infrastructure funding required by ASEAN in the next decade<sup>2</sup>, greater financial integration will facilitate the re-channelling of at least a part of the region's surplus funds towards productive investment opportunities in the region. Regional financial integration will also allow for more efficient risk diversification of assets to include foreign assets from within the region. This will not only reduce vulnerability to external developments but will contribute to achieving more stable conditions in the regional financial markets.

Following the development of the domestic financial systems in ASEAN, the next phase of development is to foster greater financial integration in the banking, insurance and capital markets and in the linking of the payment and settlement systems. The growing presence of regional financial institutions will be an important contributor to the development of SMEs in ASEAN. The availability of cross-border financing will enable SMEs to innovate, invest and further expand within the region. Beyond financing, SMEs can also leverage on the extensive networks and advisory services of regional banks to facilitate matching with regional clients and entry into new markets. This can be an important source of information on country-specific dynamics and requirements for the SMEs before venturing into new markets in the region.

The digital age also augurs well for SME businesses. The use of technology such as mobile and internet banking have enabled financial institutions to provide quality and affordable financial services to a regional SME client base. It is paramount for SMEs to embrace these technological enhancements. This includes the adoption of end-to-end supply chain management solutions that integrate the production and financial flows of SME activities, allowing for greater expansion into regional production networks.

Together with digitalisation, the financial integration process will catalyse the convergence of institutional frameworks across ASEAN countries to create a more effective regional financing ecosystem. Such institutional infrastructures and instruments include credit guarantee schemes and credit and collateral registries. Another example is the ASEAN SME Working Group's methodology for the ASEAN Benchmark for SME Credit Rating to facilitate the establishment of credit bureaus in ASEAN member states. Through these credit bureaus,

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<sup>2</sup> As estimated by the Asian Development Bank.

financial institutions would have wider access to reliable credit records of SMEs, thereby increasing the access to financing for the SMEs.

The promotion of deeper financial inclusion can be regarded as the final mile in enhancing and enriching the regional financial integration process. The ASEAN Finance Ministers' and Central Bank Governors' Meeting in March this year elevated financial inclusion as a regional policy priority. Indeed, ASEAN will continue to coordinate and intensify efforts to advance financial inclusion, including addressing cross-border financing issues for SME trade financing and investments. This is critical to ensure the benefits of regional integration are experienced by all in the region.

## **Conclusion**

While the future for ASEAN looks promising, ASEAN businesses, including SMEs, need to consider and explore an ASEAN strategy and to view ASEAN as an increasingly integrated market. Having such regional or international perspectives may prove to be a game changer for SMEs, paving a path towards sustained growth, increased job creation, and higher innovation capacity.

A crucial element in the ASEAN economic agenda is the development of the SME sector which will contribute to stronger and more equitable growth in the region. The next frontier for SMEs is to emerge as regional players that are not constrained by the domestic consumer base. SMEs possess the potential to participate in global production networks by riding on ASEAN's intrinsic strengths and prospects, multiple SME-focused policy initiatives as well as the continued wave of regional financial integration. This will allow for the transition for SMEs to benefit immensely from the ongoing regional economic and financial integration and thus contribute towards a balanced and sustainable growth of our region.