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Small and Medium-sized Enterprise Development

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Outline

- ❖ Definition of SMEs
- ❖ Is “finance” really the key problem for SME Development?
 - ❑ Impediments to SME development
 - ❑ Business development services
- ❖ Recognize that not all SMEs survive and grow
 - ❑ Facilitating easy entry/exit
- ❖ SMEs still need access to Finance!
 - ❑ Alternative sources
 - ❑ Challenges in access to finance
 - ❑ New financing techniques
- ❖ Changing the global SME scene
- ❖ Case studies

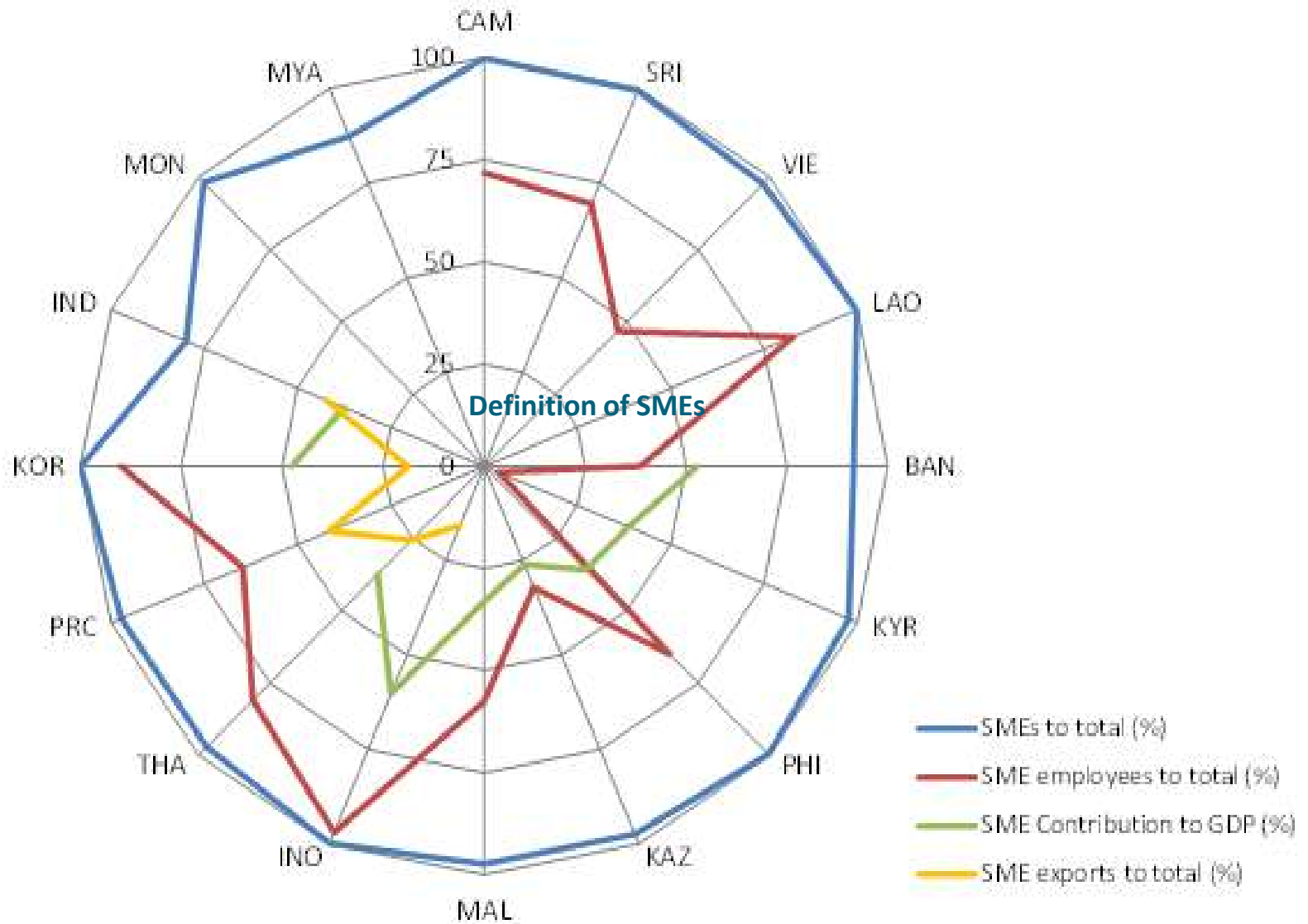
Definition of SMEs (1)

- ❖ No standardized definition of SMEs across country
- ❖ SMEs defined by law or policy guideline at the national level
- ❖ Four major criteria by law: (i) number of employees, (ii) asset, (iii) turnover, and (iv) capital
- ❖ SME policy design relies on national definition

Definition of SMEs (2)

Region	Country	SME Definition					
		Employee	Asset	Turnover	Capital	By Sector	Legal Basis
Central Asia	Kazakhstan	✓	✓				✓
	Kyrgyz Republic	✓		✓		✓	✓
	Tajikistan			✓			✓
East Asia	China, People's Rep. of	✓		✓		✓	✓
	Korea, Rep. of	✓		✓	✓	✓	✓
	Mongolia	✓		✓		✓	✓
South Asia	Bangladesh	✓	✓			✓	
	India				✓	✓	✓
	Sri Lanka		✓	✓			
Southeast Asia	Cambodia	✓	✓				
	Indonesia		✓	✓			✓
	Lao PDR	✓	✓	✓			✓
	Malaysia	✓		✓		✓	✓
	Myanmar	✓			✓	✓	✓
	Philippines	✓	✓				✓
	Thailand	✓	✓			✓	✓
	Viet Nam	✓			✓	✓	✓
Pacific	Fiji	✓	✓	✓			
	Papua New Guinea	✓					
	Solomon Islands	✓		✓			

SMEs' Economic Contributions



Is “finance” really the key problem for SME development?

- ❖ Financial sector’s willingness/capacity to lend
- ❖ SME’s ability to borrow
 - Business plan?
 - Accounts?
 - Paying tax?
 - Cash flow projection?
 - Collateral?

Impediments to SME Development

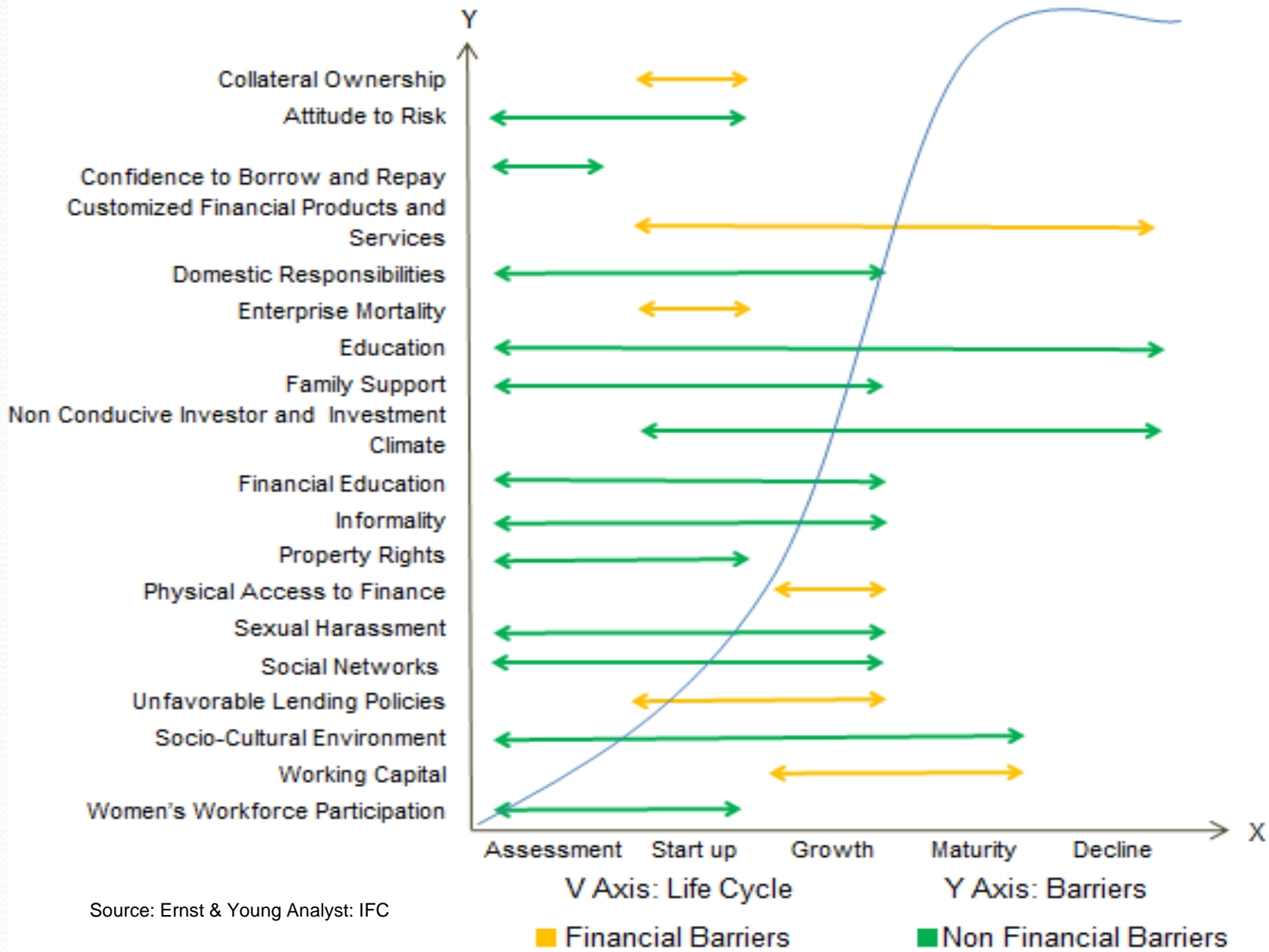
❖ Internal factors

- ❑ Lack of entrepreneurial experience
- ❑ Shortage of skilled labor
- ❑ Overall financial literacy
- ❑ Financial management, accounting and business management skills
- ❑ Lack of marketing skills

❖ External factors

- ❑ Lack of support for start-ups and early stage firms
- ❑ Lack of access to affordable business facilities
- ❑ Regulatory requirements and taxation
- ❑ Limited markets with limited customer base, especially in rural areas
- ❑ Access to finance

Constraints faced by Women-owned SMEs



Source: Ernst & Young Analyst: IFC

Business Development Services (BDS) (1)

❖ Factors of SME Needs in BDS:

- (i) **Demand-side:** geographical situation, consumer attitudes, purchasing power, politics and governance.
- (ii) **Supply-side:** skills, networks, access to resources, infrastructure, information availability, government regulations and policies

❖ Criteria for BDS services:

- (i) outreach,
- (ii) efficiency,
- (iii) effectiveness, and
- (iv) sustainability

Business Development Services (BDS) (2)

- ❖ **Clustering** (horizontal and vertical) and **networking** can facilitate access to knowledge sharing spillovers, achieve economies of scale and scope.
- ❖ **Business incubators/programs** can fill the gaps through rudimentary training, a space to launch the business, and sharing of business contacts.

BDS Instruments

1. Micro Level

- (i) Training
- (ii) Extension, consultancy and counselling
- (iii) Developing commercial entities
- (iv) Technology development and transfer
- (v) Information i.e., Trade fairs and exhibitions
- (vi) Business linkages i.e., subcontracting, franchising, business clusters and collaborative production networks

2. Meso Level

- (i) membership organizations
- (ii) service delivery organizations
- (iii) commercial organizations

3. Macro Level

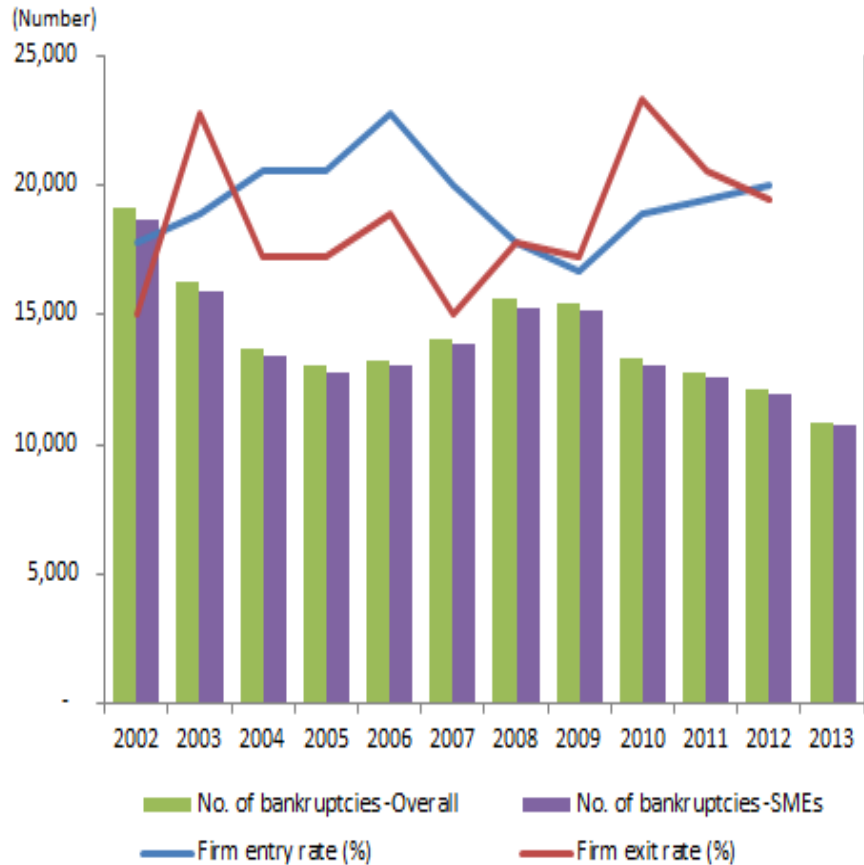
- (i) setting up national SME agencies
- (ii) supporting conferences, meetings and publications
- (iii) establish regulatory committees
- (iv) decentralize SME development policies
- (v) support for national and local dialogue
- (vi) improved procedures for SME access to public tenders, exports and bank credits.
- (vii) develop conducive environment for SME dev't
- (viii) strengthen advocacy capacity of trade associations

Recognize that not all SMEs survive and grow

- ❖ Fundamental nature of SMEs – Need to be the basis of policy formulation
- ❖ Entry/exit is in fact the strength of SMEs as a sector
- ❖ Regenerate business
- ❖ Facilitating bankruptcy
- ❖ Easing business start up

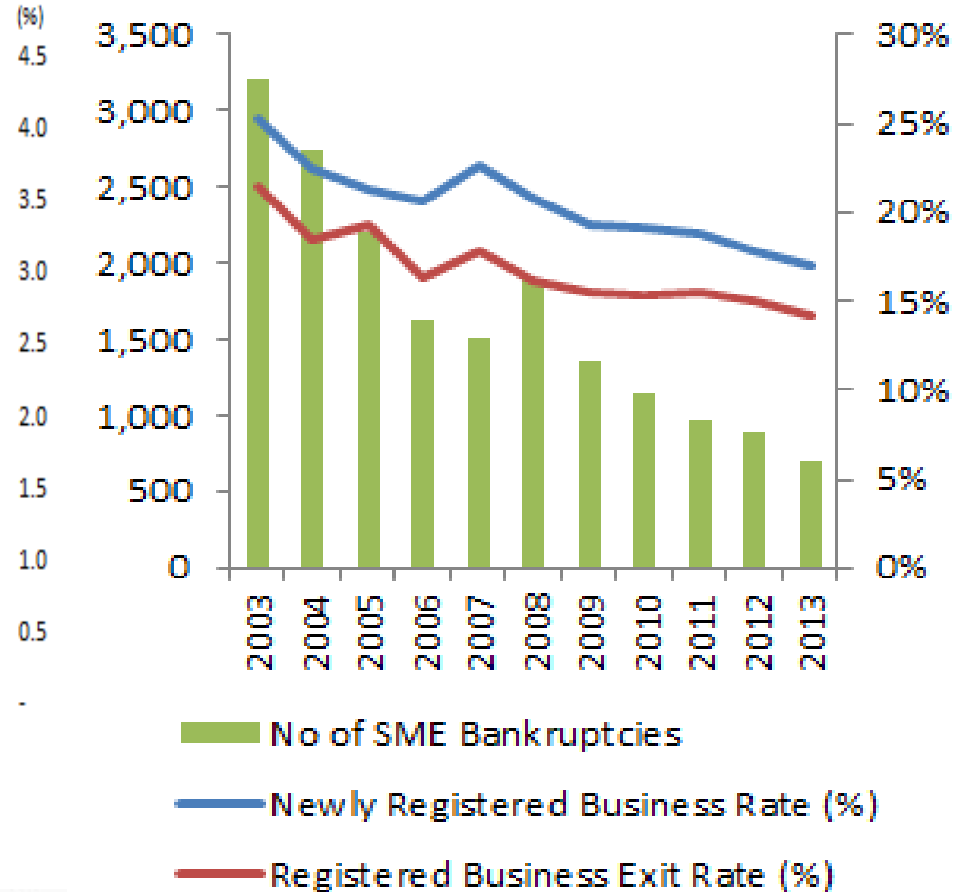
Entries and Exits

Japan



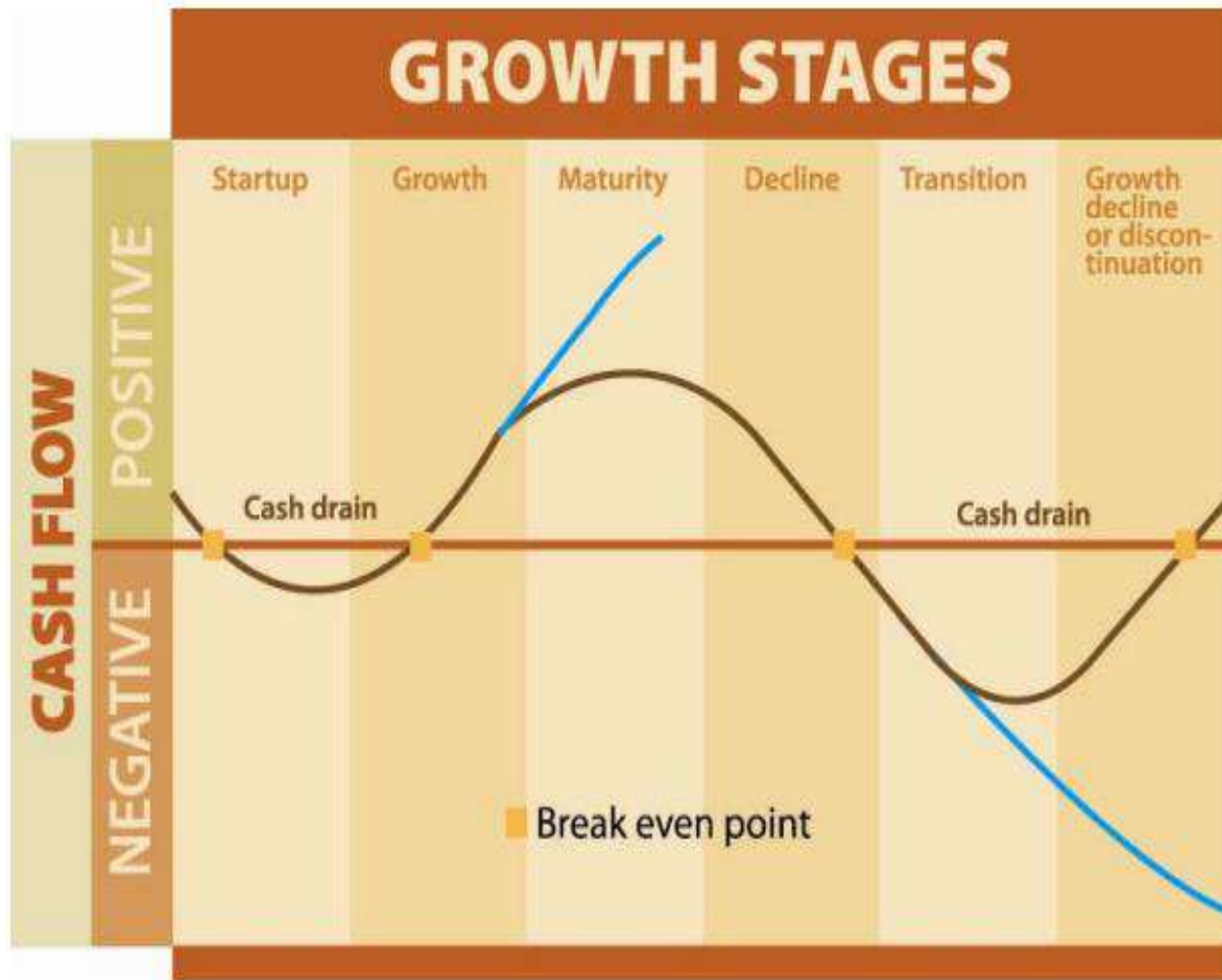
Source: 2015 White Paper on Small and Medium Enterprises in Japan, SME Agency.

Korea, Rep. of.



Data source: Small and Medium Business Administration and National Tax Statistics Korea

Business Life Cycle



Source: Abe et al., 2012.

Bankruptcy

Resolving Insolvency Indicators in Selected Countries

Country	Time required (in years)	Cost (percentage of estate)	Recovery rate (cents on the dollar)
PRC	1.7	22.0	36.0
Japan	0.6	3.5	92.9
Kazakhstan	1.5	15.0	43.3
Mongolia	4.0	15.0	17.8
Republic of Korea	1.5	3.5	83.1
Singapore	0.8	3.0	89.7
Tajikistan	1.7	9.0	36.9
Uzbekistan	2.0	10.0	39.9

Source: World Bank, Doing Business 2015 (Washington D.C., World Bank, 2015).

Facilitating Entry and Exit

Support for Entry

- ❖ One-stop shop for SME start-up, licensing, registration, etc.
- ❖ Access to inexpensive or communal business facilities
- ❖ Access to educational services to improve SME entrepreneurs' knowledge of basic business operational, marketing and financial needs
- ❖ Expansion of corporate structures available to SME start-ups (LLC, SP, partnerships, limited life partnerships, cooperatives, S-Corporations, etc.)
- ❖ Easing tax system compliance for SMEs
- ❖ Access to finance: (i) credit data infrastructure; (ii) legal framework for secured transactions; and (iii) sustainable credit guarantee systems

Support for Exit

- ❖ Enhancement to bankruptcy mechanisms to include ability for reorganization rather than simply liquidation
- ❖ Ease of post-liquidation tax implications for former SME owners if obligations are forgiven
- ❖ Legal confirmation and clarity over separation of personal liability of SME owners from direct SME obligations
- ❖ Debtor-in-possession (DIP) finance or exit finance

SMEs still need access to finance!

❖ Alternative Sources

- Public Sector
- Banking Sector
- Nonbank Sector
- Capital Market

SME Finance Policies

	Banking Sector						Public Sector	Nonbank Sector				Capital Markets			
	Refinancing facility to banks	Public credit guarantee scheme	Mandatory lending to MSMEs	Interest rate subsidy	Public credit bureau	Secured transaction law	Direct lending/soft loans	Refinancing facility to leasing firms	Refinancing facility to factoring firms	MFI development program	NBFI industry development (except MFIs)	Equity market development for SMEs	Bond market development for SMEs	Venture capital development for SMEs	Tax incentive for SME issuers and/or investors
Low-income economies	TAJ		✓		✓			✓							
	BAN	✓			✓			✓	✓		✓	✓			
	CAM									✓	✓ (pawn business)				
	MYA							✓							
Lower-middle-income economies	KYR	✓	✓		✓					✓					
	MON	✓	✓			✓	✓	✓							
	IND	✓	✓		✓	✓*		✓			✓ (TReDS)**	✓		✓	
	SRI	✓	✓	✓	✓			✓							
	INO		✓	✓	✓	✓				✓	✓				
	LAO									✓					
	PHI		✓	✓	✓	✓	✓	✓		✓		✓			
	VIE		✓		✓	✓		✓							
	PNG		✓		✓			✓		✓					
SOL	✓	✓					✓			✓	✓ (credit unions)				
Upper-middle-income economies	PRC	✓	✓		✓	✓				✓		✓	✓	✓	✓
	KAZ	✓	✓		✓				✓	✓					
	MAL	✓	✓		✓	✓*	✓	✓				✓		✓	
	THA		✓			✓*	✓ (draft)	✓				✓	✓	✓	
	FUJ	✓	✓	✓***	✓			✓			✓				✓
High-income economies	KOR	✓	✓	✓				✓				✓	✓		

* Funded by private and public sectors. ** TReDS in India: Trade Receivables Discounting System for facilitating trade receivable finance for MSMEs, proposed by the central bank. *** Mandatory creation of microfinance units in banks.

Source: ADB Asia SME Finance Monitor 2014.

Concerns on Subsidized Credit Schemes

- ❖ Harmful for banking sector expansion to the market
- ❖ Limited impact
- ❖ Difficulty in targeting resulting in inefficiency/leakage
- ❖ Increased risk for bloating national budgets

Impediments to Access to Finance

- ❖ Lack of appropriate financial infrastructure such as credit bureaus and credit registries
- ❖ Lack of appropriate financing for different stages of SME development

Banking

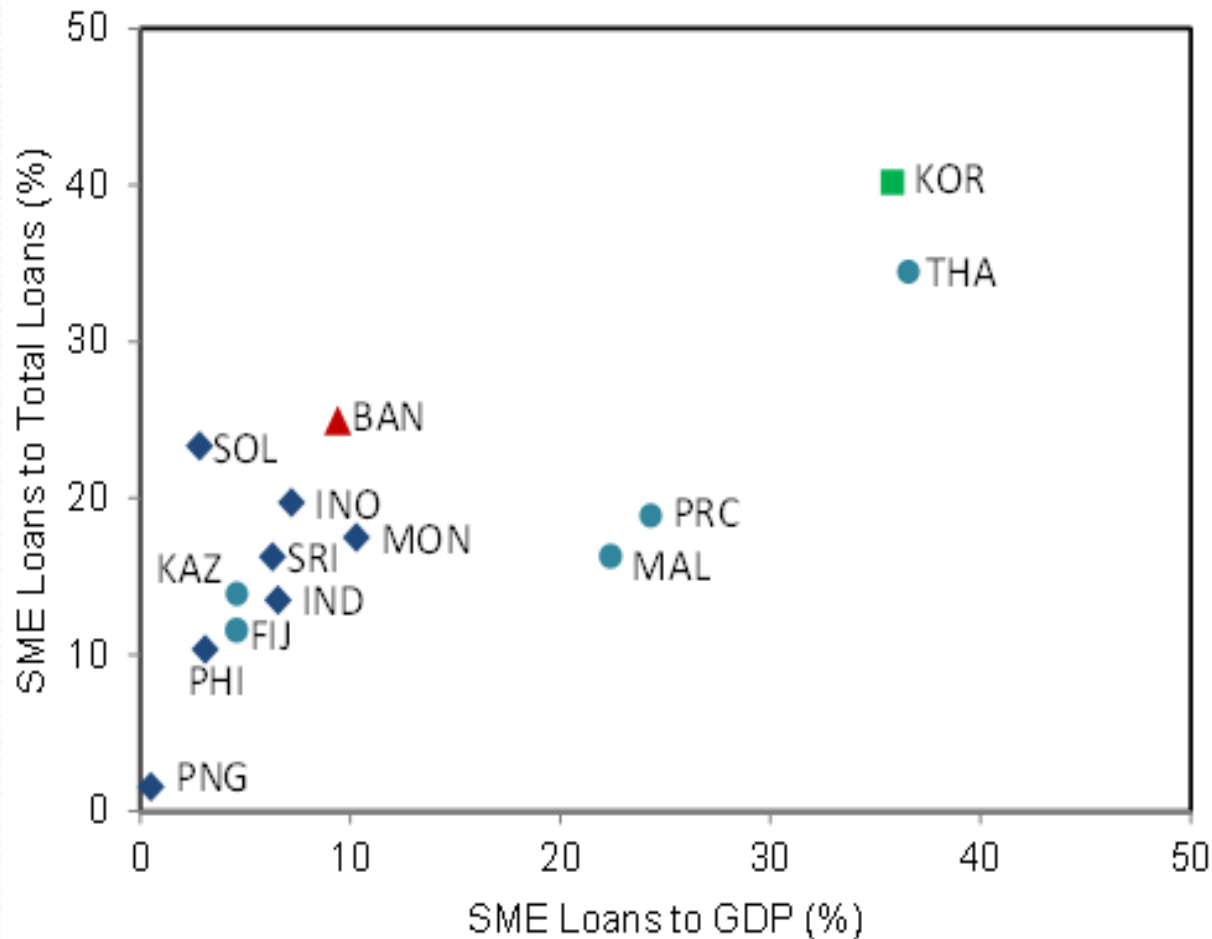
- ❖ Success/lack of success in loan applications
- ❖ Bureaucratic and burdensome application process
- ❖ Lack of collateral and scope of collateral
- ❖ High interest rates
- ❖ Mis-match of loan terms vs. financing needs
- ❖ Volatility of sales and thus income including seasonal changes

NBFI/Capital Markets

- ❖ Lack of corporate bond markets and small-cap equity access
- ❖ Underdeveloped NBFIs
- ❖ Lack of tailored financial products by financial institutions
- ❖ Push for use of non-local currency financing
- ❖ Lack of knowledge and understanding of available resources and products by NBFIs and capital markets

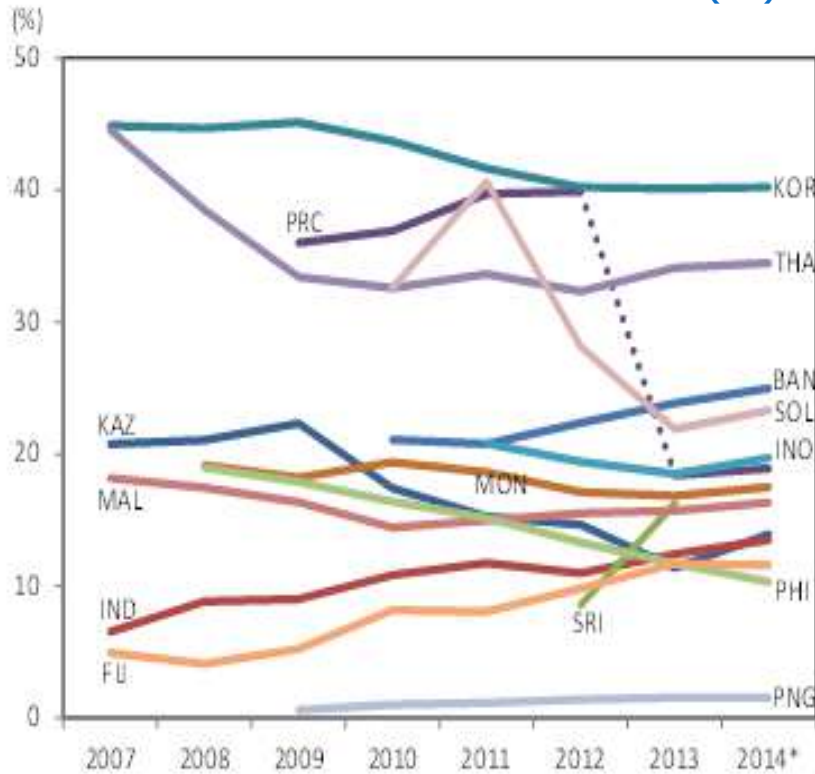
Access to Bank Credit

SME Loans, 2014

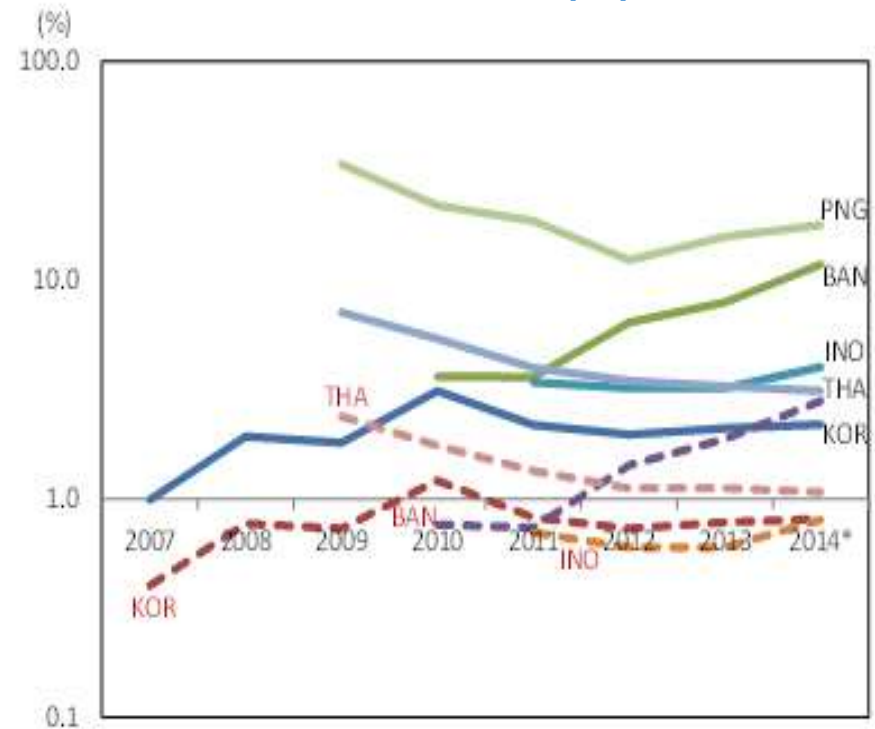


Access to Bank Credit

SME Bank Loans to Total Loans (%)



SME NPLs (%)



* March/2014 (IND), June/2014 (FIJ [Q2] and KOR), September/2014 (KAZ, PNG, PHI, and SOL), December/2014 (BAN, PRC, INO, MAL, MON, and THA).

Notes: For PRC, data based on SME loans outstanding until 2012; while after 2013, based on micro and small enterprise (MSE) loans outstanding. For PHI, data based on total funds set aside for MSMEs (mandatory lending; 10%).

Source: Asia SME Finance Monitor 2014.

— SME NPLs to SME loans, - - - SME NPLs to total loans.

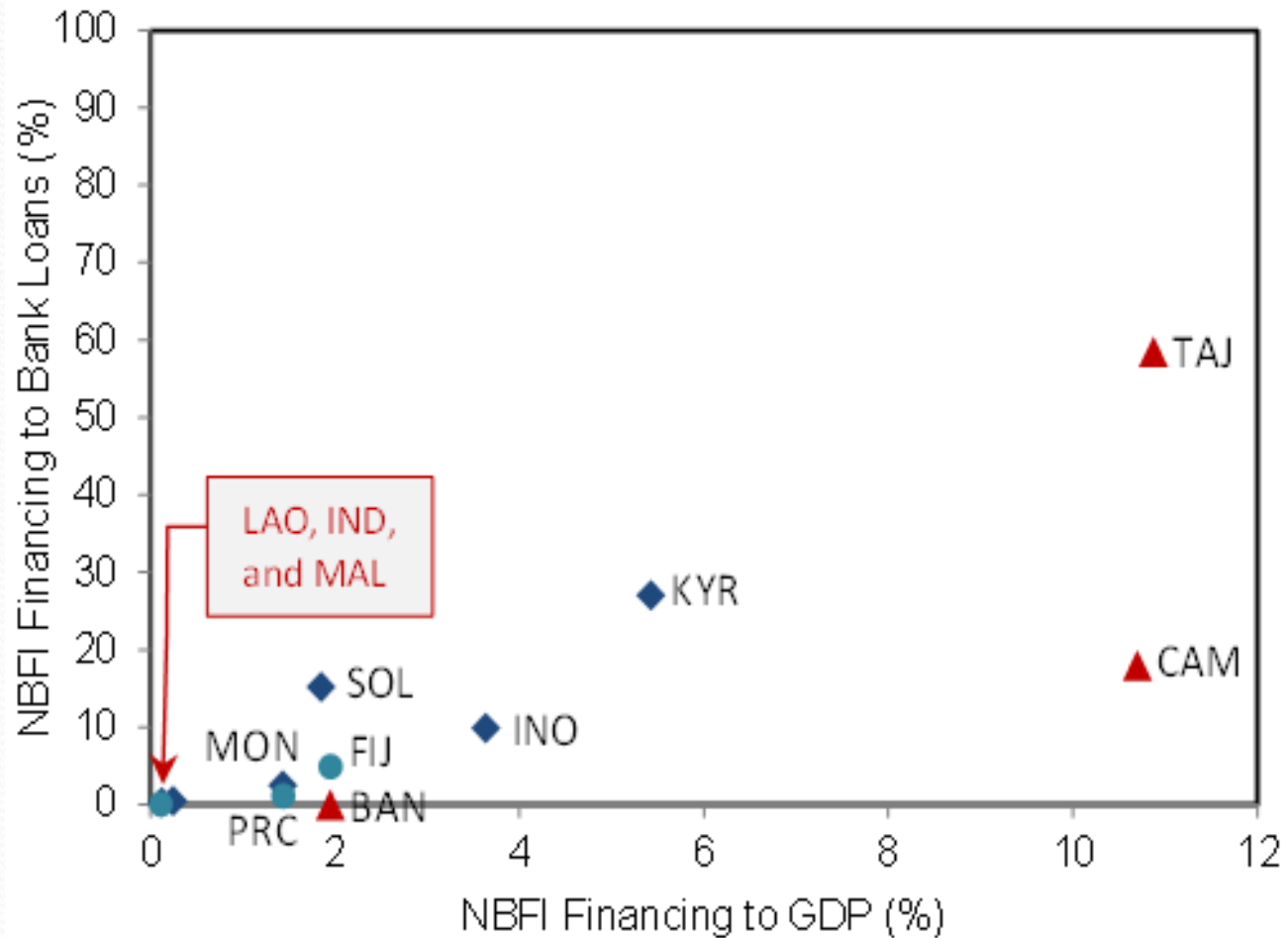
* June/2014 (KOR), September/2014 (PNG [Q3]), December/2014 (BAN, INO, and THA).

Notes: NPLs based on the national loan asset classification. For BAN, the ratio of borrowers with SME NPLs to total SME borrowers. For KOR, the ratio of SME classified loans to total SME loans.

Source: Asia SME Finance Monitor 2014.

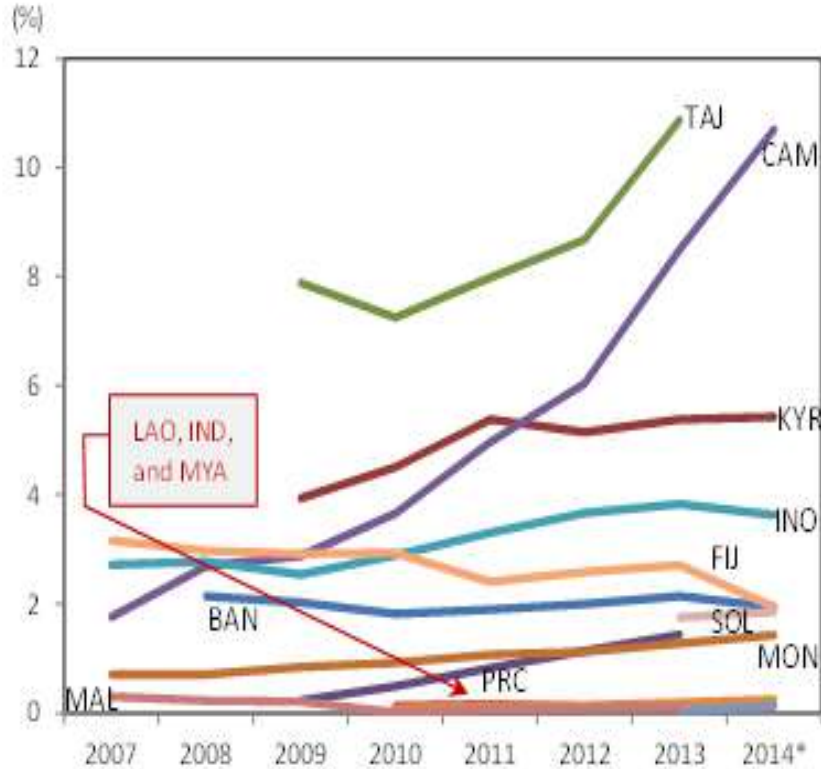
Access to NBFIs

NBFI Financing, 2014

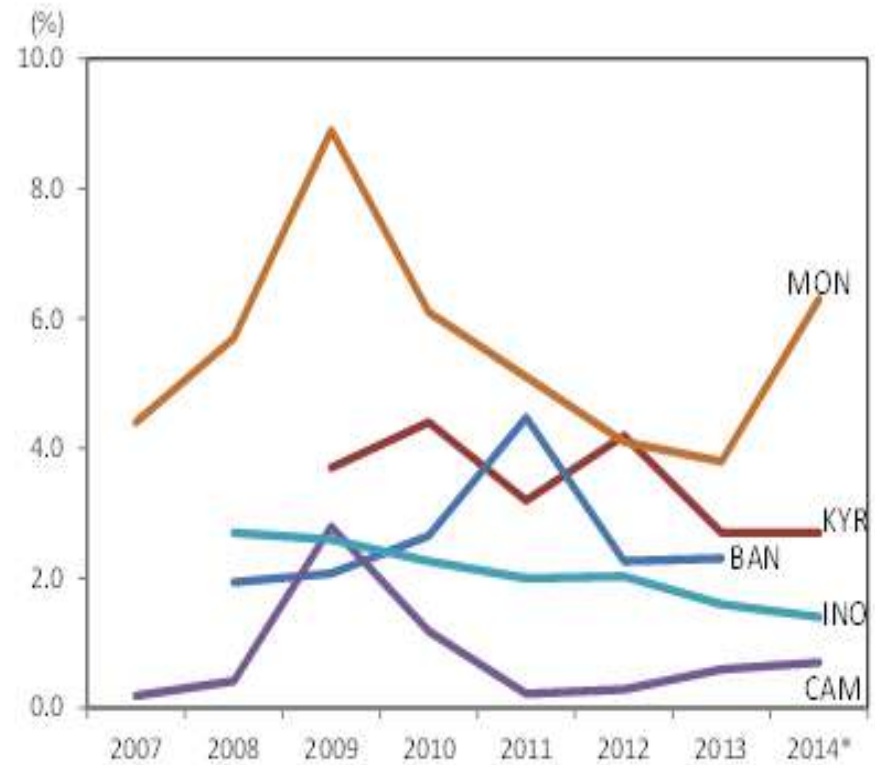


Access to NBFIs

NBFI Financing to GDP (%)



NBFI Nonperforming Financing (%)



* March/2014 (MYA), April/2014 (LAO), June/2014 (BAN and FIJ [Q2]), September/2014 (CAM and SOL), November 2014 (KYR), December/2014 (INO and MON).

Notes: Microfinance institution (MFI) loans disbursed (KYR, IND, and TAJ), MFI loans outstanding (BAN [NGO-MFIs], CAM, PRC, LAO, and MYA), NBFI financing (FIJ, INO, MAL, MON, and SOL).

Source: Asia SME Finance Monitor 2014.

*end of year data except for KYR (November 2014).

Notes: Ratio of nonperforming financing (NPF) to total financing by NBFIs including MFIs, based on the national loan asset classification.

Unrecovery ratio of loans (BAN). Based on doubtful plus bad debts (INO).

Source: Asia SME Finance Monitor 2014.

SME Capital Markets

SME Equity Markets in Selected Asian Countries

Name of Markets	Market Type		Established	No. of Listed/Registered Companies	Market Capitalization		Year of data	Exchange rate (end 2014)	
	Exchange	OTC			LCY (million)	US\$ (million)			
SME Board	SZSE		2004	732	CNY	5,105,800	834,417	2014	6.12
ChiNext	SZSE		2009	406	CNY	2,185,100	357,101	2014	6.12
KOSDAQ	KRX		1987	1,061	W	143,088,000	130,163	2014	1,099.30
KONEX	KRX		2013	71	W	1,425,000	1,296	2014	1,099.30
FreeBoard		KOFIA	2000	117	W	12,711,000	11,563	2014	1,099.30
SME Platform	BSE		2012	82	Rs	90,699	1,432	2014	63.33
EMERGE	NSE		2012	6	Rs	4,292	68	2014	63.33
ACE	Bursa Malaysia		2009	107	RM	9,665	2,765	2014	3.50
SME Board	PSE		2001	4	P	34,470	773	2014	44.62
mai	SET		1998	109	B	392,495	11,907	2014	32.96
UPCoM	HNX		2009	169	D	37,169,559	1,749	2014	21,246.00

BSE = Bombay Stock Exchange, HNX = Hanoi Stock Exchange, KOFIA = Korea Financial Investment Association, KONEX = Korea New Exchange, KOSDAQ = Korean Securities Dealers Automated Quotations, KRX = Korea Exchange, LCY = local currency, mai = Market for Alternative Investment, NSE = National Stock Exchange, OTC = over the counter, PSE = Philippine Stock Exchange, SET = Stock Exchange of Thailand, SME = small and medium-sized enterprise, SZSE = Shenzhen Stock Exchange.

Source: Asia SME Finance Monitor 2014.

Financing Techniques for SMEs

Low Risk/ Return	Low Risk /Return	Medium Risk/ Return	High Risk/ Return
Asset-Based Finance	Alternative Debt	Hybrid Instruments	Equity Investments
<ul style="list-style-type: none"> ❖ Asset-based lending ❖ Factoring ❖ Purchase order finance ❖ Warehouse receipts ❖ Leasing 	<ul style="list-style-type: none"> ❖ Corporate bonds ❖ Securitized debt ❖ Covered bonds 	<ul style="list-style-type: none"> ❖ Subordinated loans/ bonds ❖ Silent participations ❖ Participating loans ❖ Profit participation rights ❖ Convertible bonds ❖ Bonds with warrants ❖ Mezzanine finance 	<ul style="list-style-type: none"> ❖ Private equity ❖ Venture capital ❖ Business angels ❖ Specialized platforms for public listing of SMEs ❖ Equity derivatives

Source: ADB-OECD Study on Enhancing Financial Accessibility for SMEs (2014).

SMEs may also wish to consider **Crowdfunding** or **Cooperative Financing** as alternatives

Changing the Global SME Scene

- ❖ **Information and communication technology** and utilization of **e-commerce** expanded outreach and access to information
- ❖ Development of global **logistics industries** is changing the division of labor at the global scale
- ❖ The pattern of international division of labor, or the **global value chain** is changing rapidly

Global Value Chains and SMEs

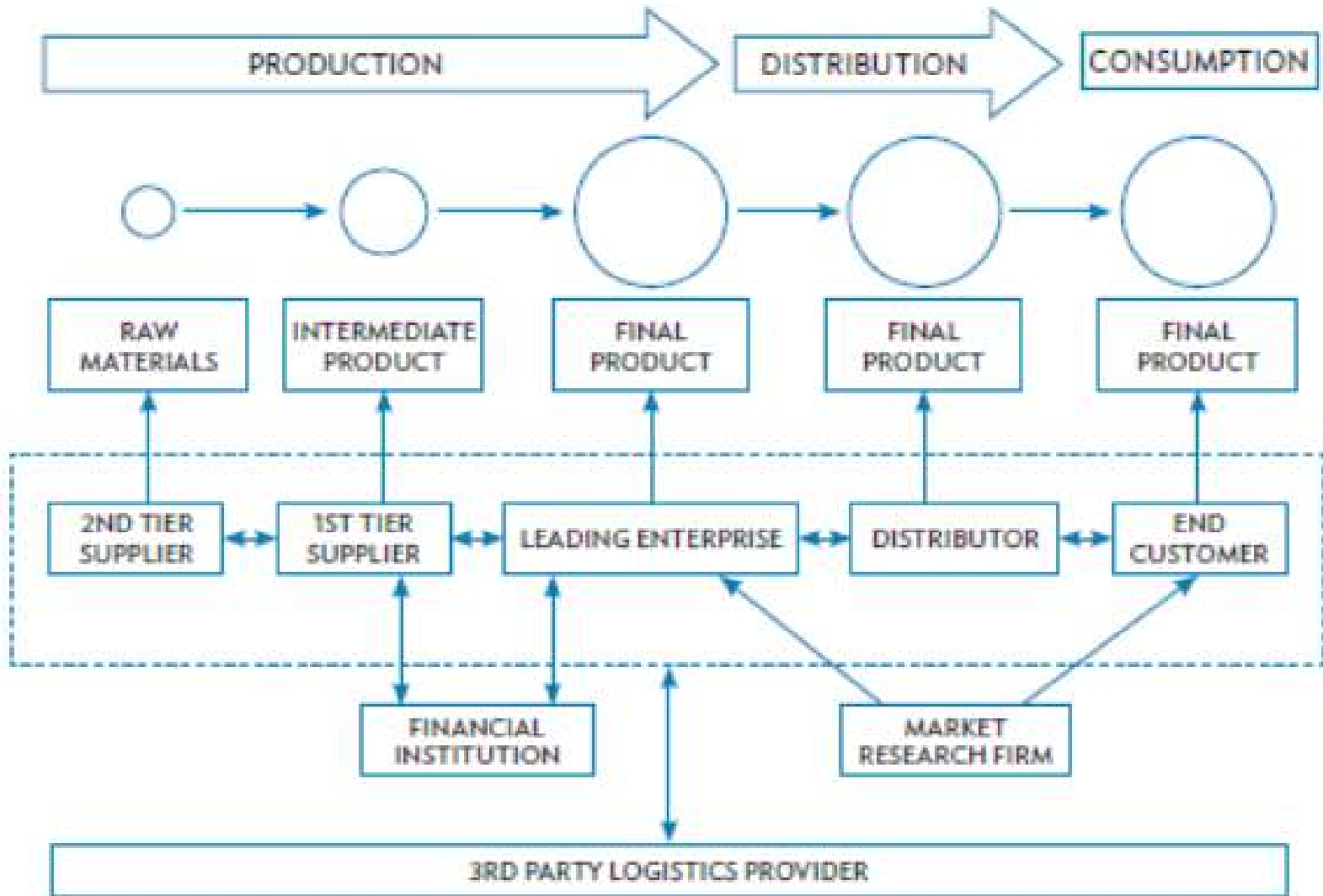
❖ Global value chain (GVC)

- ❑ Value chain: full range of value-adding activities to bring a product or service through different stages of production. GVC: a value chain that operates in more than one economy. (APEC 2014)
- ❑ GVCs have evolved and spread in many business sectors, e.g., agribusiness, automotive, electronics, and handicraft.

❖ SMEs in GVCs

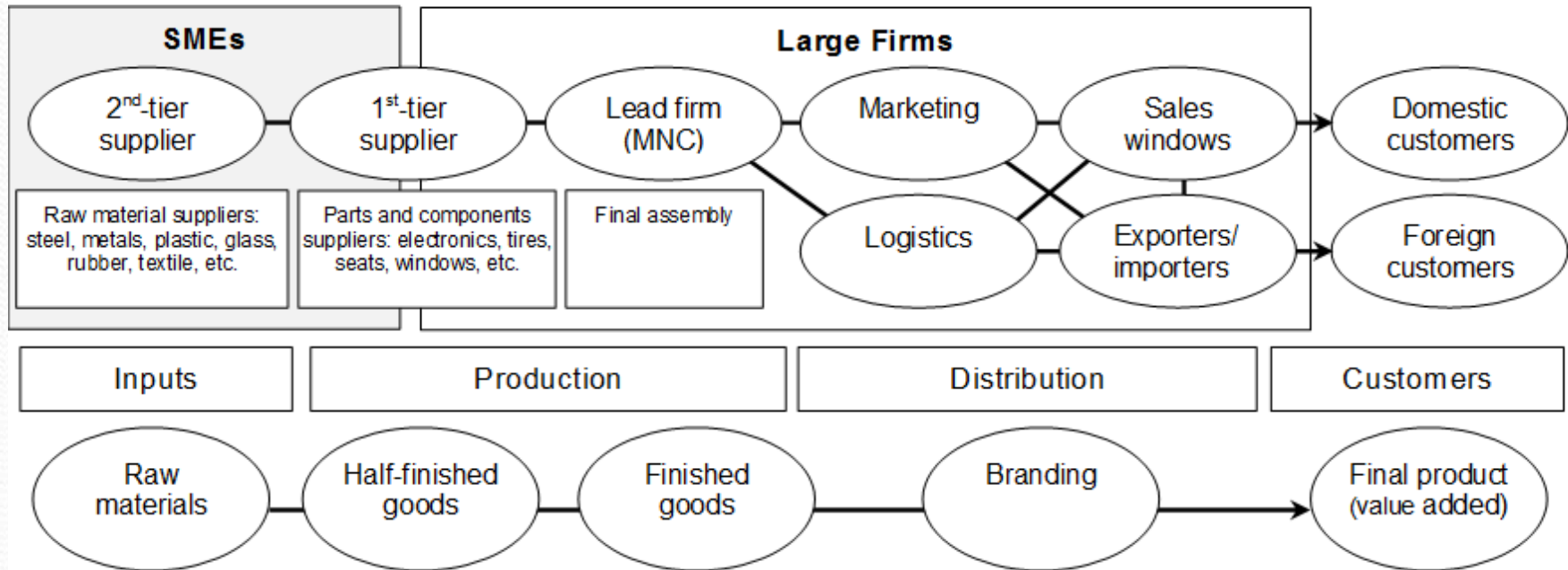
- ❑ Material suppliers, parts and components suppliers, export-oriented manufacturers, subcontractors with multinational large firms, distributors, service sectors entering overseas markets, etc.
- ❑ Benefits: increased competitiveness, product quality enhanced by technology transfer, business expansion, and job creation.
- ❑ Barriers: labor market rigidity & regulations across the country; non-tariff barriers; poor infra for trade; SMEs' inability to meet quality, standards, specifications for products; managerial constraints; and insufficient financial resources.

Flow of Global Value Chains

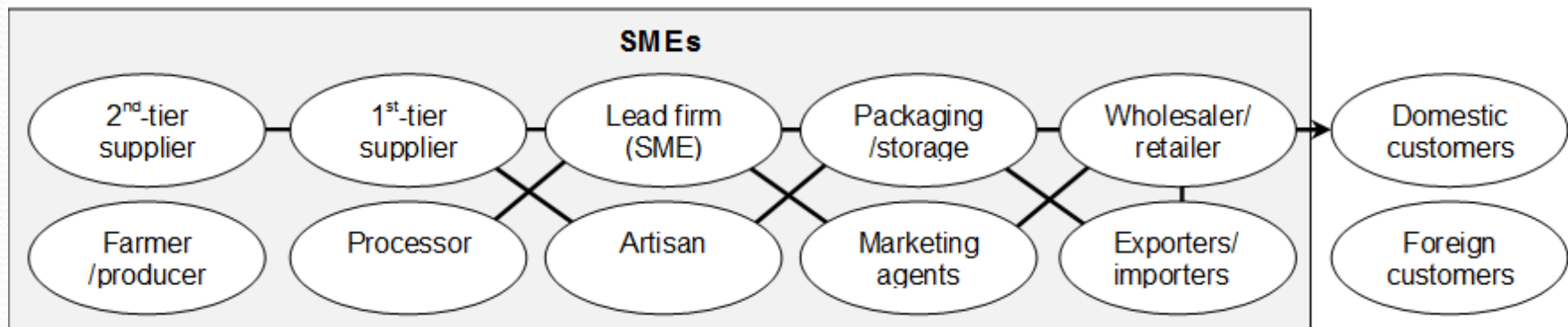


Flow of Global Value Chains

Vertical Firm Linkage



Horizontal Firm Linkage



Case Study - Kazakhstan (1)

SME Landscape

- ❖ Registered SME in Kazakhstan: 1.54M in 2013 and 1.59M in 2014.
- ❖ In 2011, Government launched program **“Increasing Competitiveness and Performance of SMEs”**
 - ❑ Goal: Increased outputs of SMEs with target of 40% SME contribution to GDP by 2030 and 50% by 2015
 - ❑ The program have increased SME contribution to 43% GDP in 2013 (T9,020 billion (71.8% increase)
- ❖ In Sept 2014, **“Private Entrepreneurship Law”** of 2006 was amended, revision of SME definition, i.e, micro enterprise category, expanded size of the small firm segment, etc.

Case Study- Kazakhstan (2)

Policy Regulations and Programs

Damu Entrepreneurship Development Fund

- ❖ Est. in 1997 as the a wholly owned subsidiary of national management holding company “Baiterek,” originally act as SME Fund, allocates and manages government funds to facilitate SME financing.
- ❖ Has provided partial credit guarantees SMEs, as part of its SME support programs since 2010.
- ❖ Credit Guarantee Scheme: up to 70% for long term bank loans to SME, priority sectors manufacturing, medical services, education, and tourism.

Case Study- Kazakhstan (3)

❖ **Kazakhstan: MFF SME Investment Program, Tranche 3**

- ❑ Approved: 15 December 2014 (additional financing: 24 June 2015)
- ❑ Loan: USD 130 million (additional financing: USD 98 million)
- ❑ ADB approved a multitranche financing facility (MFF) with an aggregate amount not exceeding \$500 million on 29 September 2010.
- ❑ ADB's first sovereign operation that provides local currency (tenge) fixed interest rate financial intermediation loans.
- ❑ Help Damu continue with the implementation of the government's Action Plan to increase access to medium term finance for SMEs.

Case Study - Mongolia (1)

Credit Guarantee Fund of Mongolia (CGFM)

- ❖ Established in 2012. Began operations in 2013 as special state owned enterprise
- ❖ Provides partial credit guarantees to banks and non-banks' making SME loans
- ❖ By law, the CGFM can only offer one basic guarantee product (a 60% guarantee)
- ❖ Offers credit guarantees through-out Mongolia, even in remote regions
- ❖ Job creation has occurred on average in each credit guarantee issued. Yet, success has been impaired due to:
 - Lack of products
 - Lack of trust of a government-run entity by the banking sector
 - Limited knowledge of the program offerings and processes by SMEs, banks and non-banks
 - Limited technical capacity
 - Does not address lack of long-term financing

Case Study - Mongolia (2)

ADB: Supporting the Credit Guarantee System for Economic Diversification and Employment Project

- ❖ ADB \$60 million loan, converted into local currency by MOF
- ❖ Supports Longer-term financing for SMEs by requiring at least 5 year loans
- ❖ Aims to revise law, build capacity, enhance outreach and expand credit guarantee product-set:
 - ❑ Products will also be issued to target specific needs of SMEs, such as:
 - Women entrepreneurs/SMEs
 - Non-urban based SMEs
- ❖ Loan funds will be placed as long-term “Time Deposits” into banks to partially fund each guarantee issued
- ❖ Through innovative recycling mechanism, ADB loan funds may support \$432 million of SME projects over the life of the ADB loan and support creation of 13,200 jobs

Case Study- Viet Nam

Viet Nam: Second SME Development Program

- ❖ Approved: 23 October 2013
- ❖ Loan (ADF): USD 50 million
- ❖ Support the Government reforms efforts by:
 - (i) enhancing the policy and planning framework for SME development;
 - (ii) improving the efficiency of administrative systems in support of SME development and operations;
 - (iii) strengthening the regulatory framework for competition policy; and
 - (iv) enhancing SME access to finance.

Case Study -Non-Sovereign Projects

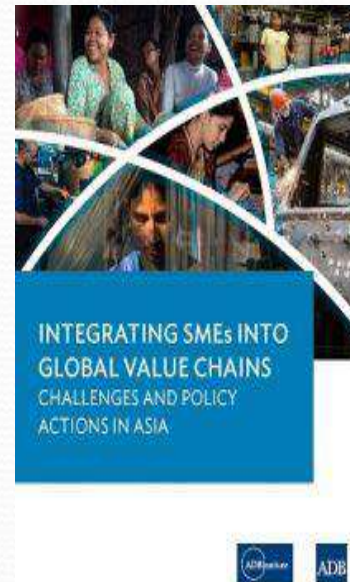
- ❖ Sri Lanka: Senior Unsecured Loan to Nations Trust Bank – SME Finance Project
 - ❑ Approved: 6 February 2013
 - ❑ Loan (OCR): USD 15 million (5 year)
 - ❑ Help meet rising demand on SMEs for financing and give them better access to funding.
- ❖ Kyrgyz Republic: Senior Unsecured Loan in Kyrgyz Investment and Credit Bank SME Finance
 - ❑ Approved: 17 January 2012
 - ❑ Loan: USD 10 million
- ❖ Armenia: SME Finance Program
 - ❑ Approved: 22 November 2011
 - ❑ Loan: USD 65 million
 - ❑ Extend debt facilities to Armenian banks for on-lending to SMEs and increase the capacity of local banks to provide SMEs with longer-term financing to support SME growth and productivity
 - ❑ Participating banks: ACBA Credit Agricole, Ameriabank, Ardshininvestbank, and Inecobank.

References



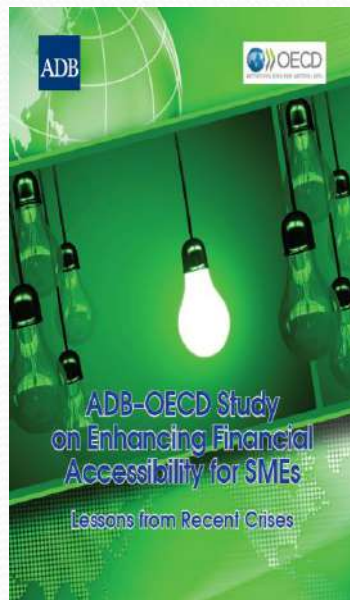
Asia SME Finance Monitor 2014

[<http://www.adb.org/publications/asia-sme-finance-monitor-2014>]



Integrating SMEs into Global Value Chains: Challenges and Policy Actions in Asia.

[<http://www.adb.org/publications/integrating-smes-global-value-chains>]



ADB-OECD Study on Enhancing Accessibility for SMEs.

[<http://www.adb.org/publications/adb-oecd-study-enhancing-financial-accessibility-smes-lessons-recent-crises>]