



TOWARDS INCLUSIVE AND SUSTAINABLE GROWTH IN THE ASEAN ECONOMIC COMMUNITY

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Research Objectives

This report aims to comprehensively assess the opportunities and challenges faced by Micro, Small and Medium Enterprises (MSMEs) in ASEAN – particularly those with inclusive and responsible business practices such as Social Enterprises (SEs) – with regards to access to finance, technical support, and an enabling environment for their sustainability and growth.

To this end, the study focuses on the MSME financing and technical support landscape in all 10 ASEAN Member States. It takes stock of the financing and technical support options currently available to MSMEs along the spectrum, ranging from traditional finance such as bank loans, to alternative finance such as crowdfunding and impact investing. An analysis is also conducted on the 'missing middle' phenomenon in MSME financing as well as responsible and inclusive financing in ASEAN.

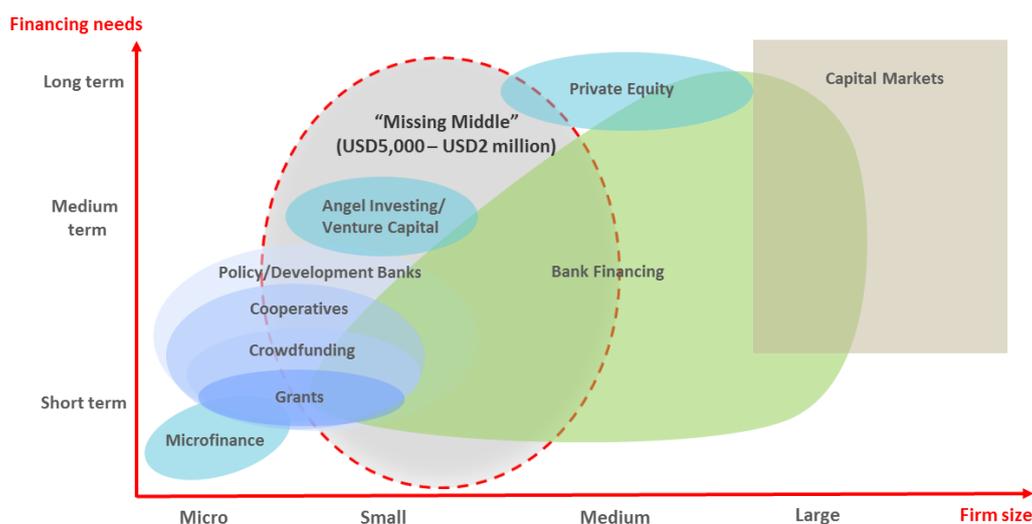
The study also proposes **key recommendations** to enable the growth of MSMEs, as well as a 160-page **Directory of SME Financing and Technical Support Options** which could serve as a valuable resource for MSMEs in the region.

MSMEs are the backbone of ASEAN economies, currently making up 88.8-99.9% of all enterprises in ASEAN and 51.7-97.2% of total employment¹. They also contribute about 30-53% of GDP and 19-31% of exports.² Thus, the successful establishment of the ASEAN Economic Community (AEC) as set out in the ASEAN 2025 Blueprint necessitates ensuring growth for all – especially the MSME sector. As ASEAN continues to surge ahead as the third largest market in the world, it is vital to ensure that MSMEs are not left behind and social responsibility and inclusivity remain at the core of ASEAN's development.

This report was the result of a 12-month study including primary and secondary research. Phase I started from Sept 2016 with comprehensive secondary research, followed by Phase II which consisted of in-person interviews and stakeholder consultations with investors, foundations, farmer groups, business associations, women entrepreneur networks, ASEAN bodies, incubators/accelerators, government agencies and others.

Key findings

- MSME development has been recognised as one of the key pillars of growth in all 10 AMS.
- MSMEs continue to face barriers in access to finance. There exists a **'missing middle' phenomenon**, where MSMEs in early- to growth-stage³ remain underserved by financiers. They typically exceed upper thresholds to qualify for smaller loans such as microfinance, and yet are perceived by financial institutions to be risky and costly customers.

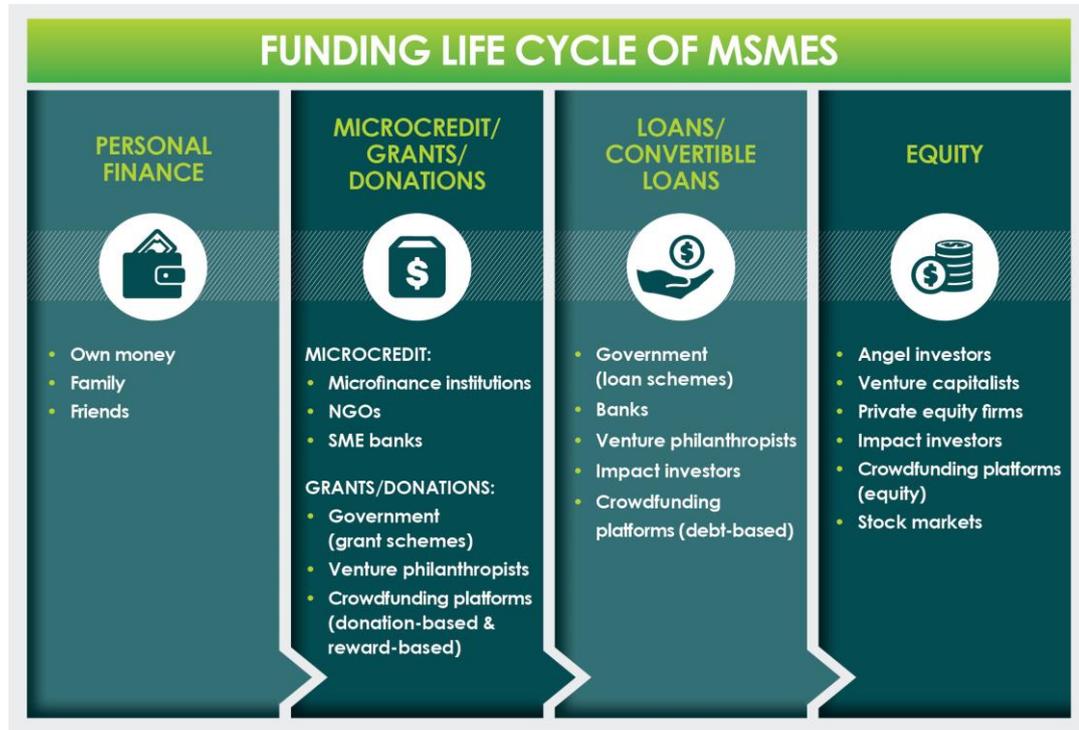


¹ ASEAN Strategic Action Plan for SME Development (2016-2025) <http://asean.org/storage/2015/12/SAP-SMED-Final.pdf>

² ASEAN Strategic Action Plan for SME Development 2016-2025

³ from as low as USD5,000 to up to USD2 million

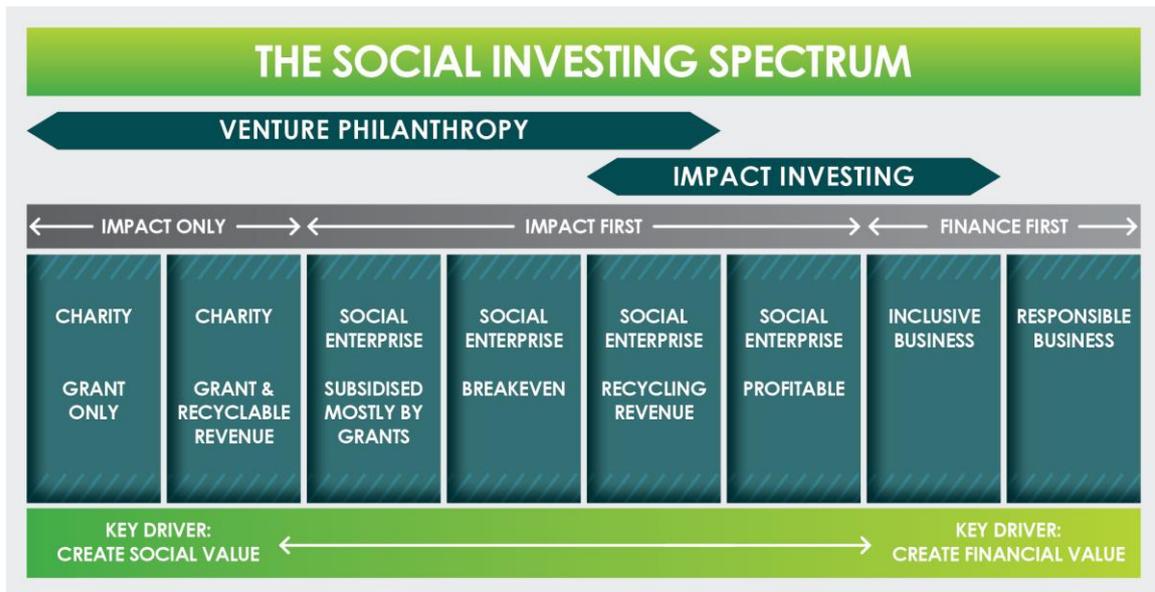
- The uptake of available financing options by MSMEs has generally been low. Their loan applications are typically rejected due to incomplete financial records, their small size, non-participation in production networks and lack of collateral, business track records and a sound business plan.
- Own savings, family and friends are still the most dominant sources of MSME financing, followed by bank loans⁴.



- **Women entrepreneurs** tend to face more formidable financial hurdles than their male counterparts. In general, women do not receive the same level of resources as men to tackle financial challenges. Challenges frequently cited by women when obtaining bank loans include complex loan paperwork, lack of collateral and proper documentation, low levels of financial literacy, high transaction costs, lack of a support network, and cumbersome land titling processes which affects their ability to use land as collateral. Further, several surveys point to women's low uptake of support services provided by the government such as trade fairs, regulatory training, and skills training.
- As there remains a strong dependence on bank loans among MSMEs in ASEAN, the need to explore and promote **alternative finance** for MSMEs has become increasingly imperative. Alternative sources of finance through angel investing, venture capital, private equity and financial technology (fin-tech) have started to gain traction, albeit to varying extents depending on the stage of economic and financial development.
- For social enterprises (SEs), **inclusive financing mechanisms** such as philanthropy, venture philanthropy and impact investment have also emerged as new financing avenues. However, while philanthropy has a long-standing history in ASEAN, venture philanthropy and impact investment are still in relatively nascent stages in the majority of AMS. There continues to be a lack of patient capital⁵ available for early-stage SEs, with a sizeable gap for ticket sizes of USD200,000 and below. Philanthropists and impact investors often cite the lack of hard business skills such as financial projection and operational management on the part of SEs in ASEAN as a significant hurdle in identifying potential investees.

⁴ Even in more economically-developed AMS such as Singapore and Malaysia, more than 50% of SMEs surveyed cited bank loans as one of their primary means of financing.

⁵ Patient capital is another name for long term capital. With patient capital, the investor is willing to make a financial investment in a business with no expectation of turning a quick profit. Instead, the investor is willing to forgo an immediate return in anticipation of more substantial returns down the road.



- While AMS have been active in formulating and implementing policies and programmes aimed at improving financial accessibility for SMEs, the breadth and depth of such policies and programmes appear to be a function of levels of economic development. For example, more mature ASEAN economies such as Singapore, Malaysia, Thailand, and Indonesia have taken steps to endorse and/or regulate alternative financing mechanisms beyond bank loans, but such initiatives remain generally lacking in the less developed countries.
- There has been a proliferation of incubators and accelerators in the region focusing primarily on the high technology sectors. However, incubators and accelerators dedicated to SEs are few and far between.
- While the banking sector continues to dominate the financing landscape in ASEAN, the notion of **responsible finance** has yet to permeate this critical financing mechanism. Except for sanctioning 'sinful' industries such as gambling and illegal practices, environmental, social and governance (ESG) criteria have not been factored into banks' lending decisions. As financial intermediation is the backbone of every modern economy, banking associations and regulators have an important role to play in harnessing the potential of responsible finance for sustainable development in ASEAN.
- While there has been a growing recognition of these practices at the regional level, **responsible and inclusive business conduct** (or 'Corporate Social Responsibility') continues to be peripheral to the core business in the majority of enterprises in ASEAN, with corporate philanthropy being the dominant activity.

Recommendations

1. Strengthen responsible and inclusive conduct

- **Actively promote responsible and inclusive business practices** to be at the core of every business, including MSMEs.
- **Larger corporations should take the lead in their respective industries to influence and support MSMEs in their supply chain.**
 - a) Larger corporations need to be more active in diffusing and strengthening responsible business practices along their respective supply chains.
 - b) Larger corporations should also build up the capacity of MSMEs by providing supply chain financing to and venture capital investment in high-potential companies.
 - c) Many SEs in ASEAN are also well-positioned to catalyse poverty eradication and should be integrated in the supply chains of larger corporations.
- **Design and implement value-chain financing⁶.** This has proven to be a potential financing mechanism for agricultural MSMEs, particularly smallholder farmers. Value chain finance fills the gap in rural finance where formal financial institutions are reluctant to enter, while providing an alternative to informal middlemen offering high interest rates. Equally important is the need to engage larger agribusinesses to integrate the poor and marginalised as suppliers, workers and clients in their respective value chains.
- **ASEAN should foster a conducive ecosystem which supports businesses in their transition towards responsible business practices:** A regional guideline – taking into consideration the drafted *Regional Strategy on CSR and Human Rights in ASEAN* – should be adopted and implemented in consultation with governments, businesses, Civil Society Organisations (CSOs) and other stakeholders. Such regional initiatives promote active multi-stakeholder dialogues as well as identify specific roles for the different stakeholders.

2. Deepen technical support for MSMEs to improve access to finance

This will enable MSMEs and SEs to gain better access to alternative finance, as well as responsible and inclusive financing options.

- **Reinforce efforts to equip MSMEs with hard business skills.** These should involve cross-sector collaboration between the public, private and civil society actors, providing support such as free/subsidised training courses and one-to-one consultations at MSME advisory centres.
- **Support entrepreneurial networks for peer support** such as the ASEAN Mentorship Entrepreneurs Network (AMEN) newly set-up by the ASEAN Business Advisory Council (ASEAN-BAC).

3. Promote alternative finance with an emphasis on inclusive financing options

- Ensure regulators' guidelines encourage and **allow experimentation of innovative financial products and services** within the existing regulatory framework. This can be the crucial first step towards designing enabling regulations for alternative finance to flourish. The advent of crowdfunding, for instance, as well as the rise of venture capital have opened up new possibilities of securing capital for MSMEs, which should be embraced.
- Harness potential of **fintech** for financial deepening, which will require greater collaboration between policymakers, industry associations and private sector experts⁷.
- **Recognise the need to promote inclusive financing options** as a sustainable mechanism to support SEs and advance social good across the region.

⁶ Value chain financing typically entails guaranteed purchase prices and the provision of technical assistance, agricultural inputs and credit by large agribusinesses to farmers, farmer organisations or farmer-led agribusinesses.

⁷ One such example is Singapore's fintech regulatory sandbox that aims to provide regulatory support to the country's burgeoning fintech landscape.

- **Launch state-funded social investment funds** to provide customised financial support and technical assistance for SEs.
- **Provide government support for incubators, accelerators, and ecosystem builders** to build up the capacity of SEs in ASEAN, thereby attracting social investors to the region.
- **Enact regulatory reform to foster social investment**, including improvements to the investment climate and removing barriers facing venture capitalists as well as SEs in receiving foreign capital.

4. Provide targeted support to improve women's access to finance

- **Develop targeted government programmes to enhance women's entrepreneurial capabilities.** Such programmes could include: (i) designing and delivering entrepreneurship development programmes in partnership with women entrepreneur associations and CSOs, (ii) creating national marketing programmes targeting women-owned and women-led MSMEs and (iii) creating and supporting formal networks dedicated to capacity building for women entrepreneurs.
- Direct investment, or encouraging private sector investment, into **venture capital funds that serve women entrepreneurs.**
- **Integrate women entrepreneurs into supply chains** to increase their likelihood of obtaining loans and microfinance.
- **Sensitise financial institutions** to the barriers faced by and financing needs of women entrepreneurs.

5. Promote responsible finance

- **Leading national banks in individual AMS to take the lead in adopting Environmental, Social and Governance (ESG) criteria** in their lending decisions, given their national presence and outreach.
- Governments should promote responsible finance by **sensitising banks to the fact that high performance in ESG criteria is indicative of a company's long-term success.**

Final phase of project

The next phase of the project will focus on disseminating the above recommendations among key stakeholders in ASEAN. This will include face-to-face meetings and technical consultations – both at a national and regional level – with stakeholders such as ASEAN bodies, national governments, businesses, business associations, chambers of commerce, stock exchanges and civil society organisations.

If you are keen to find out more about the report or take part in the consultations, please contact:

Melissa Chong

Programme Manager

ASEAN CSR Network

melissa@asean-csr-network.org