ASIAN CENTRE FOR ECONOMIC & ENTREPRENEURSHIP DEVELOPMENT AND EDUCATION
AN INDIA SME FORUM INITIATIVE

THE ROLE OF SMES IN ASIA & THEIR DIFFICULTIES IN ACCESSING FINANCE

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INTRODUCTION

Asia is rapidly playing the role of a global growth pole, and it is quickly emerging as the industrial and information technology hub of the world. Asia is the home of India and China - giants that are reshaping international business and the global economy. Asia comprises of the vast and diverse region which include India, China, Japan, Korea, Singapore, Kazakhstan, Malaysia, Philippines, Thailand, Bangladesh, Nepal, Indonesia, Vietnam, Uzbekistan, Cambodia and various other countries. The one important characteristics of theses vast and diverse region is the presence of large SME sector. The Enterprise in the SME sector are at different stage of evolution in their respective economies, having different roles and providing disparate contributions. And therefore, the challenges they face and the corresponding policies aimed at strengthening their competitive performance also vary.

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, ho wever, it is neither the full picture nor universally correct. SMEs are a source of employment, innovation and competition, they provide impetus to the entrepreneurial spirit and a way to proper utilization of skills, because they enjoy a vast geographical presence as compared to big companies, SMEs also contribute better income distribution.

The importance of SME for an economy is so critical that most policymaker and development practitioner consider the health of the SME sector as a priority. It's a hope of the economy that an elite few will hop on from garage to great like the Apple, Microsoft and Google. If we talk about an Asian example of the same, Infosys of India was started with capital of just $250 and has risen to become a business with a revenue of $22 Billion and is listed on NASDAQ. This type of SME development is not a fantasy but it can be only done if given the right set of factors and conducive environment to achieve that growth.

For a developing country and economy SME development is the key component of wider economic development and a source to reduce poverty as the SME sector is also seen as the major contributor of the employment and income. SME development is sometimes confused with private-sector development. In developing nations, SMEs may also act as a vital link between the informal economy of family businesses and the institutionalised corporate sector.

Some of a country's more capable SMEs may also be a source of foreign exchange profits provided they can fulfil the quality and quantity criteria necessary to export their products or services abroad.

There is also a widespread belief that a thriving SME sector fosters competitiveness and an entrepreneurial culture, both of which are beneficial to economic growth. Furthermore, since they cross the boundaries of commercial activity, SMEs are frequently perceived as being more flexible and agile, as well as more inclined to innovate, than their bigger and more established colleagues.

What exactly is an SME?

The definition of a SME varies greatly from nation to country and even within single countries, depending on the economic sector in question.

As a result, there are no general determinants or requirements for a SME. Much relies on the character of the relevant host nation, as well as the profile of its own corporate sector, from which a relative assessment of a SME is often produced, sometimes on a very arbitrary basis. In some countries, the number of workers is the only criterion used to determine whether a company is a SME or not. Other nations apply the same criterion, plus another depending on the value of the firm's assets or the amount of its revenues.

Some differing definitions of SMEs in Asia

Countries	Definition
Singapore	SME will be defined as an enterprise with an annual sales turnover of under S$100 million, or that employs less than 200 workers.
Malaysia	SMEs are defined as firms with sales turnover not exceeding RM20 million OR number of full-time employees not exceeding 75.
India	The threshold for investment in Small Enterprises sector ranges between 1 crore and 10 crores while the threshold of turnover ranges between INR 5 crore and INR 50 crores. In case of Medium Enterprises, the threshold of investment ranges between INR 10 crores and INR 50 crores while the threshold of turnover ranges between INR 50 crores and INR 100 crores

Indonesia	Fewer than 100 employees
Vietnam	Micro, small, and medium-sized enterprises having no more than 200 employees registered with the state social insurance and meeting either of the following two criteria - total capital shall not exceed VND100 billion (around USD4.4 million); - total revenue of the preceding year shall not exceed VND 300 billion (around USD13.2 million).
Cambodia	Small enterprises are those with 11 to 50 workers or with start-up capital of USD 50,000 to USD 250,000. Medium enterprises are those employ 51 to 100 workers or with start- up capital from USD 250,000 to USD 500,000.
Philippines	SMEs are defined as any enterprise with 10 to 199 employees and/or assets valued from P3 million to P100 million.

Figure 1.0

ROLE OF SMEs IN ASIA

It is estimated that there are 628 Million SMEs in Asia. Role of SMEs in ASIA in Some high income, Upper Middle Income, Lower Middle income and Low-income countries through various indicators like SMEs Percentage Share of all enterprises, percentage employment share, Percentage share of exports Percentage share in GDP/ Output.

Countries	Percentage Share of All Enterprises	Percentage Employment Share	Percentage Share of Exports	Percentage Share in GDP / Output
Japan	99.7 %	70.2%	*21.4% (Implementing Direct Exports) 14.9% (Own Overseas Subsidiaries)*	53%
Korea	99.9%	87.9%	34.1%	51.2%
Singapore	99.5%	71.4%	-	47.6%
China	99.6%	90%	80%	60%
Kazakhstan	97.6%	38.7	-	28.9%
Malaysia	98.5%	66%	17.3%	37.1%
The Philippines	99.5%	62.6%	25%	35.7%
Thailand	99.8%	85.5%	28.7%	42.4%
Bangladesh	90%	80%	77%	25%
India	95%	45%	48.10%	30%
Indonesia	99.99%	97%	14.4%	61.1%
Sri Lanka	75%	45%	5%	52%
Uzbekistan	99%	78%	28%	56.9%
Vietnam	98.1%	44.5%	-	45.1%
Cambodia	99.8%	70%	-	58%

Figure 1.2

Small and medium-sized enterprises (SMEs) make up more than 96% of all Asian businesses, providing two out of three private-sector jobs on the continent. Therefore, it is vital for Asian economies' economic success that they have fully functioning support measures for SMEs. As you can see in the above figure that in most of the economies in Asia, there percentage share of MSMEs in total enterprises is greater than 95% which explains the need of the current policy maker to address the issues of the MSMEs in Asia, to add further these MSMEs employ a larger number of people from each and every economy in Asia. The percentage employment share of MSMEs of some higher income countries and upper middle-income countries mentioned above show us the importance of MSMEs in economy as they employ greater than 70% of total working age population.

A trade surplus contributes to economic growth in a country. When there are more exports, it means that there is a high level of output from a country's factories and industrial facilities, as well as a greater number of people that are being employed in order to keep these factories in operation . MSMEs exports share in total exports is on the rise and these explains the importance of their role in economy. Countries in Asia like India and China have MSMEs contributing 48.10% and 80% to the total exports.

MSMEs play a prominent role in a country like China which is 2nd in the GDP ranking. In China MSMEs has a played a role of catalyst in the economy, MSMEs in China contribute 60% of the GDP, GDP of China is $ 12.238 Trillion, MSMEs alone contribute around $ 7.3428 Trillion to the GDP China. When it comes to employment MSMEs employ 90% of the total working age population. MSMEs also contribute 80% of total exports of the country.

If even speak for a developed country like USA it is said that Small businesses are the lifeblood of the U.S. economy: they create two-thirds of net new jobs and drive innovation and competitiveness. A new report shows that they account for 44 percent of U.S. economic activity.

Along with the role of small business in the economy, it also helps to consider the small business impact in the community overall. After all, a happier and healthier population is a more productive and innovative one. Small businesses also tend to be more accountable and donate more to the local community than their bigger competitors. With more direct contact with their buyers in the community, they tend to be more directly customer-focused.

Ultimately, with all this data, there should be no questioning small businesses' effect on the economy. Entrepreneurs and MSME owners can make a big difference.

SMEs DIFFICULTIES IN ACCESSING FINANCE

SMEs in Asia are less likely to be able to obtain bank loans than large firms; instead, they rely on internal funds, or cash from friends and family, to launch and initially run their enterprises. Asian Economies. Asian economies are having a bank-dominated financial markets underdeveloped capital markets, in particular venture capital. This means that banks are the main source of financing. Although the soundness of the banking system has improved significantly since the Asian crisis, banks have been cautious about lending to SMEs, even though such enterprises account for a large share of the economic activity. Start-up companies, in particular, are finding it increasingly difficult to borrow money from banks because of strict capital requirements. Riskier SMEs also face difficulty in borrowing money from banks. It is difficult for banks to evaluate SMEs, since they often do not have solid accounting systems. Many SMEs in Asia borrow money by paying high rates of interest or offering costly collateral. Many banks prefer to lend to large enterprises rather than SMEs. The reason for this is that, for large enterprises, the financial statements are cl earer and audited.

DIFFICULTIES FACED IN ACCESING FINANCE

Lack of Information Infrastructure for SMEs

The lack of information infrastructure for SMEs exa cerbates the information asymmetry problem. There is an asymmetric information problem between suppliers and demanders of funds in general. Information infrastructures are necessary to remedy this problem. Many big enterprises list their shares on stock markets and issue securities in bond markets. They publish financial statements and accounts, and accountants and auditing companies certify them. Therefore, institutional information-sharing schemes of capital markets can facilitate access to a wide range of information necessary to estimate the creditworthiness of big enterprises. However, most SMEs have no connection with capital markets. Financial institutions can observe borrowers closely and continuously, but it is costly to do so for borrowers of small loans.

In collateral-based lending, the provision of collateral is the simplest way for SMEs and financial institutions to reduce the risk premium in loan formulations. However, with the introduction of the Basel capital accord, many governments have expanded the policy-based finance for SMEs to mitigate the constraints on SME finance as an urgent countermeasure. In this situation, efficient and lower-cost credit risk evaluation tools have been necessary for financing SMEs, especially for transaction-based lending.

Insufficient Collateral and a High Interest Rate

SMEs tend to be informal, young, have less publicly available information, and operate in unfamiliar sectors, all of which results in higher information asymmetries and risk, discouraging bank lending. Many times, these firms also do not have enough assets that can be used as collateral. Additionally, these firms might find it too costly to list in capital markets. Even when they do list, they might fail to attract enough capital market financing, as investors in these markets prefer large companies which are less risky and more liquid. The insufficient collateral of SMEs and as a result the higher interest rates for lending to them present a major hindrance to the expansion of SME credit. The limited financing to SMEs derives from their nature.

The financing problems of SMEs have not gone unnoticed. Policy makers and market participants have implemented different initiatives to try to broaden access. One involves setting up credit information sharing mechanisms to promote bank lending to SMEs. Reforms that foster the use of movable assets as collateral (such as improving collateral laws and introducing movable collateral registries) are also well regarded. Public credit guarantees are another popular tool used to channel credit toward SMEs. Other initiatives have tried to promote alternatives financing mechanisms beyond bank lending, by for example establishing online platforms to conduct supply-chain finance. In addition, governments have tried to sidestep banks by creating secondary exchanges targeted at SMEs.

These examples show how countries are approaching the problem of SME finance in innovative ways. This new focus requires some experimentation to understand what works and what doesn't in different contexts. It also requires periodic and rigorous evaluations of the initiatives to determine whether they should be continued, changed, or terminated. Governments should join these efforts by collecting and using information on SME financing and by participating in the different initiatives

REMEDIES FOR TACKLING SMEs DIFFICULTIES IN ACCESSING FINANCE

- Financial sector assessments to determine areas of improvement in regulatory and policy aspects enabling increased responsible SME access to finance

- Implementation support of initiatives such as development of enabling environment, design and set up of credit guarantee schemes

- Improving credit infrastructure (credit reporting systems, secured transactions and collateral registries, and insolvency regimes) which can lead to greater SME access to finance.

- Introducing innovation in SME finance such as e-lending platforms, use of alternative data for credit decisioning, e-invoicing, e-factoring and supply chain financing.

- Policy work, analytical work, and other Advisory Services can also be provided in support of SME finance activities.

- Knowledge management tools and flagship publications on good practice, successful models and policy frameworks

- Partial Credit Guarantee Schemes (PCGs) – the design of PCGs is crucial to SMEs' success, and support can be provided to design and capitalize such facilities.

- Early Stage Innovation Finance provides equity and debt/quasi-debt to start up or high growth firms which may otherwise not be able to access bank financing.

Governments' Development of Credit Guarantee Schemes

A credit guarantee system would make it easier for banks to lend money to SMEs. For example, in the case of an SME defaulting, the credit guarantee corporation, which is a governmental organization, would meet a percentage of the losses. For example, assuming that a credit guarantee corporation sets 80% as the guarantee ratio, if an SME entered bankruptcy, a bank could recover 80% of its loan. If an SME became bankrupt without a credit guarantee system in place, the bank would lose its entire loan.

Many countries have used CGSs for decades, in various forms, as a way to increase the flow of funds into targeted sectors and groups. The purpose of the creation of such a scheme is to contribute to the flow of funding into sectors that have difficulty raising funds, including the SME sector. A CGS makes lending more attractive by absorbing or sharing the risks associated with lending to the targeted sector. Such schemes can also increase the amount of loan funds available to an enterprise beyond its own collateral limits, because the guarantee is a form of loan collateral.

A CGS consists of at least three parties: a borrower, a lender, and a guarantor. The borrower is often an SME or a micro-enterprise, seeking debt capital. This borrower typically approaches a private financial institution (a bank, the lender) for a business loan. For reasons of asymmetry of information, the private lender will frequently turn down the loan request, at which point the guarantor intervenes. The guarantor (credit guarantee corporation), usually a government or trade association, seeks to facilitate access to debt capital by providing lenders with the comfort of a guarantee for a substantial portion of the debt. CGS reduces the asymmetry of information and hence the expected default losses, as the credit guarantee corporation (government) guarantees a portion of the loan default, so banks would like to lend money to those guaranteed SMEs.

Development of SME Credit Risk Databases (CRD), Credit Bureaus, and SME Credit Rating

The CRD will help financial institutions like Credit Guarantee corporation and Credit Rating Agencies. Member financial institutions use scoring models to evaluate creditworthiness, check the validity of internal rating systems, and align loan pricing with credit risk. In addition, the CRD Association provides consulting services to support the management of SMEs on the assumption that, if SMEs have better management, this will reduce the credit risk for member financial institutions and strengthen SMEs' business operations.

Economies in Asia could establish such systems to accumulate and analyze credit risk data and to measure each SME's credit risk accurately, SMEs would be able to raise funds from the banking sector.

Credit Bureau collects data from a variety of sources on corporate entities or individuals, consolidates it into credit profiles, and makes the information available on request to subscribers including financial and non-financial institutions.

SOME RECOMMEDATIONS

Recommendations for the Government.

- **Enhance financial awareness** - Adequate and timely information about MSME schemes needs to be actively disseminated through advertisements in newspapers and magazines and on television. The government could consider starting a dedicated TV channel to address MSMEs' need for information and to communicate policies.

- **Reduce documentation -** It would be better to do away with complex documentation requirements for seeking financial assistance and replace them with simpler procedures like a "know your customer" form that captures basic information of the owner or enterprise that can be utilized by all financial institutions.
- **Ease legal requirements -** There is an urgent need to ease the burden of legal compliance on MSMEs, at least in the first 3 years of their existence.
- **Enhance sensitivity in lending institutions**. There is a need to build the capacity of lenders so that they are more sensitive to the specific needs of enterprises in different sectors and at the different stages of the enterprise life cycle.
- **Ensure that tax policies** are fully implemented. By doing so, there will be an emphasis on enhancing the visibility of transactions and this would provide a more accurate idea of the transaction history of the enterprise involved, thus helping determine its creditworthiness.
- **Support credit enhancement.** Expand credit guarantee schemes so that they are available to MSMEs. Enforce rules for delayed payment. Ensure proper action against defaulters and against those who make delayed payments to MSMEs. A delay in payment affects cash flow to the MSME and also negatively impacts its ability to process other orders. There is also a need to determine repayment periods carefully based on the nature of the sector in which the MSME operates, especially in sectors with high seasonality of production.

Recommendations for Financial Institutions

Realign approach toward MSMEs - Financial institutions need to change their perspective from that of being just a lender to that of being a strategic business partner. They must try to establish long-term relationships with those MSMEs that have the potential to be successful. Banks must not adopt a negative attitude toward MSMEs despite high levels of nonperforming loans from past lending experiences.

Promote financial awareness - An enterprise's transaction history with financial institutions plays a crucial role in determining the enterprise's creditworthiness. Financial institutions can invest in training for loan officers so that they can communicate their institution's policies effectively to MSMEs.

Explore alternatives to requesting collateral, especially from enterprises in the early stages of the life cycle.

Expand financial schemes for MSMEs - Build up a corpus of funds that can be provided to MSMEs in need of a sudden capital infusion. Also examine different and flexible repayment arrangements for loans disbursed to MSMEs.

Reduce documentation requirements - Consider reducing the burden of documentation required for MSME loan applications. As nonbanking financial companies can provide loans with less documentation, banks need to consider changing their approach toward MSMEs.

Recommendations for Entrepreneurs

Use proper accounting practices - Maintain a proper and robust accounting system, as this can increase the chance of accessing credit by providing a transparent basis for a lender to assess the viability and profitability of the enterprise.

Register the enterprise - Ensure that the enterprise is registered and that all registrations and licenses are renewed periodically.

Create prototypes and obtain patents - Prepare a prototype and try to patent the product. Approach the enterprise's accelerator or venture capitalists for financial assistance only after a prototyping cycle is complete.

Develop networks and markets - Entrepreneurs should participate actively in trade fairs and industry events for both showcasing their products or services and for enhancing their financial awareness.

CONCLUSION

In Conclusion Small and Medium Enterprises (SMEs) play a major role in most economies, particularly in developing countries. SMEs account for the majority of businesses in Asia and are important contributors to job creation and global economic development. They represent about 90% of businesses and more than 50% of employment worldwide. Formal SMEs contribute up to 40% of national income (GDP) in emerging economies. These numbers are significantly higher when informal SMEs are included. In emerging markets, most formal jobs are generated by SMEs, which create 7 out of 10 jobs. However, access to finance is a key constraint to SME growth in Asia, it is the most cited obstacle facing SMEs to grow their businesses in emerging markets and developing countries.

SMEs play a significant role in Asian economies, as they are responsible for very large shares of employment and output in all Asian countries. However, in the bank dominated financial systems in Asia, SMEs have difficulty accessing cheap finance. Banks are cautious about lending to SMEs, even though such enterprises account for a large share of economic activity. Start-up companies, in particular, are finding it increasingly difficult to borrow money from banks, and the strict Basel III capital requirements have made the situation more challenging. Riskier SMEs also face problems in borrowing money from banks. It is difficult for banks to evaluate SMEs, since they often do not have solid accounting systems and their credit risk is not obvious to lending institutions. Many SMEs in Asia borrow money by paying high rates of interest or offering costly collateral, which hinders their growth. Many banks prefer to allocate their resources to large enterprises rather than SMEs. The reason for this is that, for large enterprises, the financial statements are clearer. SMEs are mainly riskier from the point of view of lenders, as they do not have clear accounting information and have a limited credit history.

Finally, it is important for Asian economies, especially for lower-income Asian countries, where SMEs represent the main parts of their economies, to diversify SMEs' channels of financing. It is also necessary for Asian economies to accumulate SME data in a nationwide database for categorizing SMEs based on their creditworthiness. Those that are ranked higher will receive higher credit guarantees from the government at lower costs so that they can be successful. They will have a significant role in job creation and in production. In addition, those that are risky should avoid borrowing from banks, because their use of bank loans will cause nonperforming loans.

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