CHAPTER III
Business enabling environment

The Donor Committee for Enterprise Development (DCED, 2008) noted that BEE was an interplay of policy, legal, institutional, regulatory and physical conditions that facilitated business activities. It is critical to the economic development of a country as it provides the fundamentals of steady private sector development. It is an indispensable condition for competitiveness, the growth of individual enterprises and the development of the SME sector which is a particularly vulnerable and disadvantaged segment of the private sector. The aim of all BEE programmes is to help create a more effective environment for investment and business development.

The business environment influences the choice of entrepreneurs (and investors) in locating, operating and expanding their businesses. Uncertain economic policies or those that lack proper direction can hinder economic growth even when a country makes significant progress on other development fronts. Prevailing norms and customs, laws, regulations, policies, international trade agreements and public infrastructure can either facilitate or hinder the movement of goods and services along the value chain. At the national level BEE encompasses policies, administrative procedures, regulations and the state of public infrastructure. At the regional and international level, conventions, treaties, agreements and market standards shape BEE.

In addition to these formal factors, the informal factors (e.g., social norms, business culture ethics and local expectations) can be powerful forces that influence BEE. Understanding these unwritten societal rules is essential to fully comprehending the state of the business environment, particularly for SMEs, as BEE has significant impacts on the relative competitiveness of SMEs in domestic, regional and global markets through a number of factors. These factors and associated policy prescriptions are discussed in this chapter.

A. How does BEE matter?

As a basic requirement, a healthy business environment is fundamental to enabling firms to emerge, survive and grow. Such an environment must include:

(a) A transparent, open, fair and competitive business framework;
(b) Clear, independent rule of law for all firms;
(c) Easy establishment and dissolution of businesses; and
(d) Equal and stable legal treatment for national and cross-border transactions.

In other words, governments must develop and implement policies and regulations that will enable people to start (and dissolve) businesses, and remove barriers to help these businesses become more profitable and competitive. Without a healthy BEE, a nation's SME sector will not be able to thrive. Global competition has become so intense that exports will decimate SMEs if their nation's BEE handicaps them.

BEE can reduce costs on both the private sector and government, increase productivity, and promote growth. Burdensome and unpredictable regulations are costly in terms of the time and money required for compliance as well as lost business opportunities. Enhancing BEE not only allows SMEs to spend less time and money dealing with administrative red tape, but also helps them to focus on their core business operations (e.g., marketing their goods and services). Governments can spend fewer resources on regulating and monitoring the business sector, and invest more on infrastructure and business development services.

The primary theories underlying the importance of BEE are institutional economics and transaction cost economics. North (1990) characterized institutions as "humanly devised constraints on human interaction"; they are the "rules of the game" that give incentives (or disincentives) to firms to develop and grow. In North's view, institutions were either "formal" or "informal". Formal institutions are codified in law and carry official sanctions, whereas informal institutions are the norms and values governing society. Violations of norms carry penalties such as ostracism and censure. A nation's institutional framework exists on a continuum from informal to formal and they tend to be mutually reinforcing, i.e., a society's norms become the basis of its legal system, which in turn creates laws supporting those norms (North, 1990).

As economies develop, the complexity of interactions among actors necessitates the formation of formal institutions. In a small, less-developed society, trust can function to unite partners in business dealings. If trust is violated, the violators may find themselves alienated from the rest of the community and thereby unable to earn a living. Knowing this *a priori*, businesspeople transact with some certainty that they will not be cheated. When an economy is large and actors are relative strangers to one another, the temptation to defraud may be too much for informal sanctions and therefore contract law, enforceable by courts, becomes necessary to deter opportunistic behaviour. Constraining such behaviour lowers transactions costs (Coase, 1960; Williamson, 1985; and Jaffe, Carciente and Zanoni, 2007)

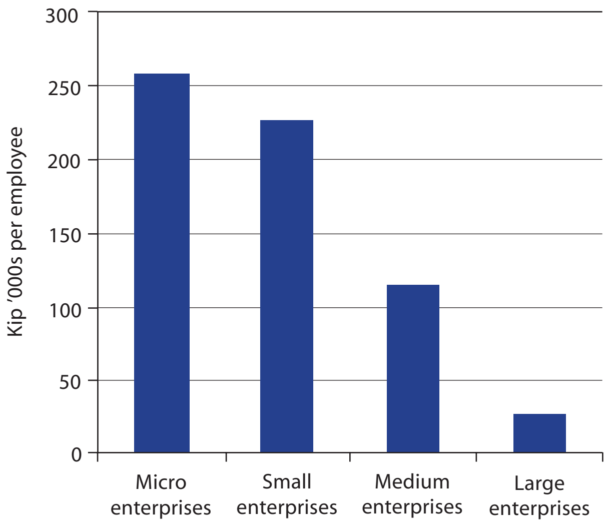
Informal practices based on trust as well as formal institutions such as the rule of law and property rights both serve to protect economic actors from expropriation of rents. Without strong institutions in communities with uncertain levels of trust, the cost of transacting business becomes too great and so there are disincentives to start new businesses or grow existing ones. For SMEs, which rarely possess the resources to undertake legal action, trust is particularly important. When few people can be trusted, transaction costs can be very high (North, 1990; and Casson, 1995).

In terms of formal institutions, property rights guard against "vertical" expropriation of rents by government, whereas rule of law (particularly contract law) protects SMEs from "horizontal" expropriation of rents by other citizens (Acemoglu and Johnson, 2005; and Troilo, 2011). Beyond property rights, policymakers should also consider corruption and excessive taxation as forms of vertical expropriation which stifle SMEs. Investigating graft and reforming the tax code are important ways policymakers can create a business enabling environment. Adopting international standards of contract law and implementing equitable and certain enforcement of those standards are ways that policymakers can help SMEs avoid horizontal expropriation of rents.

In many countries, expecially in less-developed ones, these transaction costs could be particularly substantial due to less favourable business environments. Most Asia-Pacific countries need to reform their laws because many governments have unfortunately been “controllers” rather than “facilitators” of SMEs. The consequence of this trend has been a hostile environment for the foundation and growth of SMEs, particularly for start-ups, micro and small enterprises as the attitude of control suffocates individual entrepreneurial initiatives. Moreover, those “controllers” often conduct their tasks under inadequate or unclear legal frameworks, making the situation more complicated and unpredictable for businesses. Figure III.1 presents an example of the levels of business regulatory compliance costs among different sizes of enterprises in Lao People’s Democratic Republic. It indicates that SMEs, including microenterprises, have to pay proportionately higher costs for regulatory compliance per employee than large enterprises.

Improving the business environment by lifting constraints and filling the gaps in the regulatory and administrative framework is essential for enhancing SME competitiveness. Reforms in the regulatory and administrative framework can result in substantial benefits for an economy, including faster growth, job creation, income generation, increased exports, greater incorporation, less corruption and lower

Figure III.1. Business regulatory compliance costs by firm size, Lao People’s Democratic Republic*



Source: ADB, 2009.
* Compliance cost per employee of the three main permissions required: enterprise registration, operational permissions and tax certificate.
Note: Microenterprises are defined as businesses with between one and four employees; small firms – between five and nine employees; medium-sized firms – between 10 and 99 employees; and large firms – 100 or more employees.

fiscal deficits. For example, after Viet Nam reduced the time and costs involved in registering businesses, new corporate registrations increased by 28 per cent (World Bank, 2006a).

The major benefits of improved BEE are evident in higher employment and income generation, increased trade and reduced corruption (World Bank, 2008a):

(a) Employment creation and income generation. BEE enhancement gives rise to the creation of additional employment and income generation, encouraging entrepreneurs to invest more in new or existing businesses. When regulations are fair and transparent, entrepreneurs are more willing to expand their business, since they will retain most of the profits. On the other hand, an ill-conceived regulatory regime often discourages people from making new investments. For example, tight regulation of labour markets, even though it is generally aimed at protecting labour rights, can discourage the creation of jobs in the formal sector and may increase the number of unprotected workers in the informal sector;

(b) Increased trade. BEE enhancement has a positive impact on trade by accelerating the movements of goods and services. Delays caused by excessive regulations across borders have an adverse impact on a country’s exports, especially for time-sensitive goods such as perishable agricultural products; and

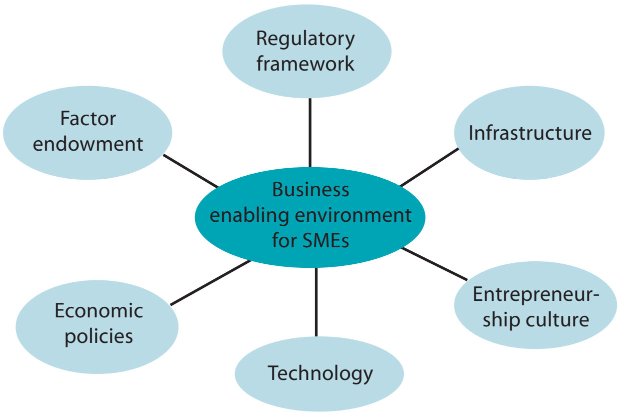
(c) Reduced corruption. Corruption can be reduced by eliminating unnecessary government interventions, and by increasing the transparency of government and business relationships. These measures, among others, can decrease the sources and opportunities where corruption manifests itself. With this in mind, the World Bank (2000) outlined a multi-pronged strategy to combat corruption and foster a competitive private sector, with components that include economic policy reform, competitive restructuring of monopolies, regulatory simplification for entry, transparency in corporate governance and collective business association.

B. Components of BEE

While acquiring competitiveness in the global market primarily depends on the entrepreneurs themselves, BEE has a large influence on their competitive performance. The particular BEE factors affecting the SME sector in any country are generally: (a) macro- and microeconomic policies, including monetary and foreign exchange management; (b) factor endowments including supplies, labour and land; (c) entrepreneurship culture; (d) technology; (e) regulatory and administrative framework; and (f) infrastructure. Figure III.2 illustrates those major components.[36]

[36] Among those major components of BEE, this chapter mainly elaborates on the regulatory and administrative framework as the key issue for SME development in Asia and the Pacific, while supporting infrastructure is briefly discussed. Entrepreneurship culture and technology are discussed in chapters IV and VII, respectively.

Figure III.2. SME business enabling environment and its components



Source: Authors' compilation.

Economic policies are crucial. Sound monetary policy to control inflation preserves individual savings that are so often used as seed capital for SME start-ups. Openness to competition and investment prepare SMEs for the global economy and enable them to enjoy the benefits of overseas capital. As previously mentioned, taxation must be kept at a reasonable level, enough to provide infrastructure but not so high as to be confiscatory (see annex III.2 for a more detailed discussion on taxation for SMEs).

Factor endowments are closely related to economic policy. These endowments can be natural resources, human capital or an advantageous geographic location. In the absence of valuable natural resources (e.g., Hong Kong, China; or Singapore), a diligent, well-educated workforce, favourable geographical location and a well-trained civil service to direct industrial development can be ample compensation. Policymakers should develop their SME sector in conjunction with the specific factor endowments of their nation being mindful of comparative advantage in specific industries, i.e., low labour costs for producing textiles and garments.

Entrepreneurship culture is also critical. Certain attitudes and values, such as an appetite for risk, propels entrepreneurial activity. Other attitudes and values, such as fear of failure and the stigma attached to failure, hinder entrepreneurial activity. This topic is futher explored in the next chapter.

Chapter VII focuses on innovation and technology. Of particular importance is access to the Internet for all SMEs, regardless of whether they compete in a high-tech sector or not. Such access increases SME awareness of global trends and opportunities.

Infrastructure such as reliable roads, ports, electricity, water, and other such facilities are fundamental to business development and growth. Policymaking in this area should concentrate on transparency and integrity, competitive and open bidding for large projects, monitoring and prevention of corruption, sound financial planning etc. For the owners of many SMEs in developing economies, the struggle to obtain basic business necessities such as water and electricity often prevents them from surmounting subsistence levels of revenue (see box III.1).

Box III.1. Importance of infrastructure

Infrastructure plays a crucial role for SME development through the availability of roads, transportation services, electric power, water supply, drainage, telephone services and storage facilities. The term "infrastructure" also often goes beyond the boundaries of physical facilities to include related concepts such as management and services as well as comprehensive industrial development plans such as cluster development and industrial or technology parks (see chapter VIII for additional information).

In Asia-Pacific developing countries, SMEs have been typically operating for decades with insufficient infrastructure which can become a major source of environmental degradation. SMEs traditionally clustered around certain focal points due to homogeneity of industrial activity and proximity to their living places. This pattern gave rise to the unchecked and unplanned spread of industrial areas over the years with the haphazard growth gradually penetrating residential areas and giving rise to serious environmental problems (e.g., Old Dhaka of Bangladesh[37]). Providing basic infrastructure and better urban planning are primary responsibilities of policymakers as this can yield both economic and environmental benefits.

While some countries have made good progress by setting up well-planned industrial estates, technology parks and economic special zones, many have yet to realize that issues related to infrastructure development and cluster development are intertwined and should be addressed holistically. UNIDO (1999) has attached significance to cluster development as an "SME cluster" is complementary to physical infrastructure as well as a comprehensive concept of supporting infrastructure for small businesses (see the previous chapter). This entails the existing and planned development of the prospective clusters receiving the latest infrastructural support facilities and environmentally friendly management systems.

So far, most BEE-related policy interventions and technical assistance activities have been conducted within the regulatory and administrative framework (JICA, 2006; and WEF, 2011) as the degree of control or ease of doing business enshrined in the regulatory and administrative framework determines the nature of BEE (World Bank, 2010a). Table III.1 lists the subcomponents of a regulatory and administrative framework.

[37] For a more detailed discussion see ESCAP, 2011.

Table III.1. Subcomponents of a regulatory and administrative framework

Component	Content and function
Business registration	The complexities of business registration differ widely between countries,[38] but in general, there are three core functions: (a) controlling business incorporation with a unique name; (b) inscription of a commercial registry; and (c) registration with the tax authorities. Efficient and easy business registration is important for encouraging the establishment of new business.
Licensing	The system of business licensing is a major entry barrier for small businesses in many countries. As licensing is a key potential bottleneck in starting a business, the gains from licensing reforms stand to be significant. Many Asia-Pacific countries have greatly benefited from resolving with this bottleneck.
Labour regulation	Every country has enacted some form of labour laws and regulatory framework to protect the interests of workers. A good set of labour regulations should include employment, industrial relations and social securities. The regulation of labour markets aimed at protecting workers should also receive due attention. A proper balance between workers' rights and employers' needs must be maintained in order to create an effective BEE.[39]
Property registration	Entrepreneurs can obtain commercial loans by mortgaging their properties (e.g., land and houses) to start or expand their business. Banks typically prefer land and buildings as collateral. Efficient property registration reduces transaction costs and improves the security of property rights. This benefits all businesses, especially SMEs. Firms generally feel that their property rights are better protected in countries with a clearly-defined property registration system.
Credit regulation	Governments can help protect creditors and facilitate lending by establishing regulations for loss recovery. Lender's rights can be particularly protected through suitable credit guarantee schemes.[40] An effective collateral system may also create a smooth credit environment for SMEs. Removing legal restrictions without affecting necessary legal protection is yet another way to improve BEE.
Corporate governance	Good corporate governance in the business community can enhance BEE with a set of policies about how an enterprise is directed or administered. A critical theme of corporate governance is accountability and transparency which aims for the reduction and elimination of corruption. A clear corporate governance code is an essential tool for enhancing corporate governance practices at the national level, thus ensuring ethical behaviour of businesses and ultimately, promoting long-term sustainability of enterprises.
Tax administration[41]	Complicated tax administration gives rise to business operations in the informal sector. Tax compliance costs are often regressive and put a disproportionate burden on small players.[42]
Trade facilitation	Trade facilitation is critical for SMEs' penetration into regional and global markets. Such integration could be achieved by simplifying documentary requirements and customs procedures, including inspection modalities.[43]
Contract enforcement	Contract enforcement reforms have proved to be beneficial in many countries. Those reform measures include, among others, simplified procedures of commercial dispute settlements and the establishment of a judicial information system. For example, the reform of contract enforcement in 2007 helped Tonga to increase its global ranking from 126 to 26 in contracts enforcement efficiencies in the "Ease of Doing Business" survey. The reform was based on a computerized case management system which set time limits on delayed cases that allowed the judge to remain on top of the docket without becoming mired in the details of case administration (Ford and Lorenz, 2008).
Alternative dispute resolution	An effective mediation or arbitration system makes it easier to settle commercial disputes, saving time and money. While it should not be taken as a substitute to the formal judicial system, introducing mediation is one way of making the system more efficient for SMEs, which typically lack resources and knowledge.
Bankruptcy law/exit rule	The existence of clear and enforceable bankruptcy laws and exit rules plays an important role in promoting SME development in a country. Such a framework, which is nearly absent in developing countries in Asia and the Pacific, is important to ensuring fair and efficient dissolution of business with full transparency and thereby reduces the risk of entrepreneurial activities. The system must develop a pre-determined set of procedures concerned with the legal definition of insolvency.
Competition policy	Competition laws foster a culture of fair competition that ultimately benefits the society through better quality, price and service. Competition laws should provide a regulatory framework in order to maintain and improve efficiency in markets as well as monitor pricing practices to restrain unreasonable price rises.

[38] For details, visit the website at www.doingbusiness.org/.
[39] ILO provides useful resources to policymakers in this regard. More details are available at www.ilo.org/global/lang--en/index.htm for information.
[40] This issue is discussed further in chapter V.
[41] See annex III.2 for more information.
[42] For empirical studies of the impact of taxation on entrepreneurship, see Henrekson, Johansson and Stenkula , 2010, and Henrekson, 2007.
[43] Various technical materials related to trade facilitation in Asia and the Pacific are available at www.unescap.org/tid/publication/publicat.asp.

Table III.1. *(continued)*

Component	Content and function
Corruption	Public corruption, which increases the cost of business, is one of the biggest hurdles in the smooth growth of the SME sector across the developing countries in Asia and the Pacific.[44] Those countries need to restructure the law and regulatory framework to reduce abuse of discretionary power by enhancing transparency and minimizing uncertainty while maximizing compliance of rules.

Source: Authors' compilation.

Box III.2. Role of information and communications technology in SME development

Information and communications technology (ICT) applications can be used to help SMEs in developing countries overcome hurdles such as lack of infrastructure and deficient institutions. According to a survey conducted by Digital Philippines for the Asia Foundation, more than 90 per cent of respondent SMEs in three main Philippine cities believe that e-commerce is gaining importance to their business (Lallana, Pascual and Andam, 2002). The e-marketplace in the Philippines is dominated by BayanTrade, a B2B e-procurement hub jointly founded in 2000 by the six largest conglomerates in the Philippines. With a buyer base of 150 companies and suppliers of nearly 350 companies, BayanTrade now also caters to sourcing and procurement services rather than only focusing on e-commerce – covering a wide range of industries and markets in Philippines (BayanTrade, 2011).

Additionally, the encompassing adoption of mobile phone usage in some underdeveloped countries has made it the mainstream communication mode for conducting business. It enables SMEs with limited ICT resources to communicate with customers and suppliers in a short period at low cost or to transfer money between business partners through mobile banking. In particular, farmers in remote areas with poor electricity infrastructure or network unavailability can receive real-time market information on agricultural or fish prices on their mobile phones (Melchioly and Sœbø, 2010).

E-finance, which refers to "financial services delivered through the Internet" (UNCTAD, 2001a), has also helped to facilitate the development of SMEs. Generally speaking, it includes online brokerage, insurance, banking and other financial services. E-finance for SMEs in developing countries mainly consists of Internet banking and payment, e-trade finance and online credit information. In addition to flexibility, e-finance offers lower transaction costs to SMEs as well as greater access to financial information. Government investment in information technology infrastructure is therefore a cost-effective way to enable SMEs in developing countries to access capital via e-finance, particularly in remote rural areas (UNCTAD, 2001a).

Box III.3. Public-private partnership in perspective

Governments worldwide have sought to increase the involvement of the private sector in the delivery of public services. These initiatives have enabled the mobilization of private finance in the provision of public infrastructure and services as well as policy advocacy (HM Treasury of the United Kingdom, 2011). It is now generally recognized that public-private partnerships (PPPs) offer a long-term, sustainable approach to improving infrastructure, enhancing the value of public assets and making better use of tax revenue. PPPs have developed partly due to financial shortages in the public sector. They have also demonstrated the ability to harness additional financial resources and operating efficiencies from the private sector (IMF, 2011).

The concept of PPP originated in Europe and North America but has become more prominent in recent decades for the economic development of the Asia-Pacific countries. According to ADB (2011) "[t]he term 'public-private partnership' describes a range of possible relationships among public and private entities in the context of infrastructure and other services". The idea of PPP is to involve direct participation by private finance and management expertise in financing public sector infrastructure and to sustain it on a long-term basis. In broad terms, it encompasses a diversity of partnerships, but all PPPs involve at least one public and one private sector institution as partners in a cooperative venture. A PPP works as a contractual arrangement between a public sector agency and the concerned private sector, whereby resources and risks are shared for the purpose of delivery of a public service or development of public infrastructure. PPP arrangements are growing as an alternative and effective method to mobilize additional financial resources and to harness the benefits of private sector efficiencies.

Each type of PPP has inherent strengths and weaknesses that must be recognized and integrated into the project design. Each partner to a PPP has responsibilities. The benefits of PPPs will depend, to a large degree, on effective management and monitoring systems. The latter is particularly crucial as public funding will necessitate proper accounting and transparency, not only for the identification of additional funding sources but also to ensure more effective use of public funds. In addition, for a PPP to function properly, each participant should be a principal and thus capable of autonomous bargaining. This usually requires the public sector participant to be established as a special agency before collaboration becomes possible (Partnerships for Public Service, 2011).

PPPs can be useful for a number of activities especially in the areas of services, transport and logistics, trade facilitation and industrial parks. Government support for SME development is being provided increasingly through PPPs. The development of clusters to enhance the competitiveness of SMEs and their global reach (as discussed in box III.1) is also a key area for PPP involvement.

[44] The Global Corruption Report of Transparency International provides some useful insights in this regard. For more details visit the website at www.transparency.org/.

C. BEE surveys

There are a number of international surveys relevant to the assessment of business environments in the economies of Asia and the Pacific. Major business environment surveys include the "Ease of Doing Business and "Economic Freedom of the World Exercise" surveys, the Global Competitiveness Index and the Corruption Perception Index. Each is discussed briefly below.[45]

1. Ease of Doing Business survey

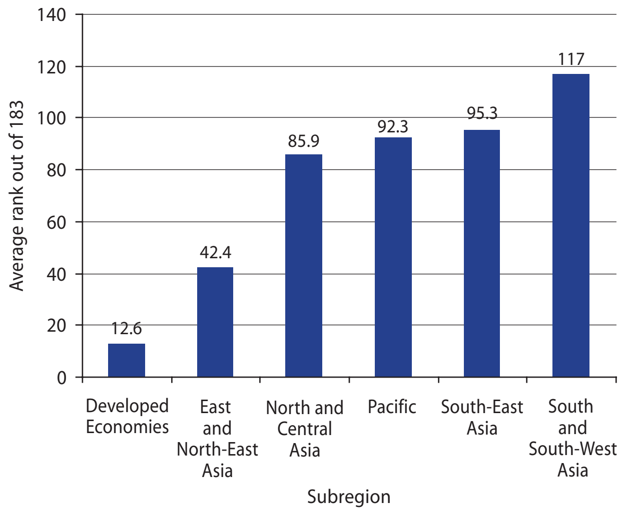
Although not specific to the SME sector, the World Bank's annual "Doing Business" rankings are perhaps the most comprehensive survey of economies (183 in its latest iteration) and their differing business conditions.[46] The exercise seeks to quantify and rate the ease of doing business in an economy, based on ten components: (a) starting a business; (b) dealing with construction permits; (c) getting electricity; (d) registering property; (e) getting credit; (f) protecting investors; (g) paying taxes; (h) trading across borders; (i) enforcing contracts; and (j) resolving insolvency. Although there is some debate about the methodology, the findings are useful for highlighting an economy's strengths and weaknesses in terms of doing business. A high ranking can indicate that a government has created a regulatory environment more conducive for business operation (ESCAP, 2009a). Table III.2 shows the Doing Business 2012 rankings for Asia-Pacific economies covered by the survey.

Figure III.3 presents the averaged survey results among five developing subregions of Asia and the Pacific: (a) East and North-East Asia; (b) North and Central Asia; (c) Pacific; (d) South-East Asia; and (e) South and South-West Asia.[47] The results show that South and South-West Asia ranked the lowest among the five developing subregions, while East and North-East Asia ranked the highest. For comparison purposes, the averaged ranks of three developed economies in the region (Australia, Japan and New Zealand) were included and unsurprisingly indicated a better business environment than in the developing economies.

Two components of the ease of doing business survey, "starting a business" and "trading across borders" which are critical to new businesses as well as export-oriented and supporting industry SMEs, are reviewed below to provide some detailed insights.

The information gathered for the "starting a business" indicator shows the bureaucratic and legal hurdles that an entrepreneur encounters while incorporating and registering a new firm. It considers the procedures, time and costs involved in launching a commercial or industrial firm with up to 50 employees and start-up capital of 10 times the economy's per capita gross national income (GNI) (thus fitting common categorizations of SMEs in many economies in Asia

Figure III.3. Ease of doing business ranking, by subregion, in Asia and the Pacific



Source: World Bank, 2012a.
Notes: Developed economies comprise Australia, Japan and New Zealand. Taiwan Province of China is included in East and North-East Asia. Some Asia-Pacific economies (i.e., the Democratic People's Republic of Korea; Macao, China; Myanmar; Turkmenistan; American Samoa; Cook Islands; French Polynesia; Guam; Nauru; New Caledonia; Niue; Northern Mariana Islands; and Tuvalu) were excluded from this analysis due to the lack of survey data.

and the Pacific). Table III.3 shows the subregion averages for the four main sub-indicators:

(a) All procedures required to register a firm;
(b) Time spent completing the procedures;
(c) Official fees for legal or professional services for the procedures; and
(d) The minimum capital required as a percentage of income per capita.

The averaged results indicate that the South-East Asia subregion is the most difficult in which to start a business. Notably, although the averaged number of registration procedures is only slightly higher than in South and South-West Asia, the number of days needed to complete these procedures is more than double. Another interesting feature of this comparison is that while the East and North-East Asia subregion ranks relatively well in terms of the number of procedures, the amount of time needed for completion as well as the cost for these procedures, the minimum paid-in capital needed before and following incorporation is almost 30 per cent of the economy's income per capita. This is a significant, and perhaps prohibitive, initial input for potential entrepreneurs.

Ease of "trading across borders" is measured based on the procedural requirements for exporting and importing a standardized cargo of goods (see table III.4 for subregion averages). Every official procedure is counted, from the contractual agreement between the two parties to the delivery of goods, together with the time required to export or import goods. The survey specifically measured three main indicators for both exports and imports:

(a) The number of documents required;
(b) Time required; and
(c) Costs.

[45] Other major surveys include: IMD international's World Competitiveness Yearbook (available at www.imd.org/research/publications/wcy/World-Competitiveness-Yearbook-Results/#/); The Heritage Foundation and *Wall Street Journal* Index of Economic Freedom (available at www.heritage.org/index/Ranking); and the Global Entrepreneurship Monitor (available at www.gemconsortium.org).
[46] For the latest rankings, visit the website at www.doingbusiness.org/.
[47] See the Explanatory Notes in this publication for the detailed economies of Asia and the Pacific and their subregional groupings.

Table III.2. Ease of doing business in Asia and the Pacific, 2012

Economy	Overall Ease of Doing Business rank	Starting a business	Dealing with construction permits	Getting electricity	Registering property	Getting credit	Protecting investors	Paying taxes	Trading across borders	Enforcing contracts	Resolving insolvency
Singapore	1	4	3	5	14	8	2	4	1	12	2
Hong Kong, China	2	5	1	4	57	4	3	3	2	5	16
New Zealand	3	1	2	31	3	4	1	36	27	10	18
Republic of Korea	8	24	26	11	71	8	79	38	4	2	13
Australia	15	2	42	37	38	8	65	53	30	17	17
Thailand	17	78	14	9	28	67	13	100	17	24	51
Malaysia	18	50	113	59	59	1	4	41	29	31	47
Japan	20	107	63	26	58	24	17	120	16	34	1
Taiwan Province of China	25	16	87	3	33	67	79	71	23	88	14
Tonga	58	33	32	29	141	78	111	29	77	53	108
Samoa	60	22	68	32	26	126	29	66	96	80	145
Solomon Islands	74	110	36	42	168	78	46	25	86	108	115
Vanuatu	76	114	40	147	111	78	79	32	128	71	53
Fiji	77	119	73	110	52	67	46	80	113	64	126
Maldives	79	59	20	132	152	166	79	1	137	92	41
Brunei Darussalam	83	136	83	28	107	126	122	20	35	151	44
Mongolia	86	97	119	171	26	67	29	57	159	33	124
Sri Lanka	89	38	111	95	161	78	46	173	53	136	42
China	91	151	179	115	40	67	97	122	60	16	75
Viet Nam	98	103	67	135	47	24	166	151	68	30	142
Papua New Guinea	101	84	138	20	87	98	46	106	99	163	116
Pakistan	105	90	104	166	125	67	29	158	75	154	74
Marshall Islands	106	52	8	76	183	78	155	96	66	63	135
Nepal	107	100	140	99	24	67	79	86	162	137	112
Kiribati	115	141	106	159	69	159	46	6	85	75	183
Palau	116	124	39	80	20	182	174	97	124	144	61
Bangladesh	122	86	82	182	173	78	24	100	115	180	107
Indonesia	129	155	71	161	99	126	46	131	39	156	146
India	132	166	181	98	97	40	46	147	109	182	128
Philippines	136	158	102	54	117	126	133	136	51	112	163
Cambodia	138	171	149	130	110	98	79	54	120	142	149
Micronesia (Federated States of)	140	102	19	40	183	126	174	92	106	146	164
Bhutan	142	83	135	145	83	126	147	67	169	35	183
Afghanistan	160	30	162	104	172	150	183	63	179	161	105
Lao People's Democratic Republic	165	89	80	138	72	166	182	123	168	110	183
Timor-Leste	168	157	114	55	183	159	133	31	89	183	183

Source: World Bank, 2012a.
Note: Rankings out of 183 economies.

Table III.3. Starting a business, by subregion, in Asia and the Pacific

Subregion	Procedures (number)	Duration (days)	Cost (per cent GNI per capita)	Min. capital (per cent GNI per capita)
Developed economies	3.7	8.7	2.9	0.0
East and North-East Asia	6.4	14.2	5.1	27.3
North and Central Asia	4.9	14.4	6.9	3.6
Pacific	6.5	29.1	33.0	3.7
South and South-West Asia	7.1	23.1	21.58	19.1
South-East Asia	8.5	54.4	20.5	31.0

Source: World Bank, 2012a.
Notes: Rankings out of 183 economies. Developed economies comprise of Australia, Japan and New Zealand. Taiwan Province of China is included in East and North-East Asia. Some Asia-Pacific economies (Democratic People's Republic of Korea; Macao, China; Myanmar; Turkmenistan; American Samoa; Cook Islands; French Polynesia; Guam; Nauru; New Caledonia; Niue; Northern Mariana Islands; and Tuvalu) were excluded from this analysis due to the lack of survey data.

Table III.4. Facilitating international trade by developing subregions in Asia and the Pacific

Subregion	Documents for export (number)	Time for export (days)	Cost to export ($ per container)	Document for import (number)	Time for import (days)	Cost to import ($ per container)
Developed economies	5.3	9.6	941.7	5.0	9.3	971.3
East and North-East Asia	5.8	18.2	935.0	5.2	19.0	985.0
North and Central Asia	7.9	48.6	2 688.1	9.1	52.5	3 131.9
Pacific	6.7	24.1	1 006.4	7.3	25.7	1 032.2
South and South-West Asia	7.8	32.1	1 590.0	8.9	32.5	1 768.3
South-East Asia	6.2	20.0	768.7	7.2	20.5	835.1

Source: World Bank (2012a).
Notes: Rankings out of 183 economies. Developed economies comprise of Australia, Japan and New Zealand. Taiwan Province of China is included in East and North-East Asia. Some Asia-Pacific economies (the Democratic People's Republic of Korea; Macao, China; Myanmar; Turkmenistan; American Samoa; Cook Islands; French Polynesia; Guam; Nauru; New Caledonia; Niue; Northern Mariana Islands; and Tuvalu) were excluded from this analysis due to the lack of survey data.

Box III.4. Singapore's proclaimed business environment

Singapore, for the sixth year in a row, has again been ranked number one according to the World Bank's Ease of Doing Business survey in 2012. Of the ten major indicators, Singapore ranked in the top ten for eight of them: (a) starting a business (fourth); dealing with construction permits; (third), getting electricity (fifth); getting credit (eighth); protecting investors (second); paying taxes (fourth); trading across borders (first); and resolving insolvency (second).

Singapore introduced further reforms to make it easier to start and operate a business while also improving the banking system and permit attainment procedures. The simplification of the online procedures for business start-ups reduced the process to three days. Through increased Internet utilization, Singapore also cut the time it takes to issue a construction permit from 102 days to just 26 days.

The World Economic Forum's Global Competitiveness Report 2010-2011 (WEF, 2011) ranked Singapore as third. The report takes into account factors such as infrastructure, macroeconomic stability, health and education, labour market efficiency, technological readiness and innovation.[48]

In another survey conducted by a commercial rating agency, Business Environment Risk Intelligence,[49] Singapore was ranked second as the city with the best investment potential, a position that the city has maintained for 14 years. In particular, Singapore was ranked as first in the foreign trade and investment indicator, having been viewed as an attractive, tax-efficient SME location for conducting international business (Healy Consultants, 2011).

Based on the averaged results, the subregion with the lowest ease of cross-border trade is North and Central Asia. On average, this region requires the highest number of documents, takes the longest time, and is the most expensive in which to export and import. In contrast, the indicators for East and North-East Asia and South-East Asia are significantly more favourable in the region. Although South-East Asia requires more documents and takes longer than East and North-East Asia, the difference on average is slight. South-East Asia has the lowest costs for exporting and importing.

The World Bank (2012a), while collecting worldwide data for the 2012 Doing Business Indicators, recorded 245 reforms made between June 2010 and May 2011 by governments in 125 economies. Notably, in low, lower and middle income economies a larger portion of these changes were aimed at strengthening courts, insolvency regimes and investor protections than in the past. Reforms measured by the Doing Business survey have played an important role in enhancing the BEE in Asia-Pacific countries, which is illustrated by the policy response of the Government of Singapore in box III.4.

48 For more details see the website at www.weforum.org/issues/global-competitiveness.
49 The corporate profile of Business Environment Risk Intelligence is available at www.beri.com/aboutus.asp.

2. Economic Freedom of the World Exercise

The Fraser Institute's Economic Freedom of the World Exercise which has been running for more than 20 years and now spans 141 economies, conducts similar research to that by the World Bank. It is an index that seeks to use 42 data points to measure economic freedom in five broad areas that are pertinent to SMEs and the business sector as a whole. The five areas are: (a) size of government; (b) legal structure and security of property rights; (c) access to sound money; (d) freedom to trade internationally; and (e) regulation of credit, labour and business. The most recent report, published in 2011, analysed data from 2009. The rankings for some Asia-Pacific economies are shown in table III.5.

Table III.5. Economic freedom: Rankings of Asia-Pacific economies

Economy	Rank	Economy	Rank
Hong Kong, China	1	Fiji	77
Singapore	2	Malaysia	78
New Zealand	3	Azerbaijan	84
Australia	5	Indonesia	84
Japan	22	Viet Nam	88
Taiwan Province of China	26	Philippines	89
		China	92
Republic of Korea	30	India	94
Mongolia	36	Bangladesh	103
Kazakhstan	56	Sri Lanka	107
Papua New Guinea	61	Pakistan	114
Thailand	65	Nepal	129
Kyrgyzstan	70	Myanmar	140

Source: Gwartney, Hall and Lawson, 2011.

This survey considers the most relevant environmental factors to be:

(a) The size of government in business (which relates to "crowding out" issues);[50]
(b) Property rights protection;
(c) Legal enforcement of contracts;
(d) Freedom to hold foreign currency;
(e) Regulatory trade barriers;
(f) Taxes imposed on international trade;
(g) Commercial credit;
(h) Hiring and firing regulations;
(i) Price controls;
(j) Starting a business and licensing restrictions; and
(k) Bribes and extra payments.

For each of the 141 economies covered by the index, a detailed breakdown is conducted. More than 40 separate numerical ratings are applied, which allows: (a) a diagnostic to be undertaken of where a specific economy is faring less well; (b) cross-economy comparisons; and (c) monitoring of a single economy's performance over time, across any of the 42 elements that are measured by the index. For example, Viet Nam ranks relatively high in terms of "freedom to trade internationally" and "legal structure and security of property rights" however, it scores worse on the "access to sound money" component which drags down its aggregate ranking.

3. Global Competitiveness Index

Similar to the previous two indices, this index does not focus solely on SMEs but measures a range of issues that are highly pertinent to SME development, i.e., "the set of institutions, policies and factors that determine the level of productivity of a country" (WEF, 2010). As discussed in *The Global Competitiveness Report, 2011-2012,* the World Competitiveness Index tracks 12 pillars of economic competitiveness (WEF, 2011). These pillars are: (a) institutions; (b) infrastructure; (c) macroeconomic environment; (d) health and primary education; (e) higher education and training; (f) goods market efficiency; (g) labour market efficiency; (h) financial market development; (i) technological readiness; (j) market size; (k) business sophistication; and (l) innovation. Although the pillars are reported on separately, they are interrelated and the strength or weakness of one has an impact on others (WEF, 2011). Table III.6 shows the rankings for some Asia-Pacific economies included in the Global Competitiveness Index.

Table III.6. Global Competitiveness Index: Rankings for Asia-Pacific economies

Economy	Rank	Economy	Rank
Singapore	2	Sri Lanka	52
Japan	9	India	56
Hong Kong, China	11	Viet Nam	65
Taiwan Province of China	13	Kazakhstan	72
		Philippines	75
Australia	20	Mongolia	96
Malaysia	21	Cambodia	97
Republic of Korea	24	Tajikistan	105
New Zealand	25	Bangladesh	108
China	26	Pakistan	118
Brunei Darussalam	28	Nepal	125
Thailand	39	Kyrgyzstan	126
Indonesia	46	Timor-Leste	131

Source: WEF, 2011.

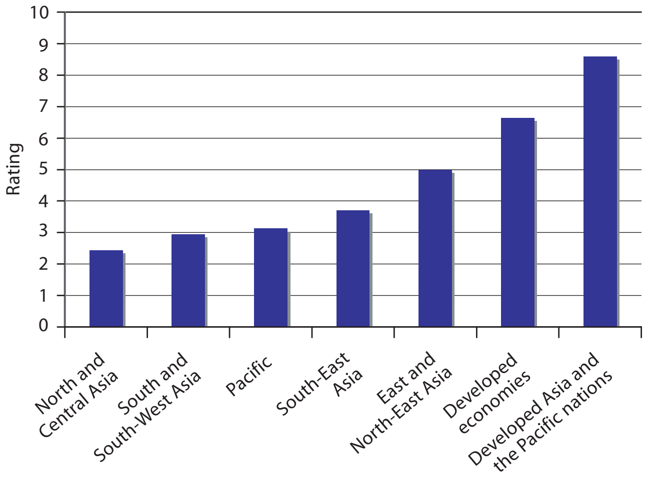
4. Corruption in Asia and the Pacific

With some exceptions (e.g., Singapore and Hong Kong, China), entrepreneurs routinely identify corruption as a significant constraint to doing business in the Asia-Pacific region (Gill and Kharas, 2007). Corruption raises the costs of doing business and creates a more unpredictable business environment, making it more difficult to plan ahead. It may also create an incentive for firms to stay informal, in order to escape the discretionary power of local officials. Opportunities for corruption are also greater where business regulations are numerous and overly complex.

[50] According to the survey, the extent to which countries use government-provided, rather than private, goods and services has a significant impact on the level of economic freedom, and thus fair competition. Government firms are not subject to the same rules as private enterprises. They do not depend on consumers for revenue, or investors for capital, and they often operate in protected markets. Consequently, the greater market share government firms hold, the less space there is for private enterprises and thus economic freedom is reduced (Gwartney, Hall and Lawson, 2011).

Transparency International, an NGO that monitors corporate and political corruption worldwide, developed the Corruption Perception Index which ranks almost 200 economies by the private sector's perceived levels of corruption in an economy (Transparency International, 2011). The rankings for Asia-Pacific economies are separated into subregional groupings and presented in figure III.4. There is a clear difference between subregions that are perceived as more corrupt and those that are less corrupt, based upon economic developments.

Figure III.4. Subregional corruption ratings in Asia and the Pacific



Source: Transparency International, 2011.
Note: Rating from 0 (highly corrupt) to 10 (very clean). Developed Asia-Pacific economies include Australia, Japan and New Zealand.

Developed Asia-Pacific economies, e.g., Australia, New Zealand, and Japan, have strong governance standards and regulations that serve to undercut corruption. In contrast, those scoring low on the Corruption Perception Index lack proper governance structures and feature excessive regulations foster corruption. Ancillary factors that serve to undermine anti-corruption efforts in the region, e.g., low public sector salaries, lack of disciplinary action and cultural tolerance of corruption, exacerbate these institutional-level shortcomings. Accordingly, SMEs in these developing economies are the most vulnerable to corruption.

A recent survey by the European Bank for Reconstruction and Development and the World Bank found that more than 70 per cent of SMEs worldwide perceive corruption as an impediment to their business (Transparency International, 2009). In this regard, SMEs face four main challenges: (a) ingrained bribery culture in the business community that SMEs are forced to acquiesce to; (b) poor knowledge of anti-bribery laws; (c) limited resources to deal with extortionists; and (d) the lack of an anti-corruption mechanism for SMEs to contact when faced with extortion. All of these factors make it difficult for SMEs to fight corruption (Transparency International, 2009).

5. Subnational surveys

An interesting, and relatively recent, development has been the creation of subnational indices, such as the provincial competitiveness index in Viet Nam, and a similar survey in Cambodia.[51] Such an approach recognizes that most SMEs have relatively limited relationships with national agencies. They interact with municipal or provincial bodies and conduct their activities largely or entirely within that sphere. The provincial competitiveness index seeks to measure and rank business conditions in the 64 provinces of Viet Nam. Such an exercise is highly pertinent to SME development as it focuses on the principal factors that impact SMEs, comprising:

(a) Cost of market entry;
(b) Access to land and security of tenure;
(c) Issues relating to the transparency of regulations and their enactment by provincial bodies;
(d) The time required to comply with regulations;
(e) Informal charges imposed;
(f) Bias towards state-owned enterprises;
(g) The proactiveness of provincial authorities in assisting firms;
(h) The provision of BDS;
(i) The availability of training for employees; and
(j) The quality of legal institutions.

In the case of Cambodia, a provincial business environment scorecard has been developed, spanning the country's ten most economically active provinces. Similar to the provincial competitiveness index in Viet Nam, ten sub-indices have been developed for measuring the enabling environment in the ten provinces. However the indices have also been tailored to suit the different conditions in Cambodia including, among others, tax administration, crime prevention and dispute resolution.

D. BEE reforms

Reforming BEE is characterized by an increasing and evolving set of interventions. These are distinct but often complementary to private sector development policies that primarily support the direct delivery of microfinance or business development services (IFC, 2008). Some BEE interventions are closely linked to the World Bank's Doing Business indicators and are viewed as "regulatory-based", such as business entry simplification, business licensing streamlining and administrative reform.[52] The goal of these BEE reforms is to reduce the burden of regulatory compliance for businesses (often coined as the "obstacles to doing business" and its associated compliance costs) while also safeguarding human health and security, environment, fair competition and other aspects of social welfare. The benefits that may accrue from this includes increased investment, productivity and employment as well as reduced corruption.

---

[51] The provincial competitiveness index in Viet Nam was developed by The Asia Foundation as part of the Viet Nam Competitiveness Initiative funded by the United States Agency for International Development. The Cambodia variant was also developed by The Asia Foundation, with support from the International Finance Corporation-Mekong Project Development Facility (MPDF), and the Australian Agency for International Development (AusAID).

[52] Import-, export- and sector-specific interventions are often also regulatory-based but are typically implemented as a part of larger private sector development interventions to improve trade facilitation and value chains for specific sectors.

These regulatory-based BEE interventions often have a defined measurable goal and objective and may involve elements of legislative change as well as administrative and procedural review. Another area of reform, alternative dispute resolution, centres on reforming the legal framework but in a different way, by focusing on the introduction of institutions and processes for alternative means of commercial mediation.

In order to achieve the set objectives of BEE reforms, specific functional aspects operate at four different reform levels – regional, national, subnational and sector levels (DCED, 2008).[53] Table III.7 sets out that these diverse functional areas and levels.

It is important for BEE reforms to be specialized to a particular level, or comprehensive enough to cover more than one level. At the regional level, for example, bodies such as ESCAP play

[53] The categories presented are not mutually exclusive. Development agencies may work at more than one level or even at all levels for BEE reforms. For example, improving BEE in a single sector can be done through one of the four functional areas or through all four. While the flip side is also true, institutional agreements can be reformed on one or all four reform levels.

Table III.7. Functional areas and levels of business environment reform

	Levels of business environment reform			
	Regional	**National**	**Subnational**	**Sectoral**
Key programme partners	Regional development bodies (e.g., African Union, ASEAN), regional economic communities (e.g., Southern African Development Community), World Trade Organization	Parliament, political parties, national government ministries, regulators, private sector representatives, business membership organizations, business media, worker organizations and consumer groups	Subnational legislatures, provincial, regional and local government authorities, local business associations and community-based organizations	Sector-specific business associations, regulators, government authorities and policies
Policy and legal framework	Improving policies and harmonizing laws and regulations that promote regional trade and investment	Improving national policies and laws that promote competition, open markets and general conditions for private sector development	Improving local policies for private sector development	Sectoral policies and laws often deal with promotional interventions and ways to enhance the value chain
	Trade policies, laws and regulations	Competition, tax, trade, labour policies and laws	Subnational policies for regional development, local economic development and private sector development	Sector development policies
Regulatory and administrative framework	Improving the regulations that hamper regional trade and investment	Improving national regulations that affect the establishment, operation and closure of private enterprises	Improving the regulations created by subnational authorities	Improving business regulations that apply to specific industry sectors or subsectors
	Trade regulations, customs administration	Business regulations; tax laws and administration; labour laws and regulation; trade regulations; customs administration	Business startup and licensing procedures	Sector licences and permits
Institutional arrangements	Supporting member states of regional bodies to design and implement reforms; improving public-private dialogue at the regional level	Improving dialogue between national government and private sector representative agencies (e.g., public-private dialogue)	Supporting local structures and processes for subnational public-private dialogue	Building and supporting sectoral business membership organizations to participate in discussions with government agencies on improving the business environment
	Trade facilitation and capacity-building	Regulatory governance and capacity building	Capacity-building	Capacity-building

Source: DCED, 2008.

Box III.5. Value chain approach for BEE reform

A value chain refers to all the activities and functions that bring a product or service from its conception and design through production to its end use in a particular industry or sector. It is so-called because of the value it adds to the product or services at each step of the business process (Porter, 1985). By taking a value chain approach to BEE reforms, all the major constraints and opportunities faced by the entities involved in every value-added step of the process can be analysed.

The value chain approach provides both a context for assessing policy barriers and a framework for organizing and prioritizing reforms in a certain industry or sector. The value chain approach facilitates the identification of binding constraints faced by BEE. The selection process of interventions aids in the strategic prioritization of these potential reforms and assesses their impact on the chain's performance. Such assessments help avoid ad hoc decision-making and promote thorough analysis of which reforms will change investment behaviour. Working within a value chain context further allows the impact of reforms to be identified and quantified easily in the steps of a specific sectoral or industrial business process.

This type of analysis contrasts with others, such as national policy studies, which do not necessarily reveal the contribution of a reform to the growth of specific sectors or industries (Kleinberg and Campbell, 2008). BEE opportunities for specific value chains to become more competitive may influence the selection of the value chains targeted for national development; thus, the value-chain approach can be further used to develop competitiveness enhancement strategies. This approach can also be applicable to analysing cross-border business processes, which are often known as international production networks or global or regional value chains.

an important role in stimulating the demand for reform by promoting good practices as well as quality policies, laws and regulations. At the national level, these regional associations can work with national agencies and ministries in reforming the current business environment. These reforms can have a significant impact on BEE by creating a business-friendly regulatory framework and reducing obstacles to doing business, e.g., easing business regulations, labour laws, customs, regulations etc.

At the subnational level, policymakers must recognize variations exist across subnational business environments and ensure their reforms cover this diversity. Reforms that remove constraints to growth, improve local market competition and strengthen local systems, procedures, skills and institutions would assist in the development of the subnational BEE. Sector-specific policies that promote BEE can be important drivers of economic performance by addressing obstacles to business (DCED, 2008).

E. Role of government and policymakers in BEE reforms

There is an important role for governments in making the BEE more SME-friendly. As mentioned above, many governments in Asia and the Pacific are still playing the role of a "controller" rather than a "facilitator". To increase the competitiveness of the Asia-Pacific SME sector, governments must design a vibrant BEE and continue reforms to keep pace with changing market conditions. Some major recommendations to governments and policymakers are:

(a) Identify the challenges and opportunities for SME sector growth focusing on capacity-building.

(b) Design effective public policies based on an understanding of the constraints faced by SMEs.

(c) Determine the factors of market failures and recognize the need for early warning signals.

(d) Implement specific programmes enabling SMEs to overcome marketing constraints.

(e) Invite the representatives of SME associations to interact with policymakers at regular intervals.

(f) Evolve support programmes for SME using PPPs.

(g) Design an outward-oriented trade regime. The macroeconomic environment would need to be stable and predictable from the perspective of small firms.

(h) Put in place economic and financial safety nets for SMEs to insulate them from the ill-effects of a possible future economic crisis.

(i) Design a fair and transparent legal and regulatory regime for SMEs.

(j) Promote FDI policies aimed at facilitating the integration of domestic SMEs into global supply chains consistent with an economy's comparative advantage and development.

(k) Create a business-friendly environment for SMEs by:
   - (i) Providing for relative ease of entry and exit of small firms, particularly for young entrepreneurs;
   - (ii) Streamlining bureaucratic rules and procedures;
   - (iii) Assessing the costs and benefits of specific regulations and eradicating the roadblocks; and
   - (iv) Simplifying import-export procedures.

(l) Reform the government's procurement system, perhaps to include e-procurement.

(m) Bestow adequate attention on trade facilitation measures and address legal and regulatory obstacles.

(n) Identify gender imbalances and make suitable provisions for encouraging female entrepreneurship.

(o) Give priority and incentives to R&D, innovations, high-risk projects and intellectual property rights (IPRs) issues in the regulatory framework.

(p) Reduce social stigma for SMEs going bankrupt and provide suitable exit routes.

(q) Provide incentives for providers of business development services.

(r) Reduce government control and interventions.

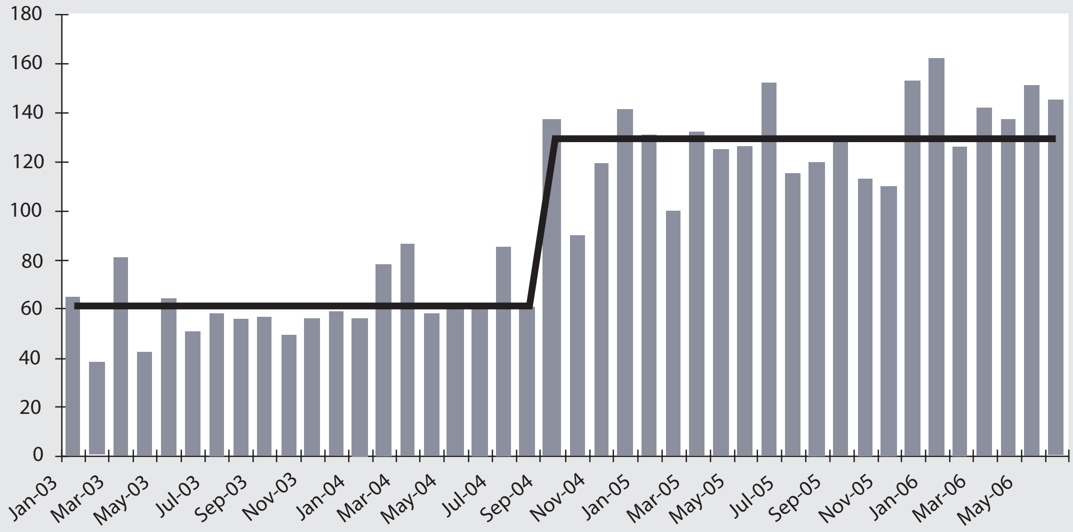
One clear problem, particularly in the developing countries of Asia and the Pacific, is the lack of government skills and knowledge needed to develop appropriate policies. There are good resource and knowledge centres within countries, such as universities and research institutions, but governments often ignore their expertise and invite foreign resource persons who may have an inadequate understanding of local conditions. However, there are also promising signs of innovation and reform as highlighted in the following cases (boxes 6-8).

Box III.6. Cambodia's reform in enterprise registration

In 2004, the Government of Cambodia reformed its enterprise registration. At that time, such registration required a minimum amount of capital of $ 5,000, and on average took 94 days, involved 11 procedures, and cost more than five times per capita GDP. This cost was among the highest in the Asia-Pacific region in terms of both time and financial demands, which motivated many firms to remain informal.

The Government took steps to lower barriers to enterprise registration in August 2004. The cost of registration was reduced from $ 650 to $ 177 while the minimum capital requirement for incorporation was reduced from $ 5,000 to $ 1,000. In addition, the number of documents necessary to apply for registration was also reduced. Those efforts paid off immediately as the average number of enterprise registration doubled from 61 to 129 per month after late 2004 (figure III.5).

Figure III.5. Monthly enterprise registrations, 2004



Source: Baily, 2007.

Box III.7. Streamlining business permits and licensing procedures in Ormoc City, The Philippines

In order to improve the business environment at the municipal and provincial levels, the Philippine Department of Trade and Industry and GTZ provided technical assistance to Ormoc City to simplify the business permits and licensing procedures. The specific objectives of the project were to monitor and evaluate the business permit procedures, recommend ways of improving the current licensing procedures and encourage other subnational governments to do the same. The project, which was implemented from December 2004 to April 2006, included assessment, planning, implementation and evaluation.

The reform reduced the process of business registration from 17 steps to 5 steps, and the time required from 17 days to 2 days. This led to a 25 per cent increase in the number of registered businesses in Ormoc from 2005 to 2006. The Philippine Chamber of Commerce and Industry awarded Ormoc City the title of the "Most Business Friendly City for Visayas" in 2006. Other municipal and provincial governments have reviewed and improved their business permit and licensing systems guided by the Ormoc model.

Source: Keppel, Buh and Spatz, 2006.

Box III.8. Reform of public procurement system

State agencies are important customers and major sources of revenue for enterprises, particularly in Asia-Pacific developing countries where the private sector is often at a nascent stage of development (ESCAP, 2009b). However, SMEs typically struggle to qualify as suppliers to the state agencies. Governments, SME development agencies in particular, could do much to make public procurement policies more accessible to SMEs by informing them about the criteria and processes to become an approved government supplier. The state agencies should streamline their procurement policies and processes to yield efficiency, thus cost-saving and ensure that procurement policies do not discriminate against SMEs.[54]

At the international level, the WTO Agreement on Government Procurement (GPA) provides an international legal framework for the liberalization and governance of public procurement markets (Anderson, 2010). Some of the main GPA features are:

(a) Guarantees of fair national treatment and non-discrimination;

(b) Minimum standards regarding national procurement processes to fair competition;

(c) Various transparency requirements;

(d) Procedures dealing with modifications of commitments;

(e) Requirements regarding bid challenges;

(f) Application of WTO Dispute Settlement Understanding; and

(g) A 'built-in agenda' for improvement of the Agreement.

Not all WTO members are bound by the GPA however, in recent years the trend has been for new WTO member countries to also seek accession to the GPA. The text and coverage of the agreement are also under ongoing negotiations as the GPA has become an increasingly important and visible international economic policy instrument (Anderson, 2010).

F. Toolkits for BEE reforms

Given existing regulatory and administrative frameworks, policymakers should prioritize when designing a beneficial BEE for SMEs in the Asia and the Pacific. Not all components of BEE are equally important, nor should all reforms be attempted simultaneously. Within this context, some multilateral and bilateral development agencies have created toolkits (e.g., handbooks/guidebooks, manuals, training modules) for BEE reforms. This section reviews four major toolkits by the International Finance Corporation (IFC), ADB, ILO and the Japan International Cooperation Agency (JICA).

1. International Finance Corporation BEE toolkit

The International Finance Corporation (IFC), a private sector development arm of the World Bank, has published more than a dozen toolkits and guidebooks for practitioners and policymakers who want to improve their business environment. The aim of the IFC toolkits is to promote reforms that support private sector development by targeting the most critical areas affecting local businesses and by bringing small businesses into the public-private dialogue. The specific actions include (IFC, 2008):

(a) Supporting the operating environment by creating a market-oriented economy where private firms can operate efficiently and effectively without hindrance;

(b) Influencing policy and legal reforms in order to reduce direct and opportunity costs of doing business without removing the protection necessary for human health and safety as well as the environment; and

(c) Strengthening institutions to ensure that reforms in the business environment are properly designed, implemented and enforced in a transparent and equitable manner.

The IFC's knowledge centre website[55] provides information on the implementation of business environment reform. The IFC has collected and analysed data on the success and failure of business environment reform efforts throughout the world in order to develop practical guides for their successful design and implementation. The guides currently focus on key topics such as: monitoring and evaluation (M&E); tax systems and SME taxation; communications; public-private dialogue; alternative dispute resolution; business inspections; business licensing; business start-up; import and export procedures; collateral reform; subnational regulation; and business advocacy (IFC, 2011a).

Currently, the following guides are available online:

(a) Monitoring and evaluation – a handbook for business environment reform;

(b) Subnational regulations – simplification of business regulations at the subnational level;

(c) Public-private dialogue – handbook for business environment reformers;

(d) Communications for business environment reforms;

(e) Business advocacy – building the capacity of business membership organizations;

(f) Alternative dispute resolution manual – implementing commercial mediation;

(g) Good practices for business inspection – guidelines for reformers;

(h) Business licensing reform toolkit;

[54] SPRING provides a good example of providing SME-support services, including its user-friendly guide to SMEs on public procurement. SPRING is the main agency for enterprise development, and is the national standards and conformance body under the Ministry of Trade and Industry of Singapore. Its objective is to enhance the (a) competitiveness of enterprises through nurturing a pro-business environment and (b) innovation and enterprise capabilities of SMEs. More information is available at the website www.spring.gov.sg/Pages/Homepage.aspx.

[55] For more details see the website at www.ifc.org/ifcext/sme.nsf/Content/BEE+Toolkits.

(i) Business start-up – reforming business registration regulatory procedures at the national level;

(j) Import and export procedures – reforming regulatory procedures for imports and exports;

(k) Reforming regulatory procedures for import and exports;

(l) Collateral reforms – reforming collateral laws to expand access to finance; and

(m) SME taxation – tax administrations and SMEs in developing countries.

These IFC toolkits offer guidance for successful BEE reforms by expounding the good practices and lessons learnt from the experiences of nations that have undertaken such reforms. The information has been developed through consultation with various government and non-government agencies and through IFC's experience in the field.

2. International Labour Organization BEE toolkit

The BEE toolkit developed by ILO is designed to create a policy environment conducive to starting and sustaining small enterprises. The specific focus of the ILO toolkit is the employment creation function of SMEs.

In the toolkit the ILO has identified six elements related to the environment in which small enterprises operate, such as the policy and legal framework, market opportunities and the availability of resources. Among the elements, the policy and legal framework is the most important one as it has an impact not only on the small enterprises but also on the other elements. Governments and other stakeholders can improve this framework to achieve the desired economic and social outcomes.

Government activities that shape the policy and legal framework for small enterprises are divided into three layers: (a) policies and laws; (b) regulations and procedures, and (c) administration. This three-layer system describes a complete procedure of policy direction setting, implementation, management and monitoring. On the basis of this model, ILO has listed the possible causes of problems, relevant reform areas and a checklist for good actions for each layer. Policymakers can design and evaluate their BEE reforms in accordance with this specific and practical information. Some specific policies on small enterprise development are also provided to address corresponding issues, such as risk management or entrepreneurship promotion, among target groups.

The importance of policy analysis is also highlighted in this toolkit. As a continuous activity, policy analysis should be conducted during the whole reform process to detect possible reform areas and to regularly assess the policy impact. This analysis procedure requires the involvement of the key stakeholders, including representatives from the public, private, labour and community sectors. ILO proposes three key tactics to enhance the cooperation among different stakeholders: (a) dialogue; (b) collaboration; and (c) coordination (ILO, 2003a).

3. Japan International Cooperation Agency (JICA) BEE toolkit

The "Effective Support Approaches for Small and Medium Enterprises by Development Stages" programme, overseen by JICA (2006), aims to provide a practical guide to BEE reformers for formulating programmes to aid SME development in target countries. The programme is aimed at analysing generic processes of SME development in developing countries, assess their development with a set of clear criteria, and develop and implement technical assistance programmes customized to the particular situation or stage of SME development (table III.8).

Within this context, JICA focuses on the five core issues of: (a) general business environment; (b) policy, institutional and operational framework; (c) business development services; (d) SME finance; and (e) technology, which serve as the primary factors affecting BEE. Each factor is reviewed, its key elements identified, and specific constraints of the factors and their specific development stages identified with a comprehensive checklist to monitor the progress of SME development. Once such constraints and development stages are identified, action plans can be developed based on assessment criteria (e.g., relevance, effectiveness, efficiency, impact and self-sustainability). The specific action plans are then combined into a five-year programme that serve as policy recommendations for a client developing country. The end result is the identification of main constraints and the development of action plans, catered specifically to local environments and factors.

JICA has implemented this BEE toolkit in a number of Asia-Pacific nations, and serves as a guide to create a BEE for Japan's export industries (especially in nations where Japan has vested business interests). For example, through this programme, JICA offered its technical expertise to assist in the development of Sri Lankan SMEs by offering policy recommendations and action plans for the Government of Sri Lanka (JICA, 2009).

4. Asian Development Bank BEE toolkit

Similar to the initiatives of IFC and JICA, ADB has developed toolkits to assist developing counties in fostering an enabling environment for SMEs. A good example to illustrate ADB's approach in detail is "The SME Development Framework (2005-2010)", which is specifically designed for the Ministry of Economy and Finance of Cambodia (MEF) (2005). First, the toolkit analysed major constraints that policymakers should address to support the growth of the SME sector. Second, those constraints – regulatory and legal framework, access to finance, SME support activities and implementation of SME policy framework – were broken down into subcategories. Each subcategory (e.g., credit information sharing, collateral and titling, leasing and business development services) led to clear-cut objectives of BEE reforms in Cambodia and specific recommendations and action plans were developed. In particular, Cambodian SMEs' effective penetration of international markets became a primary objective.

Table III.8. Development stages of SMEs

Stage 1	(a)	Microenterprises and the informal sector dominate the economy and productivity is low;
	(b)	Most businesses are small and family-based. With low educational levels, they have difficulties even with book-keeping. They have never received any vocational training and thus do not have sufficient knowledge to identify and solve their problems;
	(c)	With the businesses' limited cash flow, major capital investment is not expected, while access to the formal financial sector is practically impossible due to the businesses' informality; and
	(d)	There are neither vertical nor horizontal linkages between businesses.
Stage 2	(a)	Although microenterprises and the informal sector still dominate the economy, quite a few companies have been formalized;
	(b)	Although the nation's educational level is relatively good, employment opportunities are still limited;
	(c)	Although access to financing is still limited, informal financing is complementing the formal financing to some extent; and
	(d)	Some cases of vertical and horizontal linkages between businesses are observed.
Stage 3	(a)	Formal SMEs are playing a certain role in the economy;
	(b)	Although SMEs have minimum technical expertise and knowledge to survive in the economy, they lack managerial skills including marketing knowledge, production and quality control skills;
	(c)	Although SMEs have access to formal financing, many of them cannot fulfill the conditions to borrow money; and
	(d)	Although various linkages between companies are observed their effectiveness is limited.
Stage 4	(a)	A significant number of SMEs are growing into large companies or are securing a certain segment of the domestic market;
	(b)	Although there are SMEs that have strong technical expertise, their products are not yet competitive in the global market in terms of quality and price;
	(c)	There are no significant impediments in access to the financial sector for those SMEs that have sufficient skills and are producing competitive products; and
	(d)	A significant number of SMEs have increased their competitiveness by forming clusters and networks.
Stage 5	(a)	There are a large number of competitive SMEs, and many of them supply their products in international markets;
	(b)	Quite a few SMEs with high-level technical knowledge and expertise are manufacturing products at a level which meets international standard;
	(c)	Access to financing is adequate; and
	(d)	Many SMEs constitute supporting industries to large enterprises or are taking part in global supply chains.

Source: Modified from JICA, 2006.
Note: Stage criteria: (a) significance of SME sector in an economy; (b) SMEs' educational and technical level; (c) access to financing; and (d) linkage between companies.

Box III.9. Limited liability partnership in India

A law to allow "limited liability partnerships" (LLPs) in India was enacted by the Indian Parliament in 2008. An LLP is an alternative corporate business entity that provides the benefits of limited liability of a company but allows its members the flexibility of organizing their internal management on the basis of a mutual agreement, as is the case in a partnership firm. Under the bill, an LLP is a corporate body and a legal entity separate from its partners, having perpetual succession. While an LLP is a separate legal entity, liable to the full extent of its assets, the liability of the partners would be limited to their agreed contribution in the LLP. No partner would be liable on account of the independent or unauthorized actions of other partners, thus allowing individual partners to be shielded from joint liability created by another partner's wrongful business decisions or misconduct. An LLP entity can be registered online with the centralized registrar of LLPs, and the registration certificate can then be printed.

This reform is expected to bring relief to SME owners and will allow greater flexibility of their operations. It is particularly useful for SMEs in the service sector, including professionals and knowledge-based enterprises. So far about 6,000 LLPs have been registered in the country; however, SMEs have yet to understand fully the benefits offered under these acts and more education is necessary.

According to a recent report in the Economic Times of India, foreign investors may soon be able to set up LLPs as the Government is willing to allow FDI in selected sectors. The Government intends to cap FDI at 49 per cent of LLPs even in sectors where companies are allowed to receive 100 per cent capital from FDI (Sikarwar, 2010).

Source: Limited Liability Partnership, 2009.

Finally, it was suggested that the Government could approach major donors (e.g., ADB, JICA and the World Bank) for funding and technical assistance. Annex III.1 provides the details of "The SME Development Framework (2005-2010)" for Cambodia.

G. Lessons learnt from BEE reforms

While there is no standard process for BEE reforms, some lessons in general can be learnt from experiences in the region – covering technical, political and institutional issues. Those lessons include:

(a) Develop a strong political will to undergo changes;

(b) Identify specific constraints affecting BEE from sources such as the World Bank's Doing Business indicators;

(c) Identify priorities;

(d) Be receptive to best practices;

(e) Focus on regulatory, financial and investment frameworks, with special emphasis on fair competition;

(f) Make BEE business-friendly, especially for SMEs; and

(g) Be accountable and transparent.

H. Summary

The BEE is critical for economic development and influences the decisions of entrepreneurs to open, locate, operate and expand their businesses. It also has a profound effect on investors, as financial capital will be in short supply in environments where expropriation is rife and regulations are opaque. It is equally important to have bankruptcy proceedings that are clear and impart no stigma on failing firms. The orderly dissolution of SMEs is a nuance of policy often overlooked. This is an area of potential improvement in the Asia-Pacific region that can minimize the expenditure of scarce resources.

The BEE includes both formal and informal channels of rules, norms and support. The concept of a business enabling environment as the central result of various development agents typically covers: (a) regulatory and administrative frameworks; (b) institutional support frameworks; (c) access to finance and taxation; (d) market access; (e) technology; (f) business development services; and (g) PPPs. The role of culture and norms is discussed in the next chapter.

A number of surveys, such as the World Bank Doing Business Indicators. have demonstrated a wide variation in performance in the region. Some nations, such as Singapore and New Zealand, are exemplary while others need to improve in almost all categories. Businesses turn to governments for a wide variety of services, from customs clearances to business licences to dispute resolution mechanisms. Today, the time needed to obtain these services and, in some cases, the lack of transparency in the process (thus leading to corruption) can and often does thwart SME efforts to compete effectively (UNDP Asia-Pacific Development Information Programme, 2007).

Beyond the evidence in these surveys, the role of government and policymakers in BEE reforms have been specified. Some effective policies have been illustrated in a number of cases detailing the streamlining of permits in the Philippines and Thailand and BEE reforms in Viet Nam. Table III.9 proposes the BEE policy focus according to level of economic development.

All of the above are applicable. Some are, however, relatively more salient than others at a given stage of development. For example, financing is crucial for SMEs in all economies, but until the legal system is somewhat impartial it is difficult for capital to flow both to large companies and to SMEs. The risk of expropriation can be too great for investors to commit funds.

Information has been provided about several toolkits from IFC, JICA and ADB for guiding government officials. Countries may adapt these toolkits to their specific context with the clear objective of encouraging SME development and, by extension, national economic development. The BEE toolkits can provide some useful models to serve as a comprehensive guideline for policymakers and supporting institutions in designing and developing a business environment that is friendly for SMEs. It is important for policymakers to recognize that there may be local experts who can help. Often, policymakers look externally for assistance in improving BEE, while relevant resources in their own universities and think tanks are neglected. The search for expertise should be both global and local.

Table III.9. BEE policy focus by level of economic development

Stage of economy	Policy objectives	Policy recommendations
Developing	• Provide basic infrastructure. • Ensure legal system is fair. • Create competitive markets. • Encourage female participation.	• Earmark budgets for basic infrastructure. • Reform regulations to encourage new entrants. • Refrain from government intervention. • Provide more education to girls and remove roadblocks to female participation in the economy.
Middle	• Provide financing. • Expand market access.	• Ascertain financing needs of SMES and fulfill them (see chapter V). • Educate SMEs about exporting and other forms of participation in the global economy (see chapter VIII).
Advanced	• Adopt technology. • Spur innovation.	• Provide incentives for learning about latest technologies and innovations (see chapter VII).

Source: Authors' compilation.

Annex III.1
Cambodian enabling environment toolkit for SMEs

The SME Development Framework (2005-2010) **An overall vision: Develop a conducive business environment, which will lead to a competitive SME sector contributing to the creation of quality employment and improve the range of goods and services available to the people of Cambodia.**				
Major issues	**Phase I (2005-2007)** **Establish the framework for and enabling environment for SME development**	**Phase II (2008-2010)** **Enhance and expand the framework for enabling environment for SME development**	**Future consideration:** **Foster Competitiveness of SMEs through integration into the world economy**	**Major donor activities**
I. Regulatory and Legal Framework Vision: To reform the regulatory and legal framework for the purpose of creating and enabling business environment based on the rule of law and designed to minimize the impacts of government interventions on the private sector while providing the necessary protection of public goods.				
(A) Company registration Objective: Reduce the barriers and build the necessary system of effective registration.	• Reduce administrative and cost barriers in registration, including reduction of minimum capital requirement. • Engage in public-awareness campaign, including issuing a manual on registration process and a series of necessary templates. • Conduct pilot decentralization of company registration outside Phnom Penh.	• Commence full decentralization. • Plan for online registration system. • Link business registration at the Ministry of Commerce with tax and VAT registration at MEF and eventually merge into one procedure.	• Implement the online registration. • Expand registration to a wider segment of economy by further developing practical thresholds for firms to register.	• ADB – Cambodia SME Development Programme (CSDP) • World Bank review of investment climate and reform strategy
(B) Regulatory review and recourse mechanism Objective: Reduce regulatory compliance costs by enhancing governance and responsibilities of the relevant state agencies.	• Establish regulatory review process for existing and proposed licences and remove or streamline the requirements for both operating and regulatory licences. • Formulate a recourse mechanism to appeal administrative decisions. • Plan for a pilot programme for one-stop window for all relevant business licences.	• Continue to evaluate and remove unnecessary licences. • Implement a comprehensive system for issuance of new licences and recourse mechanism. • Develop a comprehensive programme for one-stop window for all relevant business licences.	• Continue to implement the reforms as outlined. • Expand the one-stop window programme for licensing of SMEs.	• ADB – CSDP

Major issues	Phase I (2005-2007) Establish the framework for and enabling environment for SME development	Phase II (2008-2010) Enhance and expand the framework for enabling environment for SME development	Future consideration: Foster Competitiveness of SMEs through integration into the world economy	Major donor activities
(C) Commercial legal framework Objective: Develop basic legal infrastructure needed for businesses and strengthen the rule of law.	• Enact draft laws on commercial enterprises, insolvency, secured transactions and contracts, among others, and harmonize them with the civil code. • Enact legal framework necessary to create a specialized court to resolve commercial disputes and strengthen training of judges.	• Engage in extensive capacity-building programmes for the commercial court system. • Enact legislation to establish commercial arbitration. • Implement anti-corruption legislation to improve transparency and fairness, and adopt code of ethics.	• Establish small claims court to strengthen contract enforcement for SMEs.	• (JICA – Civil Code and Procedures • World Bank Contract Law • Canada International Development Agency (CIDA) – Law on Commercial Arbitration, and Law on Commercial Court
II. Access to Finance Vision: To ensure that SMEs have access to necessary working capital as well as medium- and long-term finance by strengthening the collateral system and by providing a greater range of products from a wider variety of financial institutions.				
(A) Collateral and land titling Objective: Establish secure titling to improve collateral base, and effective mechanism of enforcement of the land law.	• Issue the legal framework for secured transaction and land registration. • Initiate the registration system for both movable and immovable properties.	• Develop and implement support programmes for banks and other financial institutions for effective collateral valuation.	• Expand the online registration systems on a nationwide basis.	• ADB – Financial Sector Programme Loan (FSPL) • Mekong Project Development Facility (MPDF) – Bank Training Institute • ADB – TA 4181 on Land Law (phase II) • World Bank and other donors – land titling project
(B) Leasing Objective: Create an enabling framework for banks to provide finance leasing	• Amend the tax law so as to enable finance leasing to occur. • Issue the legal framework on leasing covering both financial and operating leases.	• Issue IAS – 17, specifying best accounting practice for leasing. • Develop and implement training and information programmes for banks, SMEs, and equipment suppliers that promote leasing.	• Promote joint ventures or stand-alone finance or operating leasing companies.	• ADB – CSDP • ADB – FSPL • International Finance Corporation (IFC) – review of leasing industry
(C) Credit Information sharing Objective: Facilitate enhanced access to finance by reducing the risks associated with limited information on potential borrowers.	• Implement the private credit information sharing system. • Establish an enabling legal framework for operation of the system to protect the rights of borrowers.	• Expand the credit information system by providing historical and other information. • Facilitate the establishment of a private credit bureau. • Develop and implement a plan to include other financial institutions to participate in the system.	• Continue to implement the plan for expanded credit information system and inclusion of non-bank financial institutions. • Draft a plan for the feasibility of developing new information products such as credit scoring.	• ADB – CSDP • ADB – FSPL • Agence Francaise de Development (AFD) – capacity-building for microfinance institutions • Kreditanstalf fur Wiederafbau (KfW) – capacity-building for commercial banks • MPDF – Bank Training Institute

Major issues	Phase I (2005-2007) Establish the framework for and enabling environment for SME development	Phase II (2008-2010) Enhance and expand the framework for enabling environment for SME development	Future consideration: Foster Competitiveness of SMEs through integration into the world economy	Major donor activities
(D) Simplified accounting and taxation systems for SMEs Objective: Facilitate enhanced access to finance by reducing the risks related to lack of appropriate financial information.	• Issue simplified SME accounting guidelines (including the related templates). • Develop a simplified tax-reporting system for SMEs operating as companies. • Engage in extensive training programmes to both accounting professionals and SMEs (through private sector representatives).	• Continue to support the development of the accounting professionals. • Issue guidelines and specific requirements to assist the SMEs in adhering to the formal tax system.	• Develop corporate governance guidelines and disclosure requirements on financial information.	• ADB – CSDP • ADB – FSPL • ADB and IMF – public financial management programme.
III. SME Support Activities Vision: Create a dynamic market for SME support service. Assure that services are supplied in the most efficient means possible by the private sector and government. Encourage suppliers of services to respond to market signals and cater to a range of enterprise size. Finally, create a market place where SME are aware of the benefits and range of services available.				
(A) Business development services (BDS) Objective: Create a dynamic market for BDS supplies as private goods and offering a range of serviced demanded by SMEs.	• Identify existing BDS suppliers and demand for services and develop a registry by district of BDS suppliers and make it available to SMEs. • In cooperation with BDS facilitators (NGOs, donors, and business associations), identify BDS needs of SMEs and barriers to greater use.	• Develop and implement education campaign for SMEs on the benefits of BDS. • In cooperation with BDS facilitators, encourage new BDS suppliers into the market. • Encourage existing institutions to enter the BDS market or link with existing BDS providers to improve their services (for example, linkages between educational institutions and BDS providers can improve quality). • To stimulate supply and demand, encourage third parties to deliver pilot projects for voucher schemes.	• Develop in public private partnership new BDS products. • Facilitate the replication of successful BDS providers. • Encourage a BDS provider association to develop a code of ethics and independent certifications of BDS providers. • Direct delivery of BDS should be avoided by the government however, when it does occur, some cost recovery components should be introduced.	• Australian Agency for International Development (AusAID) – BDS for agriculture • JICA – BDS development • MPDF – business advisory assistance

Major issues	Phase I (2005-2007) Establish the framework for and enabling environment for SME development	Phase II (2008-2010) Enhance and expand the framework for enabling environment for SME development	Future consideration: Foster Competitiveness of SMEs through integration into the world economy	Major donor activities
(B) Access to markets Objective: Improve SMEs access to domestic and export markets through better access to information, market research, product development and promotional activities.	• Design and implement an education programme on utilizing information for access to markets. • Encourage and assist SMEs to participate in trade fairs and exhibitions. • In cooperation with SME associations develop multi-purpose facilities. • In conjunction with other stakeholders, link buyers with SMEs for clusters of SMEs.	• Develop and implement a strategy for regional SMEs to have improved access to the internet. • Facilitate better flow of useful information between public institutions, such as technical colleges and universities, and SMEs • To improve access to export market, facilitate linkages between local and international business associations.	• To enhance the use of the internet, a legal and regulatory framework for e-commerce should be implemented. • Facilitate trade fairs and product exhibitions in partnership with the private sector. • Develop and implement a matching grant scheme for SMEs to access export markets.	• ADB – TA 4121 (Garment Sector Study) • European Union – WTO assistance • European Union – export development • GTZ – trade promotion • New Zealand Agency for International Development – trade policy in agriculture • ESCAP – WTO assistance • UNIDO – market access support • World Bank – supply chain and trade facilitation
(C) Technology and human resource upgrading Objective: Improve availability and awareness among SMEs of technology and technical and managerial training.	• Review current technology and training needs, incentive structures and barriers. • Coordinate with providers of vocational training to identify needs and develop links with SMEs. • Strengthen the capacity of current research institutions and foster linkages with the private sector (including academic institutions).	• Develop an action plan for implementing opportunities identified in the phase on review. • Coordinate and work with training institutions and donors to develop toolkit packages for training and capacity building in SMEs.	• Encourage quality standards in SMEs through ISO 9000 certification process. • Encourage linkages between training and research institutions and SMEs.	• ADB – garment sector study • Government of India – vocational training • GTZ – vocational training • JICA – training centre • UNIDO – industrial standards
(D) Linkages Objective: Assist SMEs to work together and cooperate in integrated networks to improve their competitiveness and access to local and international markets.	• Review relevant regulations and procedures for the registration of associations and make recommendations for improvements. • In cooperation with other stakeholders, develop and implement an action plan for encouraging the formation and strengthening of associations. • Take an inventory of clusters, including identifying number, size, type, and location.	• Encourage the development and use of media outreach programmes for raising awareness of issues related to SMEs. • Develop, in cooperation with donors and associations, common service provisions and other related support for clusters.	• To help improve the competitiveness of clusters, encourage linkages between local clusters and international organizations. • Working together with other stakeholders, assist SMEs in clusters to become integrated in global supply chains. This can include promoting learning networks, joint international marketing, as well as a range of other services.	• ADB – FSPL • ADB – garment sector study • World Bank – trade facilitation and supply chain • JICA – feasibility of export processing zone to build backward linkages to SMEs • USAID – capacity-building for business associations

Major issues	Phase I (2005-2007) Establish the framework for and enabling environment for SME development	Phase II (2008-2010) Enhance and expand the framework for enabling environment for SME development	Future consideration: Foster Competitiveness of SMEs through integration into the world economy	Major donor activities
IV. SME Policy Framework – Implementation Process Vision: Develop a specific framework and institutional arrangements for effective policy formulation and implementation as well as monitoring of its impact. Involve the private sector representatives and obtain donor support to ensure its overall success.				
(A) Government Organizations Objective: Develop an institutional arrangement among key government agencies for effective and coordinated policy formulation and implementation.	• Formulate and implement the First SME Development Framework based on public private partnership. • Establish a secretariat for the National SME Subcommittee with a detailed work plan. • Develop and implement a plan to provide and collect information to and from SMEs. • Publish a report on the state of the SME sector and the achievements of the First SME Development Framework. • Develop a specific plan for capacity-building programmes for the government officials and private sector representatives. • Ensure that the implementing agencies are allocated sufficient resources to undertake the reforms as outlined in the SME Development Framework.	• Formulate and implement the Second SME Development Framework based on public private partnerships. • Expand the system to provide information to and collect from SMEs. • Publish a report on the state of the SME sector and the achievement of the Second SME Development Framework. • Expand the specific plan for capacity-building programmes for the government officials and private sector representatives.		• ADB – Cambodia SME Development Programme (CSDP) • World Bank review of investment climate and reform strategy
(B) Promotion of public private partnership Objective: Support the development of active private sector representation in policy advocacy.	• Develop a specific consultation process with business associations and other stakeholders to foster public-private partnerships. • Formulate a plan to enhance the capacity of business associations to provide policy advocacy on behalf of SMEs.	• Facilitate the establishment of private policy research institutions for support in policy formulation, evaluation, and monitoring of their impact.		• USAID – Capacity-building for business associations • MPDF

Source: MEF, 2005.

Annex III.2
SME Taxation

A. Taxation for SMEs

SMEs do not add significantly to tax revenue because they are small and fragmented, typically less profitable than large enterprises, and more likely to operate in the informal sector in any given economy (International Tax Dialogue, 2007). As such, tax morale plays a significant role in determining the tax revenue contributions from SMEs and the size of the informal sector (Schneider and Torgler, 2007).

SME owners usually have limited knowledge about tax codes and information on tax policies and procedures can be difficult to attain. Tax compliance costs are an additional burden for SMEs. These hindrances discourage entrepreneurship and deter SMEs from entering the formal sector. Governments and policymakers can alleviate these factors by outlining clear and straightforward taxation policies.

Tax incentives such as reduced tax rates and tax relief can also be a useful tool to alleviate SMEs' competitive disadvantage compared with large enterprises. Well-designed tax incentives could facilitate SMEs' investment to improve their capacity while increasing their cash flows. Spillover effects through SMEs could foster broader economic growth.

1. Tax compliance and business formality

As discussed above, there is association between the informal sector and the level of non-compliance with the tax code (Schneider and Torgler, 2007). The tax system is one of the key reasons for the growth of the informal sector. Non-compliance with the tax system might give a competitive advantage to SMEs as they will be able to offer their goods and services at lower price than their competitors in the formal sector. However disadvantages resulting from non-compliance with the tax system may exceed potential benefits. Annex table III.1 discusses the advantages and disadvantages of tax system non-compliance.

2. Tax compliance cost

A tax burden is not only the result of higher tax rates but also tax compliance costs that are associated with businesses. Tax compliance costs have both monetary and non-monetary elements, which can be classified under three main categories: monetary costs; time costs; and psychological costs (Annex table III.1).

Tax compliance costs have been a policy issue for the past two decades; OECD nations regularly calculate them via surveys. Discovering these costs is a recent process in

Annex table III.1. Advantages and disadvantages of tax non-compliance on various entities

Advantages of non-compliance	Disadvantages of non-compliance
Business: (a) Comparative advantage due to possibility of offering products at lower price; (b) Less harassment from tax officers; and (c) Avoidance of high compliance costs. Tax administration: (a) Lower administrative costs; and (b) Possibility of allocating scarce resources to administrating high-potential taxpayers.	Business: (a) Inability to obtain formal licences and permits from local and other government agencies; (b) Difficulty in securing credit from formal sources; (c) To avoid attracting the attention of the authorities, informal business needs to maintain a low profile. This precludes advertising, which will likely result in lost sales; (d) Vulnerable to corruption. Officials may need to be bribed to overlook the informal status of the enterprise; (e) Impediment to trading with the formal sector, which may only buy from registered VAT taxpayers; and (f) Inability to claim legitimate tax deductions and exemptions. Government: (a) Incorrect estimation of revenue potential of SME segment; (b) Violation of tax equity; (c) Risk of erosion of general compliance attitude; and (d) Non-compliance with the tax system creates risks of being associated with non-compliance with other laws, e.g., environmental and safety standards. Public: (a) Less tax revenue available for public services; and (b) Less government accountability.

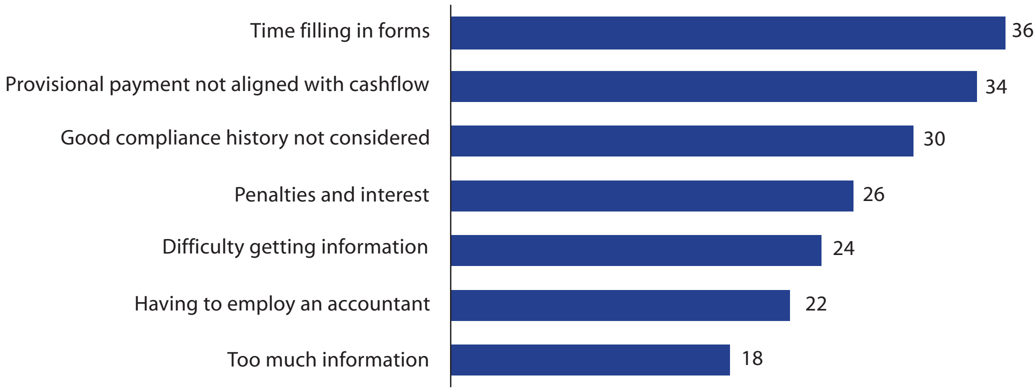
Source: IFC, 2007.

Annex table III.2. Monetary and non-monetary elements of tax compliance costs

Monetary costs	Time costs	Psychological costs
Fees paid to tax advisers, lawyers and accountants	Time spent on studying tax laws, procedures and filing returns	Stress and anxiety arising from complying with a specific tax or with tax-related activities
Salary of staff working on tax returns and tax accounting	Time spent on preparing the tax audit	Frustration as a result of taxpayer harassment
Tax literature and software	Time spent on preparing appeals	
Operational costs (telephone calls, travel and postage)		

Sources: Pope, Fayle and Chen, 1991; and Sandford, Godwin and Hardwick, 1989.

Annex figure III.1. Factors responsible for high tax compliance in New Zealand, 2003 (percentage of respondents)



Source: IFC, 2007.

developing countries and, as a result, little data is available for policymakers. The OECD country data on tax compliance indicate the disproportionate burden on SMEs; nearly all studies find a regressive pattern of tax compliance cost for smaller firms (Evans et al., 1997). A 2003 survey carried out in New Zealand outlined some factors responsible for high tax compliance including time requirements, lack of information and others (annex figure III.1).

3. Tax incentives for SMEs

Despite the importance of SMEs to economic prosperity, they are at a competitive disadvantage compared to large enterprises and TNCs. Most governments and policymakers are therefore in agreement that special incentives should be provided to SMEs in order to foster their growth. One way to achieve this is by providing tax incentives for SMEs. Tax incentives are useful due to their spillover effects through SMEs to the broader economy. This is especially the case since SMEs provide the bulk of the employment with required labour training and skill development, and are an important source of innovation. Providing tax incentives to foster and support the growth of SMEs will add value to the broader economy. SME tax incentives can mitigate the tax compliance burden of SMEs and promote inclusion into the formal sector.

Policymakers have to be careful in designing a tax incentive programme that provides the best results for specific objectives. A programme can be designed for different development stages, starting from initial investment to daily operation to re-sale or closure. In the following section we will look at various tax incentives that SMEs can get at the different stages, mainly using examples from developed countries:

(a) Reduced tax rate. Considering the high tax compliance cost for SMEs, governments can consider reducing statutory tax rates on profits earned by SME, in order to promote entrepreneurship. For example, Japan reduced its corporate tax (from 22 per cent to 18 per cent) for SMEs in 2009 to protect its SME sector from the global economic crisis (ASG Tax Corporation, 2009);

(b) Investment in depreciable assets. Since SMEs have limited access to necessary capital to invest in assets or for developmental activities, investment tax credit can lighten the financial burden and help build the required fixed assets for the SMEs. In Japan, SMEs acquiring depreciable assets (machines and equipment) can benefit from a special initial depreciation of 30 per cent of the billing cost, or a special investment tax credit of 7 per cent. Furthermore, in South Africa, SMEs can write off 100 per cent cost of the machinery and equipment (OECD, 2009a);

(c) Investment in research and development.[56] Innovation is the key for any business to be successful, and tax policies can be of great help by providing tax concessions for costs incurred on

[56] Also see the detailed discussion on the R&D tax issues in chapter VII.

Annex table III.3. SME taxation criteria

Criteria	Problem
Business turnover	(a) With high volume of cash transactions and low recordkeeping standards, determining the correct amount of turnover is difficult;
	(b) Turnover under-declaration is widespread among SMEs.
Tax paid or tax liability	(a) Losses result in zero tax liability, including for some very large businesses;
	(b) Fails to account for tax holidays.
Number of employees	(a) Some industries may be very labour intensive but have low productivity, and hence low profitability and tax liabilities;
	(b) Some capital- or technology-intensive sectors with few employees may be highly profitable.
Capital base	(a) Not all capital-intensive industries remain profitable, particularly in declining or subsidized sectors;
	(b) The burgeoning, and often highly profitable, service sectors may have minimal capitalization.
Entity type	(a) While many large taxpayers are incorporated, not all corporations are large;
	(b) There could be some unincorporated enterprises that are quite large.
Industry type	Major taxpayers may be common in highly regulated (banking or capital intensive) industries but the businesses that service these sectors may range widely in size.
International transaction	Economic globalization is now affecting businesses of all sizes, particularly importers, exporter and certain service sectors.

Source: IFC, 2007.

R&D activities. The *Durfkapitaal* scheme in the Netherlands is an example of such an incentive programme. Under this scheme, any SME that includes a R&D facility can get tax compensation up to € 50,000 (Internationaal Ondernemen, 2011);

(d) Incentives on employability. Tax policies can also promote employability by favouring SMEs that employ more people in a particular period, through specific tax relief. In this case, governments have to keep check on the duration of employment to make sure the incentives are used properly and not manipulated. In Belgium, for example, SMEs receive an allowance of $ 6,292 in each tax year for each additional staff member employed (OECD, 2009a); and

(e) Incentives for SMEs on capital gains and capital losses. Tax incentives can be provided on capital gains or capital losses from non-inventory assets (e.g., stocks and bonds) to promote greater participation by shareholders and venture capitalists in the SME sector. This will help SMEs' cash flow and enable them to expand. For capital losses, tax policies could make provisions to carry over the loss during several years, so that an SME can withstand the initial start-up process and potential losses (Irish Tax and Revenue, 2011).

B. Criteria of SME taxation

A key issue with SME taxation is that the definition for SMEs varies from one country to another and so do the applicable tax policies. Despite these differences, tax laws for SMEs have one thing in common – they specifically define the eligibility criteria for incentives aimed at SMEs. The main criteria, and main issues related to them, are presented in annex table III.3.

Business turnover is one of the most accepted criteria in determining tax rules for SMEs as there are separate definitions of it for tax purposes. This allows more targeted tax incentives and simplified tax regimes for businesses requiring special considerations, e.g., SMEs (IFC, 2007).

C. Valued-added tax reforms for SMEs

The value-added tax (VAT) threshold determines the level of turnover a business should generate in order to be exempt from VAT. Policymakers have to consider the VAT system carefully since compliance with VAT can be particularly difficult for SMEs. Various studies (Nemickas, Senchuk and Babanin, 2002; and Skatteverket, 2006) have indicated that compliance with VAT is the most problematic form of tax for SMEs.

In order to encourage SME development and their inclusion into formal markets, it is essential for policymakers to consider a proper VAT registration threshold for SMEs. Some developing countries are already reforming their policies with assistance from international organizations, e.g., IMF and the World Bank (OECD, 2007a). Some simplification processes for VAT systems are:

(a) Choosing optimal threshold. The VAT threshold varies considerably from one nation to another, mainly due to each nation's non-uniform definition of SMEs. The mean global VAT threshold is in the range of $ 90,000; in Singapore it is as high as $ 700,000 (OECD, 2009a). The appropriate threshold for a given country requires a thorough analysis of many factors, including the number of taxpayers, their expected contribution to overall VAT revenue yield per turnover band, structure and characteristics of the SME community and the level of administrative and compliance costs per turnover band (IFC, 2007). Alternatively, IMF (2001), in its publication *The Modern VAT – 2001*, proposes a formula, taking into account of the rate at which VAT is levied, valued-added per unit output, administration costs, compliance costs and the net loss to a government, for adjusting the VAT ceiling for SMEs to an optimal level;

(b) A simple VAT rate structure. Most developing countries operate with multiple VAT rates for the SME sector. This system not only increases compliance costs but also increases administration burdens. A study of VAT compliance cost conducted in Sweden established a direct correlation between compliance cost and the multiple tax rates (Skatteverket, 2006). Simplifying VAT, e.g., having a comprehensive, single VAT rate structure, can streamline SMEs into the formal sector;

(c) Cash accounting for SMEs. Most SME's problems are based on their inability to maintain cash flow. VAT is based on accrual accounting, which requires VAT to be remitted on taxable sales where the cash has not yet been received (accounts receivables[57]). When using cash accounting, VAT is paid on sales only when the cash is received and input tax credits are claimed only when cash is paid on a purchase. Cash accounting is specifically helpful to SMEs as it mirrors their daily operations;

(d) Frequency of tax return filings. In most countries utilizing the VAT system, tax returns are filed monthly and add to compliance costs. Policymakers should decrease the frequency of SME VAT returns, thus allowing SMEs to have extra cash flow. Examples can be drawn from countries such as Austria, Australia, Canada, New Zealand and Sweden on how reducing the frequency of tax filing will lead to extra cash flow for SMEs. In New Zealand, businesses submit VAT returns every six months if their turnover is less than $NZ 250,000. For businesses having a turnover of between $NZ 250,000 and $NZ 24 million, the VAT return is filed once every two months rather than on a monthly basis. Similarly, Canadian SME businesses with a turnover of less than $C 6 million but above $C 500,000 qualify for quarterly filing, while those with a turnover less than $C 500,000 qualify for annual filing with quarterly installment payments (IFC, 2007; and OECD, 2009a).

It is also important to understand the overall advantages and disadvantages these processes can have for government bodies and a business itself:

(a) Advantages of VAT reforms:
  (i) Significantly reduced compliance costs;
  (ii) Increased cash flow for the SMEs;
  (iii) Less administrative costs for government bodies;
  (iv) More entry of SMEs into the formal economy.

(b) Disadvantages of VAT reforms:
  (i) Under-reported turnover in order to take advantage of exemptions;
  (ii) Deterioration of business credibility because suppliers generally prefer dealing with clients with a registered VAT number.

D. Increasing popularity of presumptive taxation

The general taxation regime works in those countries where most SMEs operate in the formal sector. In developing economies it is almost impossible to have a general taxation regime since a considerable portion of SMEs operate informally. Because of such non-compliance with obligatory bookkeeping and accounting practices, presumptive taxation[58] is very popular in order to bring existing or new SMEs into the formal sector. Presumptive taxation does not follow a fixed manner; it is flexible and convenient in terms of operation and the scope of application. This system is generally welcomed by SME communities due to its convenience, usage and simplicity (IFC, 2007).

The presumptive tax system can be planned based on the following criteria (IFC, 2007):

(a) Turnover or gross income of the company
  (i) Tax rate based on standard percentage of turnover;
  (ii) Progressive turnover tax rates.

(b) Indicators
  (i) Number of employees;
  (ii) Energy (e.g., electricity) consumption.

(c) Combination of turnover and indicator base.
  (i) Turnover plus number of employees;
  (ii) Turnover plus energy consumption.

(d) Professional patent
  (i) Small machinery;
  (ii) Carpenter and woodworker;
  (iii) Hairdresser and barber services etc.

There are possible advantages and disadvantages connected with some types of presumptive taxes as shown in annex table III.4.

In addition to the above, certain general disadvantages associated with this tax system should also be noted (IFC, 2007):

(a) In cases of losses suffered by SMEs, the government or tax office will not be able to provide any immediate help;

(b) There is a risk of the tax system being abused by entrepreneurs and SME proprietors;

(c) The presumptive tax system discourages the growth aspect of SMEs and entrepreneurs, and will negatively affect their long-term planning.

Annex table III.5 provides comparative information on Asia-Pacific countries with regard to VAT percentage, VAT

[57] Money owed by customers (individuals or corporations) to another entity in exchange for goods or services that have been delivered or used, but for which payment has not yet been received. Receivables usually come in the form of operating lines of credit and are usually due within a relatively short period, ranging from a few days to a year.

[58] Presumptive taxation involves lump sum levies on certain small-scale business activities. The assessment of taxes through indicators or proxies helps in estimating a taxpayer's income (estimated income), and the estimation of minimum income irrespective of a taxpayer's actual level of business activity (presumptive minimum income).

Annex table III.4. Advantages and disadvantages of presumptive tax systems

Type of system	Advantages	Disadvantages
Patent	Simplicity. Low tax compliance and administration costs.	Imposes a relatively high tax burden on firms with relatively low turnover. Imposes a relatively high tax on profits during downturns when profits are low or negative.
Indicator-based tax	Less easy to misreport. May offer substantial savings in tax compliance and tax administration costs. Does not factor in tax revenues and thereby discourage income growth accompanying increased work effort.	May discourage investment in buildings and/or the hiring of additional workers.
Turnover tax	Avoids the competitive distortions of profit-insensitive taxes. Facilitates the adjustment of firms to a regular income tax system by requiring the maintenance of cash accounts measuring turnover.	Imposes a relatively low effective tax rate on business that are more profitable than others. Tends to discourage the allocation of capital to business activities where profit margins are relatively thin.

Source: OECD, 2007.

Annex table III.5. VAT and presumptive tax threshold comparison for Asia-Pacific countries

Country	VAT rate	VAT registration threshold	Presumptive tax threshold (VAT exemption)
Australia	10 per cent	$A 75,000	Convenient tax paying system for turnover under $A 75,000
China	Standard rate: 17 per cent Small entrepreneur: 3 per cent	RMB 800,000	Turnover not exceeding RMB 800,000 (6 per cent standard tax rate)
Cambodia	10 per cent	CR 125 million	n.a.
India	State level rates of 1 per cent, 4 per cent, 5 per cent and 20 per cent	Varies according to state (Rs 2,500 - Rs 2 Crore)	Turnover not exceeding Rs 4 million (8 per cent standard tax rate)
Indonesia	10 per cent	Rp 600 million	Turnover not exceeding Rp 600 million
Japan	5 per cent	¥ 10 million	Separate tax slab available for SMEs
Lao People's Democratic Republic	10 per cent	NK 400 million	Turnover below NK 100 million
Malaysia	6 per cent	RM 500,000	Separate tax slab available for SMEs
New Zealand	15 per cent	$NZ 60,000	Turnover below $NZ 60,000
Russian Federation	Standard rate: 18 per cent Reduced rate:* 10 per cent	No threshold	Up to 1,000 employees plus turnover below R 11 million
Republic of Korea	10 per cent	n.a.	Separate tax slab available for SMEs
Singapore	7 per cent	$S 1 million	Turnover not exceeding $S 500,000
Thailand	7 per cent	B 1.8 million	Different tax rate slab available for SMEs.
Viet Nam	10 per cent	No threshold	Based on turnover, which varies according to business sector and location.

Sources: TMF Group, 2009; ATO, undated; Ministry of Finance, Japan, 1999; ASG Tax Corporation, 2009; KPMG, 2012; AAJ Associates, 2010; GST Malaysia, undated; PWCCN, 2012; ADB, 2012a and 2012b; Hauerstein and Niemann, 2002; Revenue Department, Thailand, 2008; Inland Revenue Authority of Singapore, 2011; and New Zealand Institute of Chartered Accountants, 2010.
* Reduced rate for foodstuff, medical and clothing materials.

registration thresholds for business, and presumptive tax thresholds. In cases where a number of businesses are unable to register for VAT, governments may take measures to introduce presumptive tax. This will help to control the informal sector and maintain proper data on the SMEs in the long term. It will also serve as a guide for policymakers in reforming SME taxation policies.

E. Tax administration

Tax administration, particularly in developing countries, generally does not focus much on tax compliance by SMEs; a small number of major taxpayers contribute the majority of tax revenue. Attention given to small businesses is limited, with some tax administrations even discouraging the inclusion of small businesses in the tax net because of the high administrative cost-benefit ratio[59] (Bahl, 2003).

IFC, in its report "Designing a tax system for micro and small businesses," provides certain guidelines for comprehensive tax administration that includes SMEs (IFC, 2007):

(a) Tax administration reform must accompany tax policy reforms;

(b) Given the special compliance problems and service needs of small taxpayers, creating dedicated administrative structures within the tax administration to manage small taxpayer compliance and satisfy service needs is a promising reform. Similar to the operation of large taxpayer offices existing in many countries, specialized small taxpayer offices could be created;

(c) In a number of countries, the registration of businesses for tax purposes remains a slow, cumbersome and often costly process. Streamlining taxpayer registration is an important administrative reform, and should be linked to the reform of business registration requirements on a broader base. Ideally a one-stop approach to registration should be adopted;

(d) Small taxpayers have special service and information needs. These concern both the content and mode of delivery. As the use of information technology is becoming more widespread in small business communities, its use should also be considered for service and information purposes to facilitate compliance (e.g., filing and payments);

(e) Cooperation with the private sector, particularly with small business and SME associations, is important for successful compliance management. Consideration could be given to introducing some elements of associational taxation and to involving those associations in the tax collection process; and

(f) Close cooperation with local governments should be established for information sharing on tax policies and the tax regime.

59 Administrative costs per United States dollar of collection rise considerably with efforts to increase the compliance rate beyond a given point, which is determined by tax administration capacity as well as the size and structure of the group of potential taxpayers (Bahl, 2003).