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SMEs IN ASIA AND THE PACIFIC

Asia and the Pacific is a region of contrasts. The region as a whole has achieved unprecedented growth and development in recent decades. The general picture, however, hides a great diversity of economies, development experiences, and challenges. Asia is increasingly playing the role of a global growth pole, and is fast emerging as a manufacturing and information technology hub of the world economy. Yet the World Bank estimates that more than 900 million people still live in extreme poverty, now defined as less than $1.25 a day. Asia is the home of China and India—giants that are reshaping international business and the global economy through, among other things, the operations of internationally competitive enterprises such as Lenovo (China) and Infosys (India); but such giants also coexist with a large number of traditional, local micro- and small enterprises. In addition, China and India share this vast continent with Bhutan, Nepal and the Lao People's Democratic Republic, all considered least developed countries, and the region includes the small island nations of the Pacific, whose prospects for development also remain far more limited.

One characteristic of this vast and diverse region is the presence and importance of a large SME sector comprising the majority of enterprises in all the region's economies. Given the region's diversity, enterprises in general, and SMEs in particular, are at different stages of evolution in their respective economies; their relative roles and contributions also differ. Thus, the constraints they face and the corresponding policies aimed at strengthening their competitive performance are expected to vary. Nevertheless, there are also basic similarities in the broad challenges faced by SMEs in the region, for example in terms of access to finance, technology, human resources, market information and, above all, in adjusting to both the opportunities and threats of globalization.

1.1. Definitions and profiles

> *SMEs are a source of employment, competition, economic dynamism, and innovation; they stimulate the entrepreneurial spirit and the diffusion of skills. Because they enjoy a wider geographical presence than big companies, SMEs also contribute to better income distribution.*

Supachai Panitchpakdi, Secretary-General of the United Nations Conference on Trade and Development (Panitchpakdi 2006)

Most people have a broad sense of what constitutes an SME, if only a rather stereotypical image of a young and relatively fragile business. In many cases, that stereotype indeed holds true. Like any stereotype, however, it is neither the full picture nor universally correct. There is a temptation to liken SMEs to the student generation of the corporate community, containing considerable growth potential, if only their energy and enthusiasm can be harnessed and channelled in the right direction. Pushing the analogy further, some SMEs will go on to great things in later life, while most will probably achieve more modest goals, and sadly some will come to a premature end for one reason or another.

Most policymakers and development practitioners deem the health of the SME community to be highly important for an economy, whether subnational, national or regional. Not only do SMEs typically constitute the vast majority of company registrations in any economy, there is also the expectation that an elite few will make the leap “from garage to great”. The likes of Microsoft and Apple Inc. serve as living proof that the “American Dream” of SME development is no fantasy; it can be done, given the right set of factors and conditions. Here in Asia, Infosys of India was started with capital of just $250, but has risen to become a business with revenues of $4 billion, and is listed on NASDAQ in the United States of America.

Similarly, the bursting of the “dot.com” bubble in 2001 provides evidence that perils also abound for new SMEs that seek to pursue unviable business models (and for the investors that inject equity capital into them). There can be value destruction as well as value creation.

The main ingredients that make up factors and conditions conducive for SME sector development are increasingly well known and understood by policymakers and economic practitioners. Some of the fundamental ingredients of a benign enabling environment for SMEs are perennial in nature and will always hold true, particularly at the start-up stage. But it must also be recognized that SMEs do not operate in splendid isolation, and are not divorced from a constantly changing global business environment. The factors that made “SME X” successful in country A may not pertain to “SME Y” in country B. Similarly, the conditions that made “SME A” successful in “199X” may not pertain to “SME B” in “200Y”. Some of the pro-SME policy formulas are fairly generic and constant, and some are more specific and ever-changing. Just as SMEs themselves have to keep up-to-date with changing business practices (and technologies) if they want to remain commercially successful, so too must policymakers and development agencies ensure that their pro-SME prescriptions are contemporary, if they want their strategies to remain relevant and useful.

For developing and transitional economies in particular, SME development holds the added allure of being a key component of wider economic development and poverty alleviation. The SME community is seen as a major and sustainable generator of employment and income (and therefore tax revenues) for citizens working outside of the State sector. In the case of transitional economies, although many State-owned enterprises can also be SMEs, SME development is broadly synonymous with private sector development. In developing countries, SMEs can also serve as a useful bridge between the informal economy of family enterprise and the formalized corporate sector. Some of a country’s more able SMEs may also be a source of foreign exchange earnings, if they are able to meet the quality and quantity standards required to export their products or services overseas.

There is also a tendency to believe that a vibrant SME sector helps promote competition and a culture of entrepreneurship, which are both conducive for economic growth. Further, SMEs are often seen as being nimble and agile, and more willing to innovate than their larger and more well-established peers, as they navigate the frontiers of business activity. Youth versus experience. David versus Goliath. This is particularly true of entrepreneur-driven SMEs, typically seeking to exploit business opportunities, as they can "… drive structural transformation [of an economy and corporate sector] through innovation, provision of intermediate inputs and services (which permits greater specialization in manufacturing), and by increasing employment and productivity …" (Gries and Naudé 2008a, 1). Thus, some of the more innovative and dynamic SMEs can serve as catalysts in transforming developing economies in various structural ways, including advances up the value chain. The economic transformation of Taiwan Province of China is often viewed in this context.

It is important, however, to recognize that as yet there is no hard empirical evidence to support the assertion that the presence of SMEs in an economy will automatically deliver economic growth, nor alleviate poverty or lessen income inequality.[1] SMEs are not a magic bullet for poverty alleviation, and they are not specifically pro-poor, contrary to popular belief. Rather, a more modest claim can be made, namely that the size of the SME sector in an economy does appear to be positively *associated* (if not quite correlated) with gross domestic product (GDP) per capita growth in many countries. Strong SME sectors do not necessarily drive economic growth, but they are "characteristic of fast-growing economies" (Gries and Naudé 2008a, 1). That said, there is clear recognition of the importance of SMEs in job creation—a key dimension of the development process, particularly in the lagging economies of Asia and the Pacific.

1.1.1. What exactly is an SME ?

Definitions of what constitutes an SME vary quite widely from country to country and even within single countries, depending on the business sector concerned.[2] Thus, there is no universal determinant or criteria of an SME. Much depends on the character of the relevant host country, and the profile of its own particular corporate sector, from which a relative measure of an SME is then typically made, sometimes on a rather arbitrary basis. Some countries just use the number of employees as the sole criteria for determining whether a business is an SME or not. Other countries use this same criterion, plus an additional criterion based on either the value of the firm's assets or the size of revenues, typically denominated in the local currency.[3] In cases where a currency value is cited (either for assets or revenues), any marked inflation can pose a problem for the SME definition over time. The criteria for SMEs are updated in some countries from time to time.

The form of ownership profile, type of legal entity, or general provenance of the company are typically deemed irrelevant when creating the definition. Thus, while an SME is typically thought of as a locally owned and privately held business, there is no reason why it may not be a State-owned or foreign-invested enterprise. Some countries will distinguish between a microenterprise and a small enterprise, while others—by not setting a floor for SME size—effectively include microenterprises within their SME umbrella definition (this is the case in Viet Nam). The above notwithstanding, most SME definitions pertain to businesses that are formal in nature and have been registered in some manner, and exclude small-scale, informal family enterprises.

[1] See Beck, Demirguc-Kunt and Levine (2005). As the number of SMEs rise, one should not expect the Gini coefficient to automatically go down.

[2] The Government of Malaysia provides a good example of this multisector breakdown of the SME definition. See its "Definitions for small and medium sized enterprises in Malaysia", September 2005.

[3] Cambodia is a notable exception, in that its definition uses United States dollars, not the riel, as the currency of measure.

Table 1 serves to give a sense of the diversity of SME definitions in the Asia-Pacific region alone; table 2 provides the European Union definition for comparison.

Table 1. Some differing definitions of SMEs in South-East Asia

Country	Definition
Cambodia	Firms that employ between 11 and 50 employees and have fixed assets of $50,000 to $250,000 are categorized as small. Firms with 51-200 employees and fixed assets of $250,000 to $500,000 are medium-sized. Source: SME Development Framework of 2005.
Indonesia	Fewer than 100 employees.[a]
Lao People's Democratic Republic	"Small enterprises are those having an annual average number of employees not exceeding 19 persons or total assets not exceeding two hundred and fifty million kip or an annual turnover not exceeding four hundred million kip". "Medium sized enterprises are those having an annual average number of employees not exceeding 99 persons or total assets not exceeding one billion two hundred million kip or an annual turnover not exceeding one 1 billion kip".
Malaysia	Depends on the business sector. Different criteria, based on the number of employees and annual sales turnover. For details, see www.smeinfo.com.my/pdf/sme_definitions_ENGLISH.pdf.
Philippines	Fewer than 200 employees, and less than P 40 million in assets.[a]
Thailand	Depends on the business sector. Different criteria, based on number of employees and fixed capital size. For details see http://cms.sme.go.th/cms/web/homeeng.
Viet Nam	SMEs are independent production and business establishments that are duly registered according to the current law provisions, each with registered capital not exceeding VND 10 billion or annual labour not exceeding 300 people.

Sources: Cambodia, *SME Development Framework of 2005* (Ministry of Industry, Mines and Energy).

Lao People's Democratic Republic, Decree 42/PM on the Promotion and Development of Small and Medium Sized Enterprises (Vientiane, 2004), art. 2.

Malaysia, *Definitions for Small and Medium Enterprises in Malaysia* (Secretariat to National SME Development Council and Bank Negara Malaysia, 2005), available at www.smeinfo.com.my/pdf/sme_definitions_ENGLISH.pdf.

Viet Nam, Decree on Support for Development of Small- and Medium-sized Enterprises (Hanoi, Ministry of Planning and Investment, 2001), chap. 1, art. 3

[a] As cited in the Small and Medium Enterprise Development Authority (Pakistan) website (www.smeda.org.pk/main.php?id=2).

Perhaps the one common denominator is that SMEs typically make up more than 90 per cent of all registered enterprises in any country. Thus, in terms of the number of incorporations at least—if not always in terms of aggregate asset size or cumulative productivity—SMEs tend to dominate the corporate community. Economies differ, however, in the extent to which they rely on SMEs to generate a greater or lesser proportion of total output.

Table 2. Just for comparison: the European Union definition of an SME

Enterprise category	Headcount	Turnover (in euros)	Balance sheet total (in euros)
Medium-sized	< 250	≤ 50 million	≤ 43 million
Small	< 50	≤ 10 million	≤ 10 million
Micro	< 10	≤ 2 million	≤ 2 million

Source: European Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, available at http://ec.europa.eu/enterprise/enterprise_policy/sme_definition/index_en.htm.

1.1.2. SMEs in Asia and the Pacific: a profile of the corporate landscape

As noted earlier, SMEs tend to dominate the corporate community in all countries, at least in terms of company registrations, if not always in terms of aggregate size. In less developed countries, for example Cambodia, the Lao People's Democratic Republic and Nepal, SMEs represent the vast bulk of the corporate sector. And even at the other end of the economic spectrum in Asia, in Japan for example, SMEs account for about 99 per cent of all firms, 70 per cent of total employment and 50 per cent of GDP output. SMEs play an important economic role in virtually all countries, albeit to varying degrees, and it is their relationship with other elements of the corporate community—including foreign-invested enterprises and large domestic corporations (whether State-owned or private)—that is often a critical determinant of their long-term success. Mutually beneficial linkages are typically established between these various elements of the corporate community.

This is not a static arrangement. Rather, it is a fluid set of relationships that mutate over time, as individual SMEs and other business organizations inevitably wax and wane. This is particularly true of SMEs that are driven by entrepreneurs, typically seeking to exploit an opportunity that they have perceived to exist. And it is the "innovative tension" that arises which drives an economy forward; hence the crucial importance of property rights (including intellectual property rights). In the context of developing and less developed economies, Gries and Naudé (2008a), in the context of an endogenous growth model they developed, depict the role played by entrepreneur-driven SMEs in advancing an economy thus:

> In essence the transformation from a low-income, traditional economy to a modern economy … involves significant changes to production methods, a process of change where … entrepreneurs provide essential roles: first, in creating new firms outside of the household, second by absorbing surplus labour from the traditional sector, third by providing innovative intermediate inputs to final-goods producing

> firms, fourth by permitting greater specialization in manufacturing, and fifth by raising productivity and employment in both the modern and traditional sectors. (Gries and Naudé 2008a, 25)

This is not to dismiss the crucial role played by foreign-invested enterprises, and large domestic firms too, in advancing a developing economy. But it does recognize the important role played by more innovative SMEs, and acknowledges that they are not passive spectators sitting on the sidelines of an economic development exercise from which they are largely divorced.

However, the ability of more innovative SMEs to perform this economic function is significantly determined by the business environment in which they are obliged to operate. Without conducive conditions—the right kind of business enabling environment—in which to develop and grow, SMEs are likely to remain: (a) bonsai-like in stature; and (b) much less dynamic in their actions. This explains in large part why attention is often placed on various global indices and indicators that attempt to measure and compare the business environments in different countries. The better indices have a genuine benefit in identifying issues and comparing them across countries, as a basic form of diagnostic analysis.

1.1.3. Enabling environments for SMEs in the Asia-Pacific region

Although not specific to the SME sector, the World Bank's annual Doing Business rankings comprise perhaps the most comprehensive survey of economies (181 in the latest iteration) and their differing business conditions. Briefly, the Doing Business exercise seeks to quantify and rate the ease of doing business in a country, based on 10 components, comprising: (a) starting a business; (b) dealing with construction permits; (c) employing workers; (d) registering property; (e) getting credit; (f) protecting investors; (g) paying taxes; (h) trading across borders; (i) enforcing contracts; and (j) closing a business. Although there is some debate as to the methodological approach used for this exercise, the findings are useful in indicative terms and in spotlighting where a country's main areas of strength and weakness lie, in terms of doing business. Table 3 shows the aggregate *Doing Business 2009* rankings for Asia-Pacific economies covered.

Table 3. *Doing Business 2009:* aggregate rankings for Asia-Pacific economies

Economy	Rank	Economy	Rank
Singapore	1	Brunei	88
New Zealand	2	Solomon Islands	89
Hong Kong, China	4	Palau	91
Australia	9	Viet Nam	92
Japan	12	Marshall Islands	93
Thailand	13	Papua New Guinea	95
Malaysia	20	Sri Lanka	102
Republic of Korea	23	Bangladesh	110
Azerbaijan	33	Nepal	121
Fiji	39	India	122
Mongolia	58	Bhutan	124
Vanuatu	60	Micronesia (Federated States of)	126
Taiwan Province of China	61	Indonesia	129
Samoa	64	Cambodia	135
Kyrgyzstan	68	Uzbekistan	138
Maldives	69	Philippines	140
Kazakhstan	70	Tajikistan	159
Pakistan	77	Afghanistan	162
Kiribati	79	Lao People's Democratic Republic	165
China	83	Timor-Leste	170

Source: World Bank, *Doing Business 2009* (Washington D.C., 2009).

A similar exercise of sorts is conducted by the Fraser Institute's Economic Freedom of the World Exercise, which has been running for over 20 years and now spans 141 economies. Essentially it is an index that seeks to measure economic freedom in an economy across five principal components, most of which are pertinent to SMEs and the business sector as a whole.[4] The latest report, published in 2008, analyses data for 2006, and ranks Asia-Pacific economies as shown in table 4.

[4] The five components 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.

Table 4. Economic freedom: rankings for Asia-Pacific economies

Economy	Rank	Economy	Rank
Hong Kong, China	1	India	77
Singapore	2	Fiji	83
New Zealand	3	Papua New Guinea	87
Australia	8	China	93
Taiwan Province of China	18	Indonesia	101
Japan	27	Sri Lanka	103
Republic of Korea	29	Pakistan	104
Kazakhstan	42	Bangladesh	108 (joint)
Mongolia	43	Viet Nam	108 (joint)
Thailand	56	Azerbaijan	118
Kyrgyzstan	60	Nepal	128
Malaysia	72	Myanmar	139
Philippines	73		

Source: James Gwartney and Robert Lawson, with the assistance of Joshua Hall, *Economic Freedom of the World: 2008 Annual Report* (Economic Freedom Network, 2008).

While not all of the elements within this particular index's five components are entirely pertinent to SME sector development, some very much are, including (but not limited to):

(a) the size of government in business (which relates to "crowding out" issues);

(b) property rights protection;

(c) legal enforcement of contracts;

(d) freedom to hold foreign currency;

(e) regulator trade barriers;

(f) taxes imposed on international trade;

(g) private sector credit;

(h) hiring and firing regulations;

(i) price controls;

(j) starting a business and licensing restrictions;

(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 one to: (a) undertake a diagnostic of where a specific economy is faring less well; (b) make cross-economy comparisons; and (c) monitor 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 "regulation of credit, labour and business". However, it scores worst on the "access to sound money" component, which then drags down its aggregate ranking.

Thirdly, there is the Global Competitiveness Index. Like the previous two indices, this index does not focus on SMEs per se, but measures a range of issues that are highly pertinent to SME development, namely "the set of institutions, policies and factors that determine the level of productivity of a country" (Sala-i-Martin and others 2008, 3). Briefly, as discussed in *The Global Competitiveness Report 2008-2009* (Sala-i-Martin and others 2008), the World Competitiveness Index tracks 12 pillars of economic competitiveness, which are grouped into three elements. The first element contains four pillars that are essential for a factor-driven economy, namely: institutions, infrastructure, macroeconomic stability, and health and primary education. The second element contains six pillars that are essential for an efficiency-driven economy, namely: higher education and training, goods market efficiency, labour market efficiency, financial market sophistication, technological readiness, and market size. And the final element contains two pillars that are essential for an innovation-driven economy, comprising: business sophistication and innovation.

Table 5 shows the rankings for the Asia-Pacific economies included in the Global Competitiveness Index.

Table 5. Global Competitiveness Index: rankings for Asia-Pacific economies

Economy	Rank	Economy	Rank
Singapore	5	Kazakhstan	66
Japan	9	Viet Nam	70
Hong Kong, China	11	Philippines	71
Republic of Korea	13	Sri Lanka	77
Taiwan Province of China	17	Mongolia	100
Australia	18	Pakistan	101
Malaysia	21	Cambodia	109
New Zealand	24	Bangladesh	111
China	30	Tajikistan	116
Thailand	34	Kyrgyzstan	122
Brunei	39	Nepal	126
India	50	Timor-Leste	129
Indonesia	55		

Source: Xavier Sala-i-Martin, Jennifer Blanke, Margareta Drzeniek Hanouz, Thierry Geiger, Irene Mia and Fiona Paua, "The Global Competitive Index: Prioritizing the Economic Policy Agenda", in Michael E. Porter and Klaus Schwab, eds., *Global Competitiveness Report 2008-2009* (World Economic Forum, Geneva, 2008), table 3, p. 10.

An interesting, and relatively recent, development has been the creation of subnational indices, such as the Provincial Competitiveness Index in Viet Nam, and an off-shoot of this in Cambodia.[5] Such an approach recognizes that most SMEs have relatively limited relationships with national agencies and the like, and that they interface rather with municipal or provincial bodies, and conduct their activities largely or entirely within that sphere. Thus, the Provincial Competitiveness Index seeks to measure and rank the business conditions—allowing for “initial conditions”, such as natural-resource endowments—for private sector development in each of the 64 provinces of Viet Nam. Such an exercise is highly pertinent to SME development, as it focuses on 10 principal factors that impact SMEs, comprising: (a) costs 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 be compliant with regulations; (e) informal charges imposed; (f) bias towards State-owned enterprises; (g) the proactivity of provincial authorities to assist firms; (h) the provision of private sector development services; (i) the availability of training for employees; and (j) the quality of legal institutions.

In the case of Cambodia, a provincial business environment scorecard was developed, spanning the country’s 10 most economically active provinces. Like the Provincial Competitiveness Index in Viet Nam, 10 sub-indices were developed for measuring the enabling environment in these provinces, but tailored to meet the slightly different conditions in Cambodia, including, among others: tax administration, crime prevention and dispute resolution.

1.2. Market entries, survival, prosperity and exits

Nobody talks about entrepreneurship as survival, but that’s exactly what it is and what nurtures creative thinking.

Anita Roddick, founder of The Body Shop[6]

Let us now turn to SME development, and policymaking in support of that development process, as it pertains to four stages in the SME life cycle: market entry, survival, possible prosperity, and ultimate exit. Some SMEs may encounter just one or two of these stages (such as entry and exit), while other SMEs may experience all four stages. Policymakers typically pay the most attention to market entry, and relatively less effort is expended on the latter stages, for understandable reasons. But this asymmetry in the focus of most SME development can be misguided in some cases. For example, too much emphasis on removing market-entry obstacles alone can, over time, result in diminishing returns for policymakers and development partners. Rather, there needs to be a balanced portfolio of interventions that can assist SMEs in overcoming obstacles throughout their development trajectory.

There are varying perspectives on the relationship and delineation between SMEs

5 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 (USAID). The Cambodia variant was also developed by The Asia Foundation, with support from the International Finance Corporation-Mekong Project Development Facility and the Australian Agency for International Development (AusAID).

6 www.anitaroddick.com.

and entrepreneurs, and thus between SME development and entrepreneurial development initiatives. Most start-up ventures tend to be small, and therefore much of the policy-related literature pertaining to entrepreneurship is also highly relevant to SMEs. That said, SME development and entrepreneurship support are not wholly synonymous. An SME can be entrepreneurial in its endeavours, but this is not universal. For example, an SME that has been established out of necessity or that is a long-established family business (common in countries where the legal protection of property and investor rights is weak) differs significantly from an individual or individuals pursuing a very specific perceived business opportunity.[7]

For entrepreneurialism to be vibrant in an economy, a willingness by individuals to take (calculated) business risks must also be present. If the social stigma associated with business failure is perceived to be too great, or the practical repercussions of business closure are too onerous (for example, if the difficulty or cost of closing a company is too great), then entrepreneurialism will not flourish easily. In addition, the right kinds of economic incentives need to be in place to prompt potential entrepreneurs to take a leap into the unknown. If the prospect of relatively substantial financial gain is a dim one, then the motivation to venture will no doubt be constrained. That in turn necessitates that the development of new products and services can be monetized (translated into a source of income) in some manner by new business ventures. But in developing countries, where incomes are often low, and thus consumer spending power is limited, and where intellectual property right protection is often inadequate, this can be a real problem.

The Global Entrepreneurship Monitor sees entrepreneurial endeavour evolving in different ways, depending on the economic stage of the host economy. First, for a less developed, factor-driven economy, the shift from agricultural sector dominance to greater industrial activity creates a dynamic described as follows in the *2008 Executive Report* of the Global Entrepreneurship Monitor:

> As extractive industry starts to develop, this triggers economic growth, prompting surplus population from agriculture to migrate toward extractive and emergent scale-intensive sectors, which are often located in specific regions. The resulting oversupply of labour feeds subsistence entrepreneurship in regional agglomerations, as surplus workers seek to create self-employment opportunities in order to make a living. (Bosma and others 2008, 8)

Secondly, for a developing, efficiency-driven economy, the development of the industrial sector creates new venture opportunities that can be harnessed by entrepreneurs, thus:

> As the industrial sector develops further, institutions start to emerge to support further industrialization and the build-up of scale in the pursuit of higher productivity through economies of scale. Typically, national economic policies in scale-intensive economies shape their emerging economic and financial institutions to favor large national businesses. As increasing economic productivity contributes to financial capital formation, niches may open in industrial supply chains that service these

[7] Entrepreneurial initiatives are sometimes said to go through at least four stages: (a) conception or identification; (b) gestation or evaluation; (c) infancy or explosion; and (d) adolescence or exploitation.

> national incumbents. This, combined with the opening up of independent supply of financial capital from the emerging banking sector, would expand opportunities for the development of small-scale and medium-sized manufacturing sectors. (Bosma and others 2008, 8)

And finally, in an industrialized, innovation-driven economy, a third pro-entrepreneur dynamic usually becomes apparent, thus:

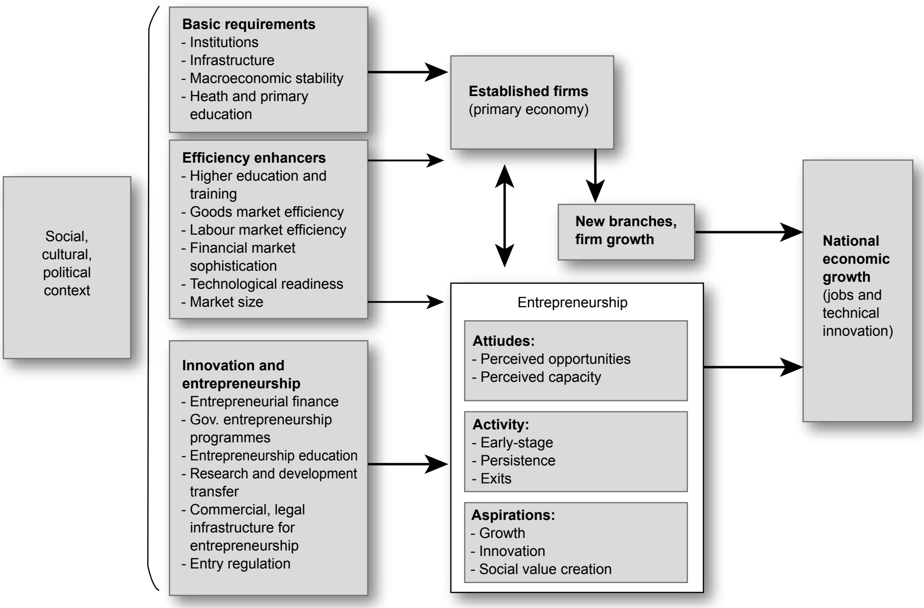
> The industrial sector evolves and experiences improvements in variety and sophistication. Such a development would be typically associated with increasing research and development and knowledge intensity, as knowledge-generating institutions in the economy gain momentum. This development opens the way for the development of innovative, opportunity-seeking entrepreneurial activity that is not afraid to challenge established incumbents in the economy. Often, small and innovative entrepreneurial firms enjoy an innovation productivity advantage over large incumbents, enabling them to operate as 'agents of creative destruction.' To the extent that the economic and financial institutions created during the scale-intensive phase of the economy are able to accommodate and support opportunity-seeking entrepreneurial activity, innovative entrepreneurial firms may emerge as significant drivers of economic growth and wealth creation. (Bosma and others 2008, 8)

Not surprisingly perhaps, views differ widely (Wennekers and Thurik 1999; Davidsson 2004; Godin and others 2008) on what are the key elements necessary to promote entrepreneurial endeavour in an economy. But clearly, the kind of "hothouse environment" necessary to seed, pollinate, nurture and harvest entrepreneurial initiatives is not easy to achieve, particularly in countries where government resources are limited. Even the advanced and affluent city-State of Singapore has had only mixed success in its relatively recent forays into developing a more vibrant and entrepreneurial business community, despite being able to apply quite considerable financial resources to this effort (see, for example, the website of SPRING Singapore at www.spring.gov.sg). Government funding initiatives in support of SME development (both debt and equity) in Singapore include the SPRING Startup Enterprise Development Scheme, Business Angels Scheme, Growth Financing Programme, Micro-Loan Programme, Local Enterprise Finance Scheme, Loan Insurance Scheme, Export Coverage Scheme (trade credit insurance), and the Internationalisation Finance Scheme.

Furthermore, Singapore is part of a relatively elite group of economies in the Asia-Pacific region with a strong industry of private sector fund management that can also pursue the venture capital/private equity support of the SME sector. One recent example is the S$30 million Sirius SME Growth Partners I fund, focused exclusively on SMEs located in the city-State. Launched in May 2008, with an initial closing of S$15 million, it aims to invest S$2 million-3 million in about 10-12 "growth and expansion-stage SMEs in various industries, who can be leaders in their respective fields" (see www.sirius.com.sg/Sirius_growth_fund.html). Exit is likely to be through trade sales or a listing on Singapore's secondary market for smaller enterprises.

This underlines the extent to which multiple economic, financial, industrial, social, cultural and other nuances are sometimes necessary, in addition to the basic regulatory structures and economic platform. The Global Entrepreneurship Monitor cites a cocktail of: (a) entrepreneurial attitudes; (b) entrepreneurial activity; and (c) entrepreneurial aspiration, which it then seeks to quantify through a series of analytical measures.[8] The consortium goes on to propose what it calls the Entrepreneurial Framework Conditions, which tend to differ, depending on the stage of the underlying economy, as discussed earlier (see figure 1).

Figure 1. The Global Entrepreneurship Monitor model of entrepreneurship and economic development



Source: Niels Bosma, Zoltan J. Acs, Erkko Autio, Alicia Coduras and Jonathan Levie, *Global Entrepreneurship Monitor 2008 Executive Report* (Global Entrepreneurship Research Consortium, 2009) available at www.gemconsortium.org/download/1240814294671/GEM_Global_08.pdf.

It needs to be underlined, however, that SME development and entrepreneurial development are not synonymous. Many (and probably most) SMEs are not entrepreneurial in nature. Rather, entrepreneurial business ventures often tend to be a subset of the SME sector, and are perhaps the most attractive to policymakers, given the prospect or potential they have for contributing most to economic growth and development.

1.2.1. Entry: what does it take to set up an SME?

The first critical stage in the development of an SME is that of market entry, or start-up. This entails all the steps and procedures to get a business up and running in compliance with the laws and regulations of the host country. There are typically two important factors in this regard: (a) the time is takes to start up a business; and (b) the cost

[8] Sadly, in the latest iteration of the Global Economic Monitor study, only two Asia-Pacific economies (Republic of Korea and Japan) were among the 43 countries taking part.

of doing so. Unreasonable waiting times and/or prohibitive costs can be major barriers for many potential new businesses, and can translate into a potentially major opportunity cost for the economy, in terms of, among other things, jobs foregone and income not generated. Within the Asia-Pacific region, Azerbaijan is recognized as one developing country that has made considerable improvements in its regulatory framework relating to start-up.[9]

But these are certainly not the only potential inhibitors to greater SME start-up rates. For example, if an entrepreneur is unable to gain access to the capital needed to finance the planned business venture, he or she may opt not to proceed. Another inhibitor can actually be found at the opposite end of the SME life cycle: closure. If the regulations pertaining to shutting down a business or bankruptcy are too onerous, then an entrepreneur may be unwilling to take the risk of establishing an SME, given the risks attendant with any new business, and the possibility of failure resulting in a gratuitously arduous process of legal closure.

While the obstacle posed by high costs of market entry can be easily understood, the obstacle posed by a time-consuming process is perhaps a little less apparent. For some business ventures, the timing of market entry can be an important determinant of success. If a business opportunity opens, but subsequently closes (for whatever reason) before all the regulatory hurdles associated with start-up are completed, then it is likely that fewer SMEs will be established. Returning to the Doing Business rankings again, table 6 shows the figures for Asia-Pacific economies covered by the survey, in terms of the ease of starting a business. This indicator is aimed at measuring the bureaucratic and regulatory hurdles that an entrepreneur must typically navigate through in order to incorporate a new firm that employs up to 50 staff and has start-up capital that is 10 times the per capita gross national income of the relevant country. There are some striking contrasts to be discerned, most noticeably in the number of days required to commence a business, which ranges from 1 to 116 days.

Table 6. *Doing Business 2009:* starting a business in the Asia-Pacific region

Economy	Number of procedures required	Number of days required	Cost (percentage per capita GNI)
Average for East Asia and the Pacific	8.6	44.2	32.3
Average for South Asia	7.4	32.5	31.9
Afghanistan	4	9	59.5
Australia	2	2	0.8
Azerbaijan	6	16	3.2
Bangladesh	7	73	25.7
Bhutan	8	46	8.5

9 See the starting-a-business case study on Azerbaijan produced by the Doing Business project: Svetlana Bagaudinova, Dahlia Khalifa and Givi Petriashvili, “Azerbaijan business registration agencies cooperate on a new one-stop-shop”, in Bruce Ross-Larson, ed., *Celebrating Reform* (Washington D.C., International Finance Corporation, World Bank and USAID, 2008).

Brunei	18	116	9.2
Cambodia	9	85	151.7
China	14	40	8.4
Fiji	8	46	25.2
Hong Kong, China	5	11	2.0
India	13	30	70.1
Indonesia	11	76	77.9
Japan	8	23	7.5
Kazakhstan	8	21	5.2
Kiribati	6	21	64.6
Kyrgyzstan	4	15	7.4
Lao People’s Democratic Republic	8	103	14.1
Malaysia	9	13	14.7
Maldives	5	9	11.5
Marshall Islands	5	17	17.3
Micronesia (Federated States of)	7	16	137.5
Mongolia	7	13	4.0
Nepal	7	31	60.2
New Zealand	1	1	0.4
Pakistan	11	24	12.6
Palau	8	28	4.6
Papua New Guinea	8	56	23.6
Philippines	15	52	29.8
Republic of Korea	10	17	16.9
Samoa	9	35	39.8
Singapore	4	4	0.7
Solomon Islands	7	57	53.6
Sri Lanka	4	38	7.1
Taiwan Province of China	8	42	4.1
Tajikistan	13	49	27.6
Thailand	8	33	4.9
Timor-Leste	10	83	6.6
Uzbekistan	7	15	10.3
Vanuatu	8	39	54.8
Viet Nam	11	50	16.8

Source: World Bank, *Doing Business 2009* (Washington D.C., 2009).
Abbreviation: GNI, gross national income.

It stands to reason that if it takes more than 100 working days to incorporate a new, small company in a country, then fewer entrepreneurs will take the plunge and embark on a business venture. A long delay in start-up also serves as a leading indicator that other, subsequent regulatory hassles associated with actually operating an SME (such as the granting of specific licences, tax appraisals or various site inspections) will also be onerous or problematic, thereby deterring entrepreneurs further.

Some observers have argued that the start-up phase for an SME usually lasts about 3.5 years (or 42 months). If an SME passes that landmark date, then it has graduated beyond the critical period when most young companies tend to fail, and therefore can be regarded as a potentially sustainable business. Interestingly, the Global Entrepreneurship Monitor project has discerned a U-shape relationship between a country's SME start-ups and its level of economic development (as measured by per capita income) (Bosma 2009). In relatively poor countries, the pace of SME start-ups can be quite impressive, but this pace then declines as the economy develops and more formal (salaried) employment opportunities evolve. Then, as the economy develops further, the pace of start-ups begins to increase again, as the domestic demand for services and goods rise, particularly for highly individualized items where economies of scale are of less relevance.

1.2.2. Survival: what does it take to advance beyond start-up?

> *.The transformation from a low-income, traditional economy to a modern economy . . . involves significant changes to production methods, a process of change where entrepreneurs provide essential roles: first, in creating new firms [i.e. SMEs] outside of the household, which offer new products; and second, in growing firms by making use of scale economies. Such larger firms tend to specialize, and the clustering of specialized firms can give rise to localization economies, further encouraging innovation and specialization.*

Wim Naudé (2008, 22).

Once an SME has successfully entered the market and commenced operations, a number of other factors will be critical in its subsequent performance, determining whether it can sustain its business model beyond the short term, and dictating whether it will be simply a survivor, or go on to prosper as a competitive entity. Those factors entail an interplay between the SME itself and its wider enabling environment. Key inputs include (but are not limited to) access to: (a) accurate and timely market information, and an ability to analyse that information in a meaningful way; (b) a range of appropriate financial resources; (c) high quality human capital; (d) technology; and (e) suitable premises. The more conducive the enabling environment; the more likely it is that SMEs will thrive.

In most cases, government agencies should not be in the business of providing these inputs directly to individual SMEs, as experience shows their ability to do so is mixed, and as such they can inadvertently undermine the development of more sustainable input providers. But policymakers do need to ensure that they are providing the kind of benign enabling environment that allows these inputs to be available, only stepping in directly when there is a clear inability of the private sector to provide such inputs, and for as briefly as necessary.

A good example is that of financing. In general, government agencies make bad bankers and private equity investors, as they lack the necessary expertise. But governments do need to ensure that SMEs have recourse to a spectrum of finance providers that offer a suitably diverse range of financial products and services. Bank loans tend to dominate this sphere, but high debt levels can sink an SME, and SMEs will be vulnerable if they rely too much on this kind of funding. If banks reduce their lending, or increase interest rates, then SMEs that rely too much on loans will suffer. It is therefore important that other pro-SME forms of financing are available, such as financial leasing, factoring, private equity and angel investing.

There is much that governments can do in this sphere, including: (a) ensuring that the regulatory framework pertaining to financing is supportive of SME-oriented funding, or at least does not constrain it; (b) catalyzing the creation and use of credit risk and scoring services that can radically reduce the perceived costs of lending to SMEs;[10] and (c) ensuring that agencies such as secured transaction registries are available, to lessen the risks associated with SME lending.

Indeed, improving access to finance is perhaps one of the most common interventions by policymakers and development partners in their efforts to support SME development. (For a profile of some of these, see Freeman 2005.) This is often because many respondents in diagnostic studies of SME development constraints perennially cite the common complaint that access to finance is inadequate. However, such responses need to be treated with some caution, as these comments can “often mask technical and managerial inadequacies” within SMEs (Gries and Naudé 2008a, 4). Rather, financing constraints play a more critical role later on, when operational SMEs are seeking to expand and develop, but lack access to sufficient long-term funding sources in particular.

Beyond debt financing, most commonly in the form of bank loans or a revolving overdraft facility, SMEs often struggle to identify alternative sources of funding, and particularly long-term funding. Ideally, private equity/venture capital is seen as an attractive proposition, as it often comes with value-added post-investment technical assistance and business strategy guidance attached to it. (Rarely do banks provide much in the way of technical assistance attached to a loan.) But most SMEs are typically too small to be eligible for this kind of equity financing (let alone an initial public offering); the transaction costs of conducting such an investment are quite high, which in turn makes investments of less than $5 million often hard to justify or engineer. Only highly prospective SMEs, with perceived potential for steep growth, are likely to make the grade. One hybrid form of financing that has been developed to try and fill this “equity finance-cum-technical assistance” gap in SME funding has been that of business angels and business angel networks. Here, high net-worth individuals, often retired after a successful career in a particular industry, take a personal equity stake in an SME and seek to mentor that business. This can be an attractive option for long-term funding support of SMEs. For more short-term funding needs, services like leasing and factoring also have very clear attractions as alternatives to “plain vanilla” debt financing.

[10] SME-oriented lending is typically seen as having high transaction costs, relative to the amounts lent. This deters banks from lending to SMEs, and conversely lending activities are focused on bigger corporate clients. One way of lessening the transaction costs of things like credit appraisal and customer due diligence is to have credit scoring bureaus.

The 2008 credit crunch: some initial considerations

The recent dramatic events in global banking and financial markets throughout 2007 and 2008 will doubtless add to the financial constraints of SMEs in many Asia-Pacific economies in 2009-2010, even if the true severity of the impact is hard to gauge. Bank credit is the most common type of formal finance relied on by SMEs, and there is little doubt that bank credit—of all kinds—is almost certainly going to be scarcer in the near term.

There is also likely to be a flight away from risk by financiers of all kinds, with regard to assets of all kinds, and SMEs will not be immune. While there is some debate as to whether SME-related financing is more risky per se, or just entails a different kind of risk, we can expect bankers to be more discerning in their lending behaviour towards smaller firms. As credit becomes rationed, those SMEs most in need of funding are likely to be hardest hit, as bankers gravitate towards firms with an established track record of being credit worthy.

Of course, some SMEs are actually financed from personal loans (and even mortgages) taken out by their owners. But these forms of credit too will probably be less freely available in the near term. The anticipated global recession will also likely make it more difficult for individuals to provide loans to relatives, colleagues and friends, further tightening credit for the SMEs that rely on such informal financing.

The relatively small proportion of SMEs able to attract equity capital will also find the going harder. Private equity and venture capital companies will themselves find it harder to raise funding for investment, and will not be able to leverage their acquisitions as much. With less equity capital available, deals will be scarcer, and the internal rates of return expectations of investors will be higher.

Although not specific to SME finance per se, the Milken Institute produces an annual survey of countries and their access to capital for business, entitled the Capital Access Index. The index is comprised of 56 different measures, grouped under seven categories: (a) macroeconomic environment; (b) institutional environment; (c) financial and banking institutions; (d) equity market development; (e) bond market development; (f) alternative sources of capital; and (g) international funding.[11] Not all of these groupings are wholly appropriate to SME financing, but a, b, c and f are highly relevant. At present, 122 economies are included in the Capital Access Index, and those located in the Asia-Pacific region are shown in table 7, along with their aggregate score and ranking for 2007.

[11] For details of the methodology used, see Appendix A of the report, which can be downloaded at: www.milkeninstitute.org/publications/publications.taf.

Table 7. Capital Access Index 2007: Asia-Pacific economies compared

Economy	Capital Access Index score (2007)	Country rank in 2007 (out of 122 countries)
Hong Kong, China	8.27	1
Singapore	7.88	4
Australia	7.61	8
Malaysia	7.14	13
Japan	7.07	15
New Zealand	7.00	18
Republic of Korea	6.87	19
Taiwan Province of China	6.57	25
Thailand	6.36	26
India	5.50	41
China	5.26	45
Philippines	4.50	62
Indonesia	4.40	64
Sri Lanka	4.11	70
Pakistan	4.06	72
Viet Nam	3.98	74
Papua New Guinea	3.77	79
Mongolia	3.36	90
Bangladesh	3.24	92
Cambodia	3.00	98
Lao People's Democratic Republic	2.11	119

Source: James R. Barth, Tong Li, Wenling Lu, Triphon Phumiwasana and Glenn Yago, *Capital Access Index 2007: Best Markets for Business Access to Capital,* (Santa Monica, Milken Institute, 2008).

But access to finance is by no means the only determinant of a conducive business enabling environment. Good governance and minimal red tape can also be an important determinant as the corollary, that is, burdensome bureaucracy and corruption, can be a major disincentive for entrepreneurial endeavour. This is not to suggest that an economy should seek to completely do away with necessary regulation and oversight, as this is still required to ensure that SMEs and other business ventures do not pursue activities that are detrimental to society, the environment, the wider economy, and so on. Ex ante approvals, as well as inspections and other forms of ex post regulatory oversight, are inevitable, at least in some fields of business that SMEs will pursue. But where such regulations and their implementation are gratuitous in nature and entail an unnecessary compliance cost or opportunity cost for SMEs, they will serve as an inhibitor of business.

This can sometimes stem from a desire by State agency officials to extract additional "rents" from businesses, including SMEs. Transparency International undertakes an annual Corruption Perceptions Index exercise that scores and ranks economies according to the perceived level of corruption. Regardless of whether one agrees or disagrees with the methodology used to generate such indices, the perceived level of corruption will be a factor in any decision made to pursue a business, even among start-up, domestic SMEs, as it raises the spectre of heightened costs and business risk. Table 8 includes those Asia-Pacific economies included in the 2008 iteration of the index.

Table 8. Corruption Perceptions Index: the rankings of Asia-Pacific economies compared

Economy	2008 ranking	Economy	2008 ranking
New Zealand	1	Maldives	115
Singapore	4	Nepal	121
Australia	9	Viet Nam	121
Hong Kong, China	12	Indonesia	126
Japan	18	Philippines	141
Taiwan Province of China	39	Kazakhstan	145
Republic of Korea	40	Timor-Leste	145
Bhutan	45	Bangladesh	147
Malaysia	47	Lao People's Democratic Republic	151
Samoa	62	Papua New Guinea	151
China	72	Tajikistan	151
Thailand	80	Azerbaijan	158
India	85	Cambodia	166
Sri Lanka	92	Kyrgyzstan	166
Kiribati	96	Turkmenistan	166
Mongolia	102	Uzbekistan	166
Solomon Islands	109	Myanmar	178
Vanuatu	109		

Source: Transparency International, *Transparency International 2008 Corruption Perceptions Index* (Berlin, Ernst & Young Global Limited, 2008), available at www.transparency.org/policy_research/surveys_indices/cpi/2008.

One area where bureaucracy can often be particularly burdensome, notably for manufacturing-related SMEs, is in the area of land acquisition/availability and construction. Firms that are unable to find and develop adequate premises may not be able to commence operations, or may remain constrained at a sub-optimal size that prevents them from developing economies of scale and renders them uncompetitive with their peers. Hence, there is a need for policymakers to ensure that adequate land is available for SMEs to establish viable operations, and that access to this land—and registering legitimate ownership rights—is not hindered by excessive red tape and/or corrupt practices. The same imperative pertains to the provision of construction permits and all the other approvals that an SME might require before erecting and inhabiting new premises. Industrial zones and incubators (addressed in more detail below), where some of the normal procedures can be circumvented, may provide part of the answer. However, it is hardly conducive to SME development, particularly in the broad field of manufacturing, when, as in some economies, it takes up to a year to complete the 25 or more regulatory steps necessary to commission a new building.

A similar issue pertains to the taxation of SMEs. A regulatory system that makes tax compliance unduly burdensome can create a major distraction and opportunity cost for the typically small number of managers and/or owners of an SME. Further, a tax regime that is overly complex or opaque in its administration and enforcement serves to make the risks of pursuing business far greater. Any sustainable business model requires some calculation of (after tax) profitability and internal rate of return, but that becomes hard to achieve if the tax liability of an SME is hard to forecast or unknown. Complex or inequitable tax regimes can also have a distortionary effect on the development of SMEs, as they are tempted to morph into forms that seem to offer a lower tax burden. But if the tax regime itself changes, as is often the case, then an SME can be rendered unviable because it was reliant on some prior tax ruling, and now finds itself with an unsustainable business model.

Simplicity, consistency and predictability tend to be the best watchwords for pro-business (and pro-SME) tax regimes and their enforcement. Recognizing that the tax regime, bureaucracy, licensing and other regulatory compliance elements for SMEs are often less than ideal, there is a common tendency for policymakers to offer incentives and other kinds of inducements, intended to offset these additional compliance costs and risks, rather like a palliative. On their part, SMEs that are surveyed will rarely say that they dislike tax or other incentive measures offered by the government, as they do offer some pragmatic value. But where the doling out of incentives makes the regulatory regime more complex, and therefore often harder to implement fairly and transparently, the consequences can actually backfire. SMEs and potential entrepreneurs see a regulatory regime that is even more laden with risk and uncertainty, and opt not to pursue business ventures for fear of encountering obstacles that are not readily apparent or that are hard to predict in terms of their impact.

A slightly more controversial issue is that relating to employment regulations, and the relative ease with which SMEs can hire, oversee and fire staff while remaining legally compliant. For example, there may be limits in the local labour code or law on the number of hours that employees may work per day or week. There may be a minimum number of weeks' salary that an employee is entitled to when laid off, or other regulatory requirements that must be fulfilled before an SME can make an employee redundant. As with regulations pertaining to the environment, there is a need to balance the interests of SMEs with that of the wider economy and society. If the regulatory regime is too onerous, then a country is in danger of regulating its business community, including SMEs, out of business. Yet a too passive regulatory regime towards business can see damage inflicted that is not conducive to sustainable development.

For SMEs in less developed countries, and small economies in particular (such as the island economies of the Pacific, or the landlocked economies of Bhutan, the Lao People's Democratic Republic and Nepal), another key determinant of long-term success—for SME development and sustained economic growth in general—is the ability to export products or services, which increasingly involve parts and components. Indeed, most firms will probably, sooner or later, aspire to serve international customers. And even SMEs that are wholly oriented towards a domestic market may need to import some items. In this context, the ability of firms to buy and sell relatively easily across national borders is another essential prerequisite for SME development, particularly in the context of the globalization of production, as will be discussed in section 2.

In general, SMEs typically cannot thrive in splendid isolation. Rather, they need to be part of a wider and vibrant corporate community, both domestically and internationally, into which they can be integrated and burgeon. It is the free flow of information, finance, human capital, skills, technology and other key inputs, between SMEs and other members of the wider economy and corporate community, that allows individual SMEs to find their competitive niches, and to be successful. This "traffic" of inputs can be facilitated and promoted through various platforms and vehicles, particularly in developing countries. One such vehicle is foreign direct investment, whereby more technically advanced overseas firms can assist local SMEs through backward linkages of various kinds. (This is explored in greater detail in the fourth section of this study.)

Another platform is business associations, which should allow members to pool and share information. Business associations may be centred on a particular location (such as a city or province), a particular industry or product, or a slightly more abstract shared goal or interest of some kind. Business incubators and clusters are another platform, often structured as public-private (or purely private) partnerships. The aim is to allow multiple SMEs to benefit from economies, synergies and other benefits derived from being located together. Indeed, there is a considerable research literature surrounding the issue of incubators and clusters for SME development, based on initiatives and experiences undertaken across the globe. As the term suggests, incubators are designed to help youthful enterprises make it through the first, critical stages of business development, as they seek to graduate to the level of a sustainable business.[12]

It should be borne in mind, however, that not all SMEs aspire to become larger enterprises. Many owners of SMEs wish to keep their business small in scale, for whatever reason. This may be because it is a family business, and the owner(s) wish to keep it that way. It may be because the SME supports a lifestyle that is deemed comfortable and adequate, so there is no need to aspire to anything more grand. Or it could be because an SME-owner worries about the so-called "tall poppy syndrome", whereby larger firms attract unwelcome attention of various kinds, so feels it is better to remain small. Or this may be because the business model itself is not easily expandable (sometimes referred to as scalable), for whatever reason, and will remain a small, niche player.

[12] However, not all SMEs are attracted to clusters or incubators, despite the apparent economies and value-added inputs that may be on offer. One reason may be that, in being located so close to other firms of a similar kind, SME owners worry that key employees will be more easily tempted away by rival companies, or that commercially sensitive information is more likely to leak out in the canteen or other shared space.

1.2.3. Exit: what can we learn from the demise of SMEs ?

“. . . most firms die young”.

R. Cressy (2006)

Turning now to SME exits, there are perhaps two scenarios we need to consider. The first is that an SME develops into a large enterprise, and therefore graduates beyond the SME sector. For all concerned, this is perhaps the most welcome outcome for an SME in most cases. The second is the actual demise and closure of an SME, for whatever reason. (As Headd (2003) notes, not all SME closures stem from business failure; some are the consequence of an orderly exit by the owner(s).)

The latter is undoubtedly a much less welcome outcome than the former, in most cases, but it should not be dismissed as a policy irrelevance. It is inevitable that not all SMEs will be successful ad infinitum. Some will have an early demise, while others may close after quite a considerable time. In general, at least half of all new companies close within two years of commencing operations. One study in the United States found that 40 per cent of manufacturing firms were defunct within five years of beginning operations. And there is clearly little utility in allocating resources that seek to artificially prolong the life of a terminally ill SME. Rather, the important issue for policymakers to ensure is that their passing does not become a constraint on new SMEs emerging, and hopefully some (hard) lessons learned are disseminated into the collective awareness of the local business community. A form of knowledge management process, if you will.

While countries are often quite zealous at recording and reporting new company start-ups, they tend to be much less focused on recording company closures. Thus, in some countries, the “births” of SMEs are diligently counted, but the “deaths” of most failed SMEs go completely unrecorded. This is the case in Viet Nam. In fact, few companies in Viet Nam actually go through the regulatory process of formally closing. Instead, many go into a state of suspended animation, which has the attraction of being able to revive the company at a later stage, should conditions change for the better. Also, the fact that it can take five years to formally close a bankrupt company serves as a deterrent against officially closing a company. But this then makes it difficult for business service providers, including banks and financiers, to have a clear picture of the SME community. This in turn adds to the risks for service providers of various kinds, which are passed on to SMEs as higher fees. For example, banks will charge a higher rate of interest on loans to SMEs, to mitigate the higher risks associated with such opacity. Equity financiers will expect a higher rate of return on their investment to mitigate the same higher perceived risk. Perhaps the most comprehensive and accurate picture of the SME community in a developing country is held by the tax authority, but this information is rarely in the public domain, or even shared among pertinent government agencies.

Returning once again to the Doing Business survey, problems encountered in undergoing company bankruptcy are measured and compared, in terms of: (a) the average time to complete the bankruptcy process; (b) the average cost of this process; and (c) the recovery rate (how many cents on the dollar claimants can expect to recover from an insolvent company). The results for economies in the Asia-Pacific region are shown in table 9.

Table 9. *Doing Business 2009:* closing a business in Asia and the Pacific

Economy	Time required (in years)	Cost (percentage of estate)	Recovery rate (cents on the dollar)
Average for East Asia and the Pacific	2.7	23.2	28.4
Average for South Asia	5.0	6.5	19.9
Afghanistan	-	-	0.0
Australia	1.0	8.0	78.8
Azerbaijan	2.7	8.0	30.1
Bangladesh	4.0	8.0	23.2
Bhutan	-	-	0.0
Brunei	2.5	4.0	47.2
Cambodia	-	-	0.0
China	1.7	22.0	35.3
Fiji	1.8	38.0	20.1
Hong Kong, China	1.1	9.0	79.8
India	10.0	9.0	10.4
Indonesia	5.5	18	13.7
Japan	0.6	4.0	92.5
Kazakhstan	3.3	18.0	25.3
Kiribati	-	-	0.0
Kyrgyzstan	4.0	15	14.2
Lao People's Democratic Republic	-	-	0.0
Malaysia	2.3	15.0	38.6
Maldives	6.7	4.0	18.2
Marshall Islands	2.0	38.0	17.9
Micronesia (Federated States of)	5.3	38	3.5
Mongolia	4.0	8.0	22.0
Nepal	5.0	9.0	24.5
New Zealand	1.3	4.0	76.2
Pakistan	2.8	4.0	39.2
Palau	1.0	23.0	38.2
Papua New Guinea	3.0	23.0	24.7
Philippines	5.7	38.0	4.4
Republic of Korea	1.5	4.0	80.5
Samoa	2.5	38.0	14.3

Singapore	0.8	1.0	91.3
Solomon Islands	1.0	38.0	23.6
Sri Lanka	1.7	5.0	43.4
Taiwan Province of China	1.9	4.0	80.9
Tajikistan	3.0	9.0	25.4
Thailand	2.7	36.0	42.4
Timor-Leste	-	-	0.0
Uzbekistan	4.0	10.0	18.7
Vanuatu	2.6	38	41.2
Viet Nam	5.0	15.0	18.0

Source: World Bank, *Doing Business 2009* (Washington D.C., World Bank, 2009).

Clearly, the relative ease with which a bankrupt SME can be wound up, and the amount that claimants (creditors, employees and tax agencies) can recover, have an impact on the perceived risk of SMEs. This in turn will influence the extent to which subsequent SMEs can access key inputs, most notably finance. In Singapore, for example, where a bankrupt SME can be wound up in less than a year, and claimants have a recovery rate of over 90 per cent on average, there is going to be a far greater likelihood that banks will lend to SMEs, compared with Cambodia or the Lao People's Democratic Republic, for example, where the bankruptcy process is virtually non-existent. In the latter countries, banks will be much more conservative in lending to SMEs, knowing that they will have little or no chance of recovering the loan amount should the borrower become bankrupt. Little wonder, therefore, that Singapore ranks far higher than Cambodia or the Lao People's Democratic Republic, for example, in the Milken Institute's Capital Access Index.

There is a relatively strong correlation between the ease of access a SME has to capital and the degree to which: (a) investors are protected; and (b) contracts can be enforced in a particular country. One often tends to think of investor protection within the wider context of corporate governance, and for larger, stock-market-listed companies in particular, where there is a need to ensure that the management of the company is working in the interests of what can be a very widespread shareholder base, including many minority shareholders. But it also applies to many SMEs also, even if their shareholder base is quite small indeed. The Doing Business survey assesses investor protection in terms of: (a) the transparency of transactions; (b) liability for self-dealing; and (c) the ability of shareholders to sue directors and officers for misconduct. This may not seem particularly relevant to most SMEs, but the manner with which a company conducts its activities and governs its internal practices, and the extent to which stakeholders have some legal recourse in cases of improper behaviour, are the sorts of issues that banks will focus on when appraising SME loan applicants.

The same broad dynamic pertains to contract enforcement, as a bank will be less willing and able to provide capital to an SME if it knows that a loan default will be difficult (costly, time-consuming or involving an uncertain outcome) to pursue by conventional legal means, notably in terms of taking possession of and liquidating any assets pledged as collateral. This is often made apparent in the selective regard banks have for collateral, only willing to take pledges on assets that can be easily sold.

1.3. Gender issues relating to SME development

Relatively little research has been conducted on gender issues in SME development within the Asia-Pacific region. One exception is a survey by Global Entrepreneurship Monitor on women and entrepreneurship, albeit on a global level. The most recent such survey, using 2007 data, but published in a 2008 report, spans 41 economies, including just six in Asia: China; Hong Kong, China; India; Japan; Kazakhstan; and Thailand. Based on earlier research, it is posited that "… investment in women's entrepreneurship is an important way for countries to exponentially increase the impact of new venture creation. Ignoring the proven potential of women's entrepreneurial activity means that countries put themselves at a disadvantage and thwart their opportunity to increase economic growth". (Allen and others 2008, 6)

In general, there tends to be a gender gap between male-owned SMEs and female-owned SMEs, although some countries seem to have attained a broad gender balance, including Japan and Thailand (Allen and others 2008, 7). Indeed, in Japan, 2007 saw more women than men starting up new businesses (table 10). That gender asymmetry pertains to both newly established firms and more mature SMEs. Efforts to rectify this asymmetry will, in most cases, need to be country-specific in nature, addressing specific socio-cultural and/or economic factors that are identified as constraining the development of more SMEs owned and managed by women. One example is the United Nations Industrial Development Organization (UNIDO) in Viet Nam, and its project regarding a women's entrepreneurship development programme in the food industry in Central Viet Nam, working in conjunction with the national Women's Union in three provinces:

> In many places in Viet Nam, men traditionally work in the fields and women process the agricultural products. As the economy was opened to the flow of goods from outside, the existence of this traditional occupation for women was put under threat. There are hundreds of women involved in the business of food processing in Danang but many had to give up in the face of severe competition from other products of higher quality. For many of them, a new hope arrived with UNIDO's project that provides skill development in business management, marketing and food processing technology.
>
> A rural resource centre at the Danang Women's Union Vocational Training Center has been established as a functional, active and viable centre where food-processing women entrepreneurs can come for information, training and advice. Entrepreneurial and technology training modules in Vietnamese and English suited to the local needs of women entrepreneurs in the Central Region are in use. Trainers have been trained from the Viet Nam Women's Union and other institutions. Women are organized in self-help groups in order to address specific constraints such as: marketing strategies and competitiveness; access to raw materials, machinery and equipment, technology, finance, training and advisory services. With additional funds from Belgium, the project has recently embarked on the introduction of a lease-purchase service for the self-help groups. The women entrepreneurs are already linked to Belgium's micro credit facility implemented by the Women's Union. (UNIDO 2003)

Another example would be the Micro-Enterprise Development Programme of the United Nations Development Programme (UNDP) in Nepal, which, although not focused exclusively on women entrepreneurs, has been markedly oriented towards women. Both the central Viet Nam and Nepal projects, and other projects focused on supporting women as entrepreneurs, stem in large part from the Beijing Declaration[13] of 1995, and tend to focus more on micro- and small enterprises, as part of poverty alleviation goals.

Table 10. Prevalence rates of entrepreneurial activity, by gender, across five Asian economies, 2007

(Percentage)

	Early stage entrepreneurial activity		Established business owners		Overall business owners	
	Male	**Female**	**Male**	**Female**	**Male**	**Female**
China	19.3	13.4	9.7	7.0	28.9	20.5
Hong Kong, China	14.3	5.8	7.5	3.8	21.8	9.6
India	9.5	7.5	8.7	2.2	18.2	9.7
Japan	3.5	5.2	8.7	8.6	12.2	13.8
Kazakhstan	11.2	7.6	6.8	4.8	18.0	12.4

Source: I. Elaine Allen, Amanda Elam, Nan Langowitz and Monica Dean, *Global Entrepreneurship Monitor 2007 Report on Women and Entrepreneurship* (Global Entrepreneurship Research Association, 2008), available at www.gemconsortium.org.

1.4. Cradle to grave: the role of policymakers and development partners in supporting the SME sector

Policymakers in developing countries and development partners tend to place special attention on SME sector development, for reasons discussed above. In recent years, such interventions have tended to shift away from direct (and often subsidized) support to individual SMEs, which can bring undesired market distorting risks, and more towards economy- and market-wide initiatives that are market-oriented in nature.

Pro-SME development interventions in developing countries tend to focus on those issues where SMEs have most problems of access, including (but not always limited to): (a) access to finance; (b) access to land; (c) access to business support services; (d) access to markets, especially overseas markets; (e) access to training and guidance; and (f) access to technology and infrastructure.[14]

The schema outlined in table 11 tries to profile some of the more common interventions used for pro-SME development, in line with best practice, although it is not exhaustive in scope. In practice, of course, there tends to be quite a lot of overlap between the various components in this SME development smorgasbord.

13 *Report of the Fourth World Conference on Women, Beijing, 4-15 September 1995* (United Nations publication, Sales. No. E.96.IV.13), chap. I, resolution 1, annex I.

14 For a cogent summary, see chapter 7 of the *Best Practice Guide for a Positive Business and Investment Climate* (OSCE 2006).

Table 11. Matrix of common SME development interventions

Group	Intervention
Training and information	Encouragement of a culture of entrepreneurship in schools, vocational colleges and institutes of higher education
	Train-the-trainers programmes of various kinds
	SME and business guidance publications of various kinds (on marketing and exporting to overseas markets, for example)
	Applied vocational training for employees of SMEs
	Information technology and distance-learning programmes for SME owners
	Training and guidance tailored for women entrepreneurs
Financial services	Micro-loans and SME-oriented loan/debt products
	Factoring
	Leasing
	Venture capital and private equity
	Angels and angel networks
	Secured transactions and registry
	Guarantee mechanisms of various kinds
	Credit scoring and ratings agencies
	Bankruptcy legislation
Support structures	Incubators (including virtual incubators)
	Clusters and technology centres of various kinds, including those linked to universities
	Business associations
	Infrastructure of various kinds and access to land
	Business-to-business (B2B) portals and e-business platforms
Policy advocacy for a conducive business enabling environment	Private sector and SME development in general, including investment promotion
	Government procurement
	Taxation issues (for example, simplified tax regime)
	Trade issues
	Permitted forms of doing business
	Other regulations in pertinent fields (for example, labour and land, zoning, dispute resolution and contract enforcement)

	Intellectual property rights and other private property rights
	Electronic commerce regulations
	Competition policy and legislation
	Reducing regulatory burdens of various kinds, so as to lessen compliance costs
	Corporate governance
	Corporate social responsibility and sustainable business
Capacity-building	For relevant state agencies (such as conducting regulatory impact assessments or speeding up customs procedures)
	For new and existing business associations, so that they become sustainable
	For providers of business development service (for example accountants, marketing firms, human resources, testing)
	For markets of various kinds
	Within SMEs themselves (such as in management or technical skills, and turning entrepreneurs into successful business people)

Such interventions are typically enacted on a country-by-country basis, coordinated between the relevant government agencies and multiple development partners. There are some examples of regional and subregional initiatives, such as the Mekong Private Sector Development Facility, and the SouthAsia Enterprise Development Facility. Both are multi-donor initiatives managed by the International Finance Corporation, but here too there is often a country-specific approach taken to individual initiatives that are pursued in areas such as the business enabling environment.

Hallberg (2000, 8) is probably right in asserting that:

> An SME development strategy is in reality . . . a "private sector development strategy", recognizing that the majority of firms are small, that they may face different constraints and opportunities than large firms, and that the types of institutions and instruments best suited to their needs may be underprovided in distorted and segmented markets. It points government action toward market-completing interventions and the elimination of policy biases by:
>
> - Addressing the market failures that create cost disadvantages for SMEs, restrict their access to markets, and inhibit the development of markets for a diverse range of financial and non-financial services appropriate for small firms;
> - Improving transactional efficiency in financial, product, and input markets relevant to SMEs, by facilitating access to information and developing mechanisms to manage risk;

- Reconsidering public policies and regulations that discriminate against small firms or produce fixed costs that create a competitive disadvantage for them; and
- Investing in public goods that open market access and build enterprise competitiveness—including infrastructure (information, communications, power, water, and transport) as well as education and technology development.

At perhaps its most “Austrian School”-lite, purist form, this approach almost entails keeping away from quasi-interventionist SME development initiatives per se, and instead focusing on trying to create—and then maintain—the key external enabling factors necessary for competitive SMEs to thrive. These are, most notably: (a) strong property rights protection and contract enforcement; (b) a stable macroeconomic and financial environment, with low inflation and currency convertibility; (c) a competition policy that allows everyone to pursue business opportunities; (d) socio-political stability; (e) regulatory and policy consistency, and an avoidance of “shocks”; (f) tax rates that are not too burdensome; (g) good governance and transparency, including low corruption levels; and (h) robust and competent State institutions for effective implementation and enforcement of all the above.

Of course, this is not a check-list for SME development only, but for a favourable business and investment climate for firms of all sizes and ownership profiles. One can work diligently to overcome a relatively small-scale (but therefore removable) obstacle that is perceived to be constraining SME development, but may have relatively little impact in the big scheme if more generic business environment issues, such as a malfunctioning tax regime (which is much harder to address), go unreformed. Diminishing returns can rapidly set in for pro-SME initiatives that incrementally shave off time or money costs for business start-up procedures, if bigger—and therefore often harder to surmount—obstacles persist.

Another fairly common approach taken by development partners is to support one or more State agencies mandated to coordinate SME-related development policies in a particular country. By building up the capacity of such bodies, it should be possible for the host country itself to lead efforts aimed at creating a more vibrant SME community. But evidence to support the attainment of this objective varies from country to country. One risk here is that the relevant State agencies end up becoming a burden on local SMEs, rather than a source of support. Rather than becoming effective exponents of SME sector development within the government, they burgeon into bodies focused on their own self-sustenance, and divert scarce resources away from the SMEs they are supposed to be helping. Given the choice, most successful SME owners in developing countries are merely looking for a safe and level playing field on which to conduct business, and are not particularly looking for special treatment. Nonetheless, many developing countries have opted to establish SME development agencies of one kind or another, and of varying degrees of effectiveness. However, international development partners should be discerning in their approach to such agencies.

The pursuit of clusters and incubators to support SME development tends to be a relatively large-scale exercise, and one that typically needs a fairly strong degree of private sector involvement to be meaningful and sustainable, and therefore attractive to SMEs. In Viet Nam, for example, the first two incubator projects enacted in Hanoi (agricultural processing and packaging) and Ho Chi Minh City (software), supported with European Commission funding, have experienced only qualified success. The concept of industry and product clusters has also been attempted in Viet Nam by a few development partners, including the Viet Nam Competitiveness Initiative funded by the United States Agency for International Development (USAID), but the gains derived seem to have been fairly limited, at best. In Mongolia, USAID attempted a cluster development initiative around meat, cashmere and tourism, also without much success. The apparent experience of Viet Nam and Mongolia contrasts with that of markedly more successful incubators and clusters in some other developing and transitional countries, notably in Eastern Europe. This issue will be revisited in more detail in the next section of this report.

In general, one finds policymakers and development partners active in most areas of SME development. The sphere is typically well covered by initiatives of various kinds, with varying degrees of success. As noted above, an area that is typically well supported is removing constraints to market entry, as: (a) this is an important prerequisite of SME development; (b) the interventions required can be relatively simple and attainable; and (c) the positive impact can be easily measured and assessed. The number of approvals required, agency office visits, official and unofficial costs, and days required to start a business (and be compliant with the law in commencing operations) can all be reduced in many developing countries. One-stop shops of various kinds have become a fairly common initiative in this field, even if they consist of multiple entrances, windows and even "back doors". Similarly, the establishment of business associations, commonly along business sector lines, is often pursued, although making such associations genuinely effective and economically sustainable in the long run is not always easy.

In short, such interventions often tend to be "low-hanging fruit" for policymakers and development partners. Conversely, some other, perhaps less readily tangible, factors relating to SME development attract less attention, partly because the positive impact arising is less immediate. But such "high-hanging fruit" may actually have a greater long-term economic development impact, if, for example, it allows local SMEs to establish greater linkages with the foreign investment enterprise community, or to export much better. As a consequence, such interventions can have a greater impact on, among other things, employment (and poverty alleviation), foreign exchange earnings and addressing socio-economic and gender imbalances of various kinds. In other words, supporting SMEs that they may graduate from survival to competitive (or sustainable) status. Having navigated through the market entry process, an SME may survive for quite some time, without really attaining a level where it can be deemed a success. This is where SME support is perhaps most necessary in many developing countries, but also harder to achieve (and measure). Sections 2 and 3 of this report focus largely on this aspect. Section 4 of the report includes some specific policy recommendations on alternative SME development initiatives that could reap dividends.