

KEY POINTS

- Small firms are the basic building blocks of regional economies in Cambodia, the Lao People's Democratic Republic, Thailand, and Viet Nam—providing jobs, income, goods, and services to communities outside metropolitan areas.
- These firms face challenges in reestablishing their operations post pandemic—depleted capital, inflation, digitalization, indebtedness, and regulatory uncertainty. In addition, many of these firms are not formally organized and most have low levels of knowledge about government support.
- Measures to improve small firms' participation in the policy process can help to ensure their inclusion in the economic recovery process. Fostering greater alignment between the objectives of public policy and those of small firms requires greater attention to the ecosystem in which businesses operate.
- This Asian Development Bank (ADB) brief adds value by discussing approaches to better integrate elements of the business ecosystem for promoting a flourishing local economy with vibrant small firms and entrepreneurial initiative.

Building Better Local Business Environments: Accelerating Pandemic Recovery of Small Firms in Cambodia, the Lao People's Democratic Republic, Thailand, and Viet Nam

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SMALL FIRMS ARE THE FOUNDATION OF LOCAL ECONOMIES

Local business environments throughout most parts of Southeast Asia are dominated by micro, small, and medium-sized enterprises (MSMEs). In Southeast Asia, it is estimated that they account for more than 97% of all enterprises, two-thirds of employment—including many jobs for women, and 40% of gross domestic product (GDP).¹ Collectively, they make a larger contribution to the economy than governments or large firms. They are especially important to the economies of regional, rural,

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¹ ADB. 2020. *Asia Small and Medium-Sized Enterprise Monitor 2020: Volume 1 – Country and Regional Reviews*. Manila.

and remote communities, as well as in supporting progress on the United Nation’s Agenda 2030 for Sustainable Development.²

Before the onset of the coronavirus disease (COVID-19), MSMEs faced many external and structural challenges such as uncertain regulatory environments, high informality, limited policy support, and lack of access to capital. COVID-19 mobility restrictions badly affected the operations of these enterprises, particularly those in retail operations and tourism-related businesses. Supporting the recovery of MSMEs, and encouraging their further growth, is essential to strengthening the long-term viability of local economies.

Local economic growth is an important policy issue for the Greater Mekong Subregion (GMS)—including Cambodia, the Lao People’s Democratic Republic (Lao PDR), Thailand, and Viet Nam. Each country has a large proportion of its population based in regional or rural areas, ranging from a current estimate of 76% in Cambodia, 66% in the Lao PDR, 63% in Viet Nam, through to 49% in Thailand.³ There are almost 10 million MSMEs in the GMS region, with most of these located outside metropolitan areas. For example, in Thailand only 18.2% of MSMEs are in Bangkok, with the remainder based in regional locations.⁴ A similar pattern can be seen in Viet Nam, with only 19.7% found in the two principal metropolitan regions, Ha Noi and Ho Chi Minh City.⁵

The large share of MSMEs outside major cities pose policy challenges. Their composition is highly heterogenous, representing informal traders to small partnerships and through to medium-sized corporations, or high-earning boutique firms. They use different legal structures and ownership patterns and are found in every industry and profession. A substantial number exist in the informal economy, where the reach of public policy and business support services are limited.

This Asian Development Bank (ADB) brief considers how to rejuvenate the MSME sector in regional and rural economies within the GMS. To answer this question, the brief spells out some of the key characteristics of MSMEs, discusses the structural challenges they face in their business operations, examines the impact of COVID-19, and puts forward some suggestions for future public policy.

MICRO, SMALL, AND MEDIUM-SIZED ENTERPRISES: THEIR NATURE AND NUMBER

What exactly is a small business? There is no one common definition of what constitutes MSMEs, and every nation within the GMS uses its own system to count and classify these business entities (Table 1). This variation makes it difficult to measure and compare the MSME sector across different countries. At its most basic, it is an independent business venture trading in the private sector that is limited in its turnover, asset base, employment size, market share, and range of products and/or services it offers.

Despite these definitional differences, there are common attributes that distinguish these firms from other types of business enterprises. A core feature is that these ventures are typically started by individuals or small groups, who usually provide the original business model, founding capital, and go on to operate the enterprise. In many cases, these founders are members of the same family. Many of the founders are women. Today, MSMEs represent an estimated 97% of all firms in Southeast Asia (Table 2).

MSMEs are widely dispersed across the physical and sectoral landscape of most countries. Unlike large firms that generally confine themselves to major population centers, small businesses can be found providing a range of services and products to rural,

Table 1: Definitions of Micro, Small, and Medium-Sized Enterprises in the Greater Mekong Subregion

	Employee Number	Assets	Turnover	Capital	Sector	Legal Structure
Cambodia	X	X			X	
Lao PDR	X	X	X		X	X
Thailand	X		X		X	X
Viet Nam	X		X	X	X	X

ADB = Asian Development Bank, Lao PDR = Lao People’s Democratic Republic.

Note: There is no formal definition of micro, small, and medium-sized enterprises in Cambodia.

Source: ADB. 2020. *Asia Small and Medium-Sized Enterprise Monitor 2020: Volume 1 – Country and Regional Reviews*. Manila.

² United Nations. 2015. *Transforming Our World: the 2030 Agenda for Sustainable Development*. New York.

³ World Bank. *Rural Population (% of total population) - Cambodia, Lao PDR, Vietnam, Thailand* (accessed 30 June 2022).

⁴ Government of Thailand, Office of SME Promotion. 2020. *White Paper on SMEs: MSME 2020 New Normal Brings Opportunities*. Bangkok.

⁵ Government of Viet Nam, General Statistics Office. 2018. *Results of the 2017 Economic Census*. Ha Noi.

Table 2: Selected Indicators of Micro, Small, and Medium-Sized Enterprises in Southeast Asia

Country	Number of MSMEs	MSMEs Share of All Firms (%)	Number of Employed by MSMEs	Females' Share of Total Employees (%)	MSME Contribution to GDP (%)
Brunei (2017)	5,876	97.2	66,123	31.1	35.5
Cambodia (2014)	512,870	99.8	1,345,100	42.7	...
Indonesia (2018)	64,194,057	99.9	116,978,631	38.7	61.1
Lao PDR (2020)	133,997	99.8	490,373	49.9	...
Malaysia (2015)	907,065	98.5	37.0
Myanmar (2019)	75,116	89.9
Philippines (2018)	998,342	99.5	5,714,262	38.2	...
Singapore (2019)	271,800	99.5	2,500,000	...	44.7
Thailand (2018)	3,077,822	99.8	13,950,241	45.6	43.0
Viet Nam (2018)	593,629	97.2	5,627,952	46.7	...

... = not available; ADB = Asian Development Bank; Lao PDR = Lao People's Democratic Republic; MSME = micro, small, and medium-sized enterprises.

Note: The "non-state sector" of Viet Nam includes (i) registered enterprises (large, medium, small, and micro), (ii) registered household businesses, (iii) registered cooperatives, and (iv) the informal sector. The data reported in the table do not include household businesses or the informal sector.

Source: ADB. 2020. *Asia Small and Medium-Sized Enterprise Monitor 2020: Volume 1 – Country and Regional Reviews*. Manila (accessed 30 June 2022); Government of the Lao PDR, Lao Statistics Bureau. 2020. *Economic Census*. Vientiane.

regional, and remote communities that have limited access to commercial, retail, and professional facilities. In Southeast Asia, an estimated 72%–85% MSMEs operate in rural areas, with only about 15%–28% found in capital cities.⁶

SMALL FIRMS ARE IMPORTANT—AND DIFFERENT

A central feature of MSMEs is their heterogeneity. They can vary in terms of the number and type of workers. These range from informal self-employment for women working in their homes or professionals working in skilled trades, through to micro-sized ventures and to small and medium-sized enterprises with sophisticated operating processes overseen by professional managers.

They can also vary significantly in terms of their legal basis. MSMEs may take the form of sole proprietorships, partnerships, limited liability companies and more complex corporate structures arrangements. Many are also informal and without any underlying legal structure.

MSMEs occupy almost every business niche. They can be found in every industry and business sector. While economies of scale may prevent large firms from successfully exploiting small or marginal

economic activities, the greater flexibility and nimbleness of small firms, coupled with their minute scale and low overhead costs, allow them to survive even in situations of low profitability.

Small firms are major employers (including themselves, their families, and staff) and contribute significantly to GDP. In Southeast Asia, over two-thirds of the labor force are employed by MSMEs. Interestingly, the employment share of MSMEs in total employment tends to decrease as a country's income level rises. In high-income countries, only 58% of total employment is found in self-employment and small firms, while in low- and middle-income countries the proportion is considerably higher. In nations with the lowest income levels, this figure comes close to 99%.⁷

Less obvious, but just as important, are the intangible benefits MSMEs provide to local economies. Small firms are often at the forefront of entrepreneurial activity, engaged in a constant process of innovation, change, and efficiency improvements, which helps economies grow and adapt. Start-up MSMEs, in particular, are a source of product and service innovation, often incubating new concepts that larger established firms are reluctant to adopt. They can provide a source of competitive tension to traditional large businesses, generating a dynamic that gives consumers more choice. At the same time, the relationship is not necessarily one way: smaller firms are often important

⁶ ADB. 2020. *Asia Small and Medium-Sized Enterprise Monitor 2020: Volume 1 – Country and Regional Reviews*. Manila (accessed 30 June 2022).

⁷ International Labour Organization. 2019. *Small Businesses and Self-Employed Provide Most Jobs Worldwide and in Asia*. Geneva.

suppliers within regional or global value chains, providing many of the niche products and services on which larger firms depend.⁸

MSMEs also play an important social, equity, and distributional role, and can contribute toward the achievement of the United Nations’ Sustainable Development Goals (SDGs). They often provide a mechanism for the poor, unskilled, and marginal groups to gainfully participate in their local economy, either as business operators or as workers. Likewise, MSMEs provide opportunities for women, young entrepreneurs, and older persons to be economically productive.

Gender equality is an important SDG-related goal that MSMEs can facilitate.⁹ Many MSMEs are founded and operated by women, either alone or with a partner. A barrier to women’s business development is that there is no common definition of business ownership by gender across countries, which limits the understanding of women’s contribution to the economy and limits opportunities for targeted policies to support such enterprises.

Finally, many smaller firms also have a strong focus on improved sustainability and environmental practices.¹⁰ The move to a low-carbon, more sustainable business model offers many opportunities to entrepreneurs. ADB has identified a range of eco-friendly opportunities across sectors, including agriculture, eco-tourism, oceans, transport, and energy.¹¹ Combined, these factors place MSMEs in an important position to help achieve the SDGs.

BUSINESS OPERATIONS AND GOALS: IT’S PERSONAL

MSMEs deal with issues in a fundamentally different way compared to other business enterprises. These are not always consistent with the most economically rational option. Profit is important, but other goals may be even more valued, such as a need to survive or to develop one’s career. MSMEs typically begin with one or two founders, whose motives for business formation can vary from income generation to goals such as creative pursuit, independence, and lifestyle change, among other things. Profit maximization and growth are not always essential. For that reason, not all MSMEs aspire to grow. And while most entrepreneurs start out by creating new small firms, not all MSMEs are entrepreneurial ventures seeking to innovate.

Business owners are central to the activities of MSMEs. Often referred to as “owner-managers,” they assume most of the decision-making and risk-taking within the business.

Personal characteristics, networks, political economy, gender norms, and subjective analysis are important in decision-making. Information-gathering is also conducted in different ways, with MSME owner-operators showing a marked preference for just-in-time, personally trusted sources of advice—such as friends and family—over government and third-party professional advisers.

MSMEs face many structural barriers and limitations to prosper. Most begin life with limited skills, industry knowledge, and start-up resources. They typically enter relatively small markets with many well-established competitors. Therefore, gaining market share is highly risky, with many failing in the process. Support infrastructure and services are also limited, with stiff competition for raw materials and business premises. Obtaining professional support services and skilled workers can also be difficult.

Consequently, the rate of prospective business closure is high. Not all nations keep data on business exit rates, but those that do indicate that up to half of all firms are likely to close within 5 years of inception, and two-thirds within 10 years.¹² Few firms survive beyond 15 years. Not all of these are failures. Some businesses cease to operate due to retirement, merges, or acquisitions. Then there is the case of micro-sized, household-based enterprises that operate due lack of alternate livelihood options and the absence of adequate social protections. These firms are likely to exit if better options come along.

Information asymmetry is another striking feature of small-scale business ventures. In general, MSMEs tend to have less knowledge and access to information on the factors that affect their business viability. This includes information on current industry conditions, legal and financial rights, and government support programs. As a result, smaller businesses are less likely to receive assistance than large corporations. For example, a recent enterprise survey in the Lao PDR has shown that transparency and access to information is a major concern of many business owners, particularly for those that are owned and operated by women.¹³

Small businesses operate in complex business ecosystems. Their creation, operation, and eventual success depends on factors within and outside the firm’s control. Given MSMEs’ limited size and resources, along with very thin financial capacity, a small change in economic conditions can shape the firm’s likelihood of success and make it harder to survive.

Many MSMEs exist as informal ventures. These are businesses that are not formally registered or compliant with legal requirements set by governments. Informal firms are common in emerging

⁸ ADB. 2021. *The Greater Mekong Subregion 2030 and Beyond: Integration, Upgrading, Cities, and Connectivity*. Manila.

⁹ Organisation for Economic Co-operation and Development (OECD). 2017. *Strengthening Women’s Entrepreneurship in ASEAN*. Paris.

¹⁰ R. Sobir. 2020. *Micro-, Small-, and Medium-Enterprises (MSMEs) and their Role in Realizing the Sustainable Development Goals*. New York: United Nations Department of Economic and Social Affairs.

¹¹ ADB. 2022. *Implementing A Green Recovery in Southeast Asia*. Manila.

¹² Eurostat. 2020. *Business Demography Statistics*. Brussels (accessed xx month year); Australian Bureau of Statistics. 2022. *Counts of Australian Businesses, Including Entries and Exits, July 2017–June 2021*. Canberra (accessed 30 June 2022).

¹³ ADB. 2022. *Provincial Facilitation for Investment and Trade Index: Measuring Economic Governance for Business Development in the Lao People’s Democratic Republic —Second Edition*. Manila.

Table 3: Selected Indicators on Governance and Formality

Item	Cambodia	Lao PDR	Thailand	Viet Nam
Worldwide Governance Indicators (WGI) (2020) (Percentile rank = 0 lowest, 100 highest)				
• Voice and Accountability	12.6	3.4	26.1	12.1
• Political Stability and Absence of Violence/Terrorism	41.0	69.3	24.5	44.8
• Government Effectiveness	38.0	22.6	63.5	61.5
• Regulatory Quality	29.8	21.2	58.7	46.6
• Rule of Law	17.8	20.7	57.7	48.6
• Control of Corruption	11.1	14.9	38.5	42.3
Share of firms operating without official documents (percentage)	96.6	69.6	...	74.1
Number of SMEs Per Capita (Persons)	1:33.5	1:51.5	1:22.2	1:16.4

... = not available; Lao PDR = Lao People's Democratic Republic; SME = small and medium-sized enterprises.

Sources: World Bank. 2022. *Worldwide Governance Indicators*. Washington, DC (accessed 30 June 2022); Government of the Lao PDR, Lao Bureau of Statistics. 2020. *Economic Census*. Vientiane; Government of Viet Nam, General Statistics Office. 2018. *Results of the 2017 Economic Census*. Ha Noi; Government of Cambodia, National Institute of Statistics. 2013. *National Economic Census 2011*. Phnom Penh.

economies and appear to be most evident in economies with weak regulatory systems and poor rule of law. Table 3 shows how lower scores on the World Bank's Worldwide Governance Indicators often coincide with a larger share of firms operating without the necessary documentation to allow them to formalize, as well as high number of MSMEs per capita. This suggests that the health of the MSME sector is related to the framework conditions that governments generate and maintain.

MSMEs in smaller Southeast Asian economies with less-developed governance systems face additional challenges. Governments often have fewer financial and human resources to devote to MSME promotion, financial assistance may be constrained, and skills in the MSME sector may be limited.¹⁴ Regulatory capacity can be of lower quality, with many laws and regulations poorly implemented. Corruption may discourage firms from adopting formal legal structures and add cost burdens to business operations. Physical infrastructure is often poor, making it more difficult and costly to obtain raw materials and to deliver goods and services to markets. Digital connectivity is also limited, making it harder to secure an effective online presence—a critical ingredient for firms seeking to expand beyond their local economy.

GOVERNMENT POLICY CAN MAKE A DIFFERENCE

In these situations, two important principles can make a difference: (i) improving transparency, and (ii) keeping a medium- to long-term perspective. While the success or failure of an MSME

often depends upon the quality of managerial, strategic, and operational decisions it makes, the public policy, laws, and regulations it faces are significant in setting the broader environment.

It is not only the quality of the regulation that is important. Implementation requirements should be clear, easy to understand, transparent, readily accessible, and applied fairly and with minimum burden. Similarly, consistency of policy direction, including setting medium-term strategies, and timely communication influence businesses' response to policy.

As Table 4 shows, the impact of government can vary significantly from one nation to another. For example, the amount of time spent in dealing with regulations, the extent to which corruption is reduced, the ease of participating in the formal financial sector, and the level of informality all reflect differing degrees of administrative efficiency and compliance with existing legal frameworks.

Similarly, the “ease of doing business”—the time, cost, and regulatory compliance burden required to enter a market—also varies between nations. A growing recognition of the importance of MSMEs to local economies and the impact of government regulations on their vibrancy has led many nations to reform their administration processes. Since 2018 for example, the Lao PDR has taken steps to improve the regulatory environment, with recent analysis showing a significant reduction in the cost and processing time of business registrations (Box 1).

¹⁴ Association of Southeast Asian Nations (ASEAN). 2021. *Mid-Term Review of the ASEAN Strategic Action Plan for SME Development 2016-2025: Evaluation Report*. September. Jakarta: ASEAN.

Table 4: Selected Business Environment Issues

	% of firms experiencing at least one bribe payment request	% of senior management time spent dealing with government regulations	% of firms competing against informal enterprises	% of firms with a checking or savings account
Cambodia (2016)	64.7	16.4	77.8	39.4
Lao PDR (2018)	40.3	0.8	39.9	54.6
Thailand (2016)	9.9	4.8	25.1	87.7
Viet Nam (2015)	26.1	1.7	49.5	55.8
East Asia and Pacific regional average	27.9	6.8	45.0	74.6
All country average	15.8	8.4	48.8	87.1

Lao PDR = Lao People's Democratic Republic.

Source: World Bank. 2020. *Map of SME-Support Measures in Response to COVID-19*. Washington, DC.

Box 1: Greater Transparency in the Regulatory Environment is Good Business

Micro, small, and medium-sized enterprises (MSMEs) in the Lao People's Democratic Republic (Lao PDR) account for 99% of all businesses in the country and generate most private sector jobs. With the coronavirus disease (COVID-19) affecting households and businesses across the country, and the government struggling with slower growth and debt, the small firm sector has a crucial role to play in supporting the nation's economic recovery.

Yet, despite their immense importance in boosting national productivity and creating jobs, MSMEs in the Lao PDR continue to face barriers in doing business. One persistent impediment is the complex regulatory environment. Those businesses with the fortitude to acquire the licenses and permits necessary to operate also face informal charges levied at the local level.

The result is that many MSMEs simply try to operate under the radar. According to the Lao PDR *Economic Census* data in 2020, 70% of firms in the country operate informally, 78% lack a business license, and 87% do not have a tax identification number.^a

Women-led enterprises, which make up 56% of all small and medium-sized enterprises, have an even lower level of compliance, with female entrepreneurs reporting that their business registration takes longer and costs more.

The response of MSMEs to the Lao PDR's regulatory environment contributes to the government missing out on considerable tax revenue—funds that are desperately needed for critical spending on public health and education. Recognizing this funding gap, the government underscored the importance of making tax payments easier in its *9th Five-Year National Socio-Economic Development Plan (2021–2025)*.^b The national government has been taking steps since 2018 to improve the regulatory environment

for MSMEs, with a focus on simplifying procedures to obtain business registration certificates and tax identification numbers. At the same time, the government has succeeded in reducing the cost and processing time of business registration by one-third.

However, further reforms are needed to spur entrepreneurs to take advantage of new business opportunities and create more jobs. A study by the Asian Development Bank (ADB) and the Lao National Chamber of Commerce and Industry (LNCCI) found that greater transparency in the regulatory environment is needed to reduce information asymmetries that distort markets and to build trust in government systems.

Building transparency need not be difficult. To start with, the government can take simple steps like creating websites where MSMEs can obtain information on economic planning, regulations, and procurement opportunities, or introducing one-stop portals for enterprises to apply for registration, licenses, and permits. These measures can eliminate significant transaction costs in starting a business.

Transparency can also be expanded through regular dialogue between all levels of government and the private sector. Such collaboration, often held as public forums, helps to identify barriers that businesses face in local and global markets and leads to appropriate solutions. The Annual Lao Business Forum is an excellent example of dialogue that can be replicated at sector and subnational levels.

Businesses thrive in transparent markets, with access to information critical to the success of all enterprises. According to ADB-LNCCI research, around two-thirds of businesses said

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they do not have access to necessary procedures and forms for coordination with the government, nor access to information on public procurement opportunities. Good progress has been made by the national government in reducing some of the regulatory hurdles to business development—steps that have quickened the time for MSMEs to obtain business registration.

^a Government of the Lao PDR, Bureau of Statistics. 2020. *Economic Census*. Vientiane.

^b Government of the Lao PDR. *9th Five-Year National Socio-Economic Development Plan (2021–2025)*. Vientiane.

Source: ADB. 2022. *Provincial Facilitation for Investment and Trade Index: Measuring Economic Governance for Business Development in the Lao People's Democratic Republic—Second Edition*. Manila.

Yet, there is substantial room for improvement. COVID-19 has had devastating human, social, and economic costs across the Lao PDR. Broader measures by the government to address MSME concerns about transparency in the regulatory landscape will be an important step in revitalizing the investment climate and helping to restore economic growth.

INSTITUTIONAL SUPPORT FOR MICRO, SMALL, AND MEDIUM-SIZED ENTERPRISES HAS BEEN STRUCTURAL AND OF A LONG-TERM PERSPECTIVE

Institutional support for MSMEs became widespread in Southeast Asia from the 1990s onward. For example, SPRING Singapore was founded in 1996, Thailand's Office of Small and Medium Enterprises Promotion was created in 2000, Viet Nam's MSME Development Agency (now the agency for Enterprise Development) in 2001, the National Small and Medium-Sized Enterprise Office in the Lao PDR in 2004, and Malaysia's SME Corporation in 2009. The Association of Southeast Asian Nations became more involved in MSME policy issues through initiatives such as its Strategic Action Plan for SME Development 2016–2025.

Before COVID-19, policy support for MSMEs had tended to be micro or macro in nature:

- **Micro-level strategies** focused on the individual firm, its owner(s) and staff. Micro-level strategies have been important in dealing with the personal aspects of individual MSME operations, including: the provision of business counseling and advisory services (such as Indonesia's *satu pintu* [one-stop shops] or the Lao MSME service centers); training and business development skills; assistance in hiring staff; and helping firms develop marketing or financial strategies (Table 5).
- **Macro-level approaches** dealt with economywide, aggregate business conditions, or large-scale structural factors impacting all firms. Macro-level approaches have usually focused on issues including infrastructure, communications, financing mechanisms, regulations, tax, and broad-range sectoral industry assistance.

A key trend observed in 2020–2022 has been the rapid usage, adoption, and trust of digital technology. This allowed many households and businesses to continue operating during the COVID-19 pandemic. Many MSME merchants in Southeast Asia have benefited from the digital transformation that is currently underway (Box 2).

Table 5: Examples of Policies Targeted at Micro, Small, and Medium-Sized Enterprises

Policy	Description
Financial aid	Offering access to grants, subsidies, loan guarantees and/or discounted loans
Legal	Creation and/or reform of legal operating structures (such as special purpose companies) to accommodate specialized needs of start-up ventures and existing MSMEs; reduction in regulatory burdens, compliance, and reporting requirements
Taxation	Adoption of specialized tax rates, benefits, or rebates for smaller firms; streamlining of tax collection processes and compliance requirements
Competition policy	Providing exemptions from some provisions of competition laws for MSMEs, treating small firms with the same rights as consumers, enforcing competition laws to deter anticompetitive conduct that disadvantages smaller traders
Employment	Support to encourage businesses to employ staff, including rebates and grants for target groups such as women and youth; provision of employment agency services; and skills training in management and human resource practices
Incubators / workspaces	The provision of dedicated low-cost workspaces and business premises for early-stage business ventures
Value chains	Encouraging MSMEs to participate in regional or global business chains as a supplier to larger firms
Skills training	Upskilling business owners, other firm managers, and/or employees in both business skills as well as in industry-specific skills
Business advice	Providing access to professional business advisers, facilitators, and consultants with specialized knowledge relevant to the sector, either on a free or subsidized basis

MSME = micro, small, and medium-sized enterprises.

Source: Authors.

Box 2: The Rise of Digital Micro, Small, and Medium-Sized Enterprise Merchants During the Pandemic

A survey of 3,000 digital micro, small, and medium-sized enterprise (MSME) merchants in six countries during 2021 found that firms adopted digital technology in three key areas to help their businesses survive: (i) financial services, including cashless payments and access to credit or insurance; (ii) digital platform cooperation that facilitated customers facing solutions such as the sale of goods and services; (iii) back-office solutions that enhanced non-customer facing activities.

In Southeast Asia, one in three of the digital MSME merchants surveyed believed that they would not have survived the coronavirus disease (COVID-19) pandemic without access to such digital solutions. About half of MSMEs also reported satisfaction with the

newly adopted digital technology, as it allowed them to access a wide customer base and offered user friendly navigation for business transactions. Eight out of 10 of these MSMEs also believed that online platforms deliver a positive impact to their MSME business in terms of creating more jobs and sustaining their revenue growth during the pandemic period.

However, a key concern of these digital MSME merchants was the high transaction fees of digital platforms. For example, one in three observed that the fees associated with these digital solutions were too expensive. At the same time, 9 out of 10 believed that digital financial services are a key enabler for the revenue growth in their business.

Source: A. Bajjal et al. 2021. *e-Conomy SEA 2021*. Bain & Company, Google, and Temasek. 10 November.

DURING COVID-19, SUPPORT FOR MICRO, SMALL, AND MEDIUM-SIZED ENTERPRISES SHIFTED TO CRISIS RESPONSE

With MSMEs highly susceptible to external shocks, COVID-19 posed a major threat to their sustainability. The rapid spread of the disease and subsequent restrictions on the movement of people and goods impeded “business-as-usual” operations, with major impacts on the small business community globally and MSMEs in the GMS (Box 3).

ADB conducted a detailed examination of the impact of COVID-19 on MSMEs in selected countries, including the Lao PDR and Thailand.¹⁵ The study found that while a small group of firms benefited from the pandemic, most businesses suffered setbacks. The hardest hit were usually those that produced non-essential items, particularly tourism-based enterprises that play major role in many regional economies. The survey also noted that digitalization

has become increasingly important to MSMEs, including for distribution, marketing, and administration.

Policies to support MSMEs in the pandemic took a variety of forms, with a summary of measures shown in Table 6. They included financial support through debt restructuring and fee waivers, tax reductions or deferrals, and employment assistance such as wage support schemes. Attempts to stimulate consumer demand and trade support for exporters were also provided, along with liquidity injections to banks to stimulate lending to the private sector. New assistance programs were also developed to incentivize digitalization through subsidies to go online or to expand online trading. The COVID-19 relief initiatives provided to businesses were generally consistent with requests from the business community for support. However, MSMEs in smaller regional economies generally received less targeted support than larger firms operating in the formal economy within cities.

Box 3: Impact of COVID-19 on Micro, Small, and Medium-Sized Enterprise Behaviors

Data from the Global Enterprise Monitor indicates that the coronavirus disease (COVID-19) pandemic has resulted in changes among small business owner-operators globally. These include

- reduction in household incomes for business owners and employees;
- perceived increase in difficulty in starting a business;
- reduction in the proportion of people involved in starting a business or operating a young business;

- reluctance of entrepreneurs from closing nonviable businesses and starting new ventures due to cost of failure;
- reduction in employment of staff by new start-ups to minimize their future risks; and
- increased digitalization of business models by micro, small, and medium-sized enterprises.

Source: Global Entrepreneurship Monitor. 2021. *Global Entrepreneurship Monitor 2021/22 Global Report: Opportunity Amid Disruption*. London: Global Entrepreneurship Research Action.

¹⁵ ADB. 2022. *Asia Small and Medium-Sized Enterprise Monitor 2021: Volume II—How Asia’s Small Businesses Survived a Year into the COVID-19 Pandemic: Survey Evidence*. Manila.

Table 6: Examples of Policy Responses for Micro, Small, and Medium-Sized Enterprises

Country	Policy Response
Cambodia	Credit guarantees Delayed deferred loan repayments Loan interest reductions Concessional loans to MSMEs Tax exemptions and deferrals in selected sectors Wage subsidies
Lao PDR	Concessional loans to MSMEs Income tax exemptions Profit tax exemptions
Thailand	Concessional loans to MSMEs Wage subsidies to employees Cash support to self-employed Credit guarantees to MSMEs
Viet Nam	Corporate tax rate reductions, waivers, deferrals Payroll, social security, tax rate reductions, deferrals, and waivers

Lao PDR = Lao People's Democratic Republic; MSME = micro, small, and medium-sized enterprises.

Sources: ADB. 2022. *Asia Small and Medium-Sized Enterprise Monitor 2021: Volume II—How Asia's Small Businesses Survived a Year into the COVID-19 Pandemic: Survey Evidence*. Manila; World Bank 2020. *Map of SME-Support Measures in Response to COVID-19*. Washington, DC.

However, the understanding of the impact of COVID-19 on MSMEs in local economies and the comparative effectiveness of policy measures is still limited. The real number of firms that were forced to close due to COVID-19 is not known. Importantly, the pandemic unearthed weaknesses in information systems for supporting the formulation of agile policy responses and forward-looking recovery policies.

Also notable during COVID-19 was the role of business associations, which educated their members about COVID-19 and acted as a conduit between government and industry in distributing assistance. In Cambodia, the Cambodia Women Entrepreneurs Association took an active role in raising awareness on the government's COVID-19 assistance program and researching its effectiveness, while the Vietnam Association of MSMEs promoted the government's post-COVID-19 regulatory reform initiatives among its members.¹⁶

EMERGING TRENDS FOR PANDEMIC RECOVERY AND BEYOND

Dealing with the immediate consequences of COVID-19 has been the focus of MSME policy and local economic development since 2020. With economies now reopening their borders, it is important that the focus of policy shift toward a broader set of trends that

are important for MSMEs in rural, regional, and local communities. These trends are somewhat different from those observed before the pandemic, entailing a need to shift from previous approaches to allow for a greater alignment across systems. Emerging trends and their potential implications for MSMEs are provided in Table 7.

Meanwhile, several important issues for MSMEs have tended to be overlooked in policy discussions. The first is that despite their important contribution to economic growth and livelihoods, MSMEs issues continue to remain largely unattended in policy debates. This is in part because their size and scope are difficult to measure. For example, many informal firms typically do not pay taxes or contribute to public income. Their employees often do not have the same protections as other workers, and their ability to evade laws gives them an unfair competitive advantage relative to legitimate firms. However, a continuation of this situation presents a major risk to economies in Southeast Asia being able to bounce back better.

It is therefore important to identify (i) strategies to de-risk, and (ii) create greater alignment between objectives of public policy and those of MSMEs as they are a major economic stakeholder. For firms, this will require support for risk-taking, as this is a major determinant of entrepreneurial endeavor. One of the most common mechanisms is business insurance, which is especially significant to smaller ventures that have thinner margins, higher failure rates, and own capital investments. There is evidence to suggest in several markets around the world that insurance continues to be difficult to obtain for many MSMEs. This impacts on entrepreneurial capacity, rates of new venture creation, and on exit rates of firms from a local economy.

Another mechanism is allowing greater ease of entry and exit. Most existing business assistance services provided by governments are typically focused on business start-up, operations, and growth. Dealing with cessation and exit from the marketplace, or transfer from one owner to another, is often regarded as “supporting failure” and so overlooked. Yet assistance in managing closure or transfer is important. Done well, it allows unsuccessful business operators to leave with minimal losses, and may support willingness to try new projects in the future.

Fostering alignment requires information. Much of the information that is made available in the public domain is often sporadic, measures only a limited number of dimensions, and is collected using different definitions across nations at different times. It is difficult to evaluate many of the current policy issues in the absence of this data. For example, the number of businesses that failed during COVID-19 is still not known, or information on the levels of exit and entry over time. Comprehensive, robust, sex-disaggregated, and publicly available data about the MSME sector is still difficult to obtain. The Lao PDR and Viet Nam both publish the results of their economic census, containing a range of useful MSME data, but both these typically only take place every 5 years. Cambodia's census takes place once a decade and is currently underway.

¹⁶ Cambodia Women Entrepreneurs Association. 2020. *How Small Businesses Have Coped with the Impact of COVID-19*. Phnom Penh.

Table 7: Post-Pandemic Recovery Trends and Potential Implications for Micro, Small, and Medium-Sized Enterprises

Trend	Description
Regulatory reform	The momentum behind improving the ease of doing business has stalled and there is a danger that—absent any further reforms—the business operating environment will become more difficult for local small firms.
Reskilling and upskilling	Working patterns changed significantly during COVID-19, with working from home normalized. New managerial expertise and digital skills are needed to leverage the benefits of hybrid work arrangements.
Unpaid work	Women are involved with unpaid work, and this affects their participation in the labor market as employees and business owners. Working from home and hybrid work arrangements offers greater flexibility to balance responsibilities, but such provisions may substitute gaps in social services and reinforce gender norms.
Inflation	An additional economic challenge is that of a higher-inflation world. Inflation can increase input and labor costs for businesses. Most MSMEs trade on low profit margins, so their capacity to absorb such additional outlays is limited.
Trade and investment	Strong regional trade and investment gave Southeast Asia a buffer against slow growth amid COVID-19. The Regional Comprehensive Economic Partnership will further support for economic growth. Herein it will be important to maximize local firms’ participation and smooth the path for MSMEs to leverage benefits.
Digitalization	Digital technologies provide an important pathway for MSMEs into regional and global markets, but the quality of online presence and provision for online payment varies substantially.
Indebtedness	MSMEs that survived COVID-19 increased their level of indebtedness and leveraged tax deferrals to do so. This helped promote short-term capacity to survive but raised the long-term level of debt borne by a business. MSMEs typically have few financial reserve funds and may struggle to meet these debts, resulting in more firm failures at a later point in time.
Climate change	Extreme weather events will likely see changed rainfall and monsoon patterns, changed fishing patterns, and greater heatwaves and droughts. These patterns are predicted to continue and may increase in severity if attempts to limit global warming are unsuccessful. MSMEs are impacted by these events through damage to business premises, adverse trading conditions, and population movements, among others. Climate change will also impact on investment preference and future sectors that new MSMEs operate.
Demographics	The current gap in MSME statistics makes it difficult to assess changing demographic patterns among business owner-operators. To promote gender equality, it is crucial to know how many female-run MSMEs exist and how their participation is increasing, static or declining. Older entrepreneurs are a significant part of the business ecosystem, yet there are few policy measures to encourage this age cohort in Southeast Asia. Many MSMEs are also adopting a low-employment model, which may require other policies to stimulate job generation.

COVID-19 = coronavirus disease; MSME = micro, small, and medium-sized enterprises.

Source: Authors.

Fostering alignment also requires a defined MSME voice. In many nations, business associations play an important role in acting as a conduit to government. However, they often tend to be dominated by larger metropolitan firms, which pay the largest membership fees, have a more sophisticated knowledge of government, and the capacity to devote dedicated staff to these issues. As a result, much business- and industry-specific consultation focuses on larger sized firms in major cities and can lead to public policy responses that inadvertently give preferential treatment to larger firms, government trading enterprises, and multinational corporations. There is a need to ensure the regional small firm perspective is clearly heard within such discussions.

These points are not exhaustive. Many other issues in the MSME development space are also significant but have been given only cursory treatment. Public policy tends to favor the “low-hanging fruit” approach rather than one that encompasses the entire

business ecosystem. A whole-of-system approach is needed, with a process in place to support transition, in which each individual policy support measure is part of a broader holistic perspective.

POSSIBLE NEXT STEPS: AN ECOSYSTEM APPROACH TO MICRO, SMALL, AND MEDIUM-SIZE ENTERPRISE DEVELOPMENT

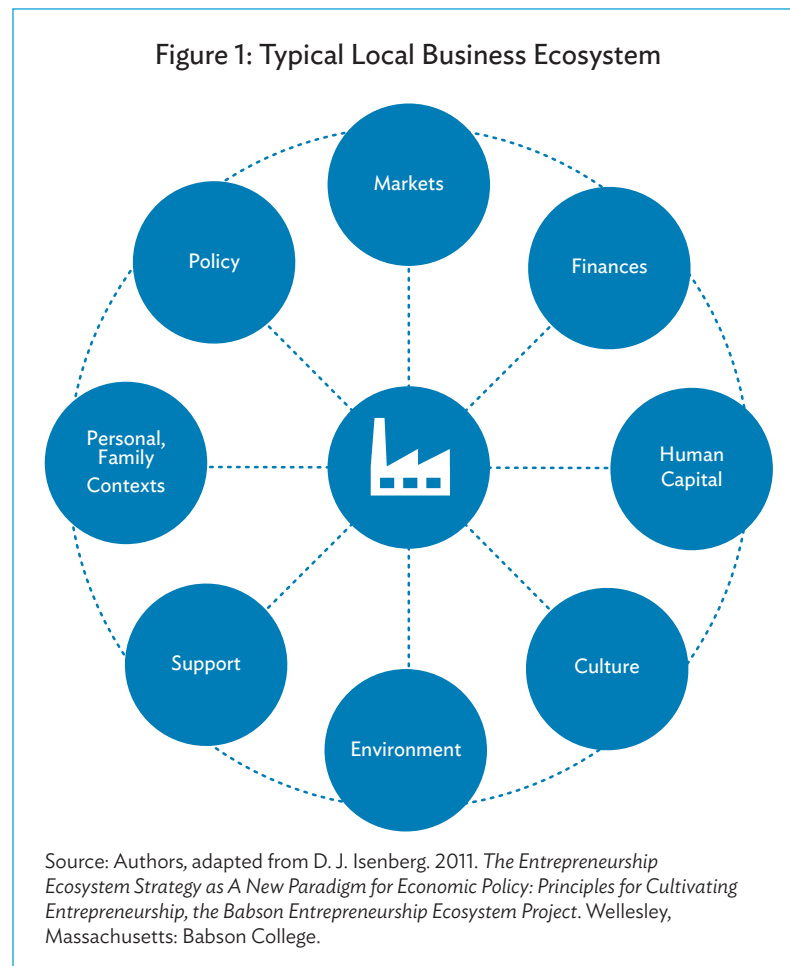
MSMEs operate in complex environments and their success depends on different variables, many of which are interrelated. A change in one business operating condition can have unforeseen consequences on other parts of the MSME ecosystem. Successful local economies are often those that understand and manage these factors in a way that promotes regional businesses. This requires a more nuanced policy approach that considers the entire ecosystem in which businesses operate.

An ecosystem is a somewhat nebulous concept, described by the Boston Consulting Group as “this fuzzy term is aptly named, as it represents all of the components, each with their own niche, or vital role to play, that together create a fertile environment for business growth. When one of the components is missing or weak, start-ups or growth may be hindered.”¹⁷ In short, it is an integrated set of rules, processes, policies, institutions, individuals, and businesses that operate together to facilitate, nurture, and encourage the growth of the MSME sector.

The government is a key player in the establishment of a successful MSME ecosystem but cannot achieve it alone. It also requires decentralized planning and participation of local business operators, business associations, investors, advisers, and suppliers. As Pidun, Reeves and Schussler note, “If designing a traditional business model is like planning and building a house, designing an ecosystem is more

like developing a whole residential district: more complex, more players to coordinate, more layers of interaction and unintended emergent outcomes.”¹⁸ In short, a system-wide perspective is needed. It is perhaps easiest to conceptualize this by identifying not only the many different variables that affect the success of MSMEs in a community, but also their interrelationships.¹⁹ Figure 1 shows how this might apply to firms.

A holistic approach to small firm development is needed because MSMEs are a major economic stakeholder and progress on transformational policy objectives of governments and global commitments requires their alignment with these goals. While it may be tempting to promote a handful of targeted measures, policy makers need a mix of tools to address the needs of this heterogeneous sector, with different emphasis across time and spaces.

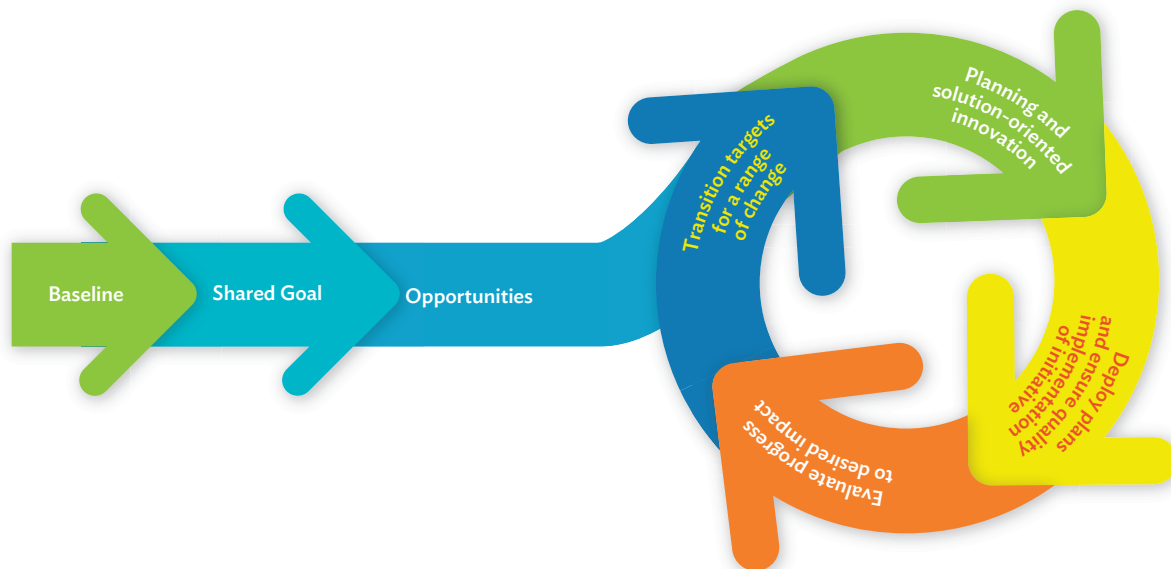


¹⁷ L. Ferguson and K. Zueli. 2022. *ICIC's Small Business Ecosystem Framework - ICIC*. Boston: ICIC.

¹⁸ U. Pidun, M. Reeves, and M. Schussler. 2020. *How Do You "Design" a Business Ecosystem?* Boston: Boston Consulting Group.

¹⁹ D. J. Isenberg. 2011. *The Entrepreneurship Ecosystem Strategy as A New Paradigm for Economic Policy: Principles for Cultivating Entrepreneurship, the Babson Entrepreneurship Ecosystem Project*. Wellesley, Massachusetts: Babson College.

Figure 2: Micro, Small, and Medium-sized Enterprise Ecosystem Transition Process



Source: Authors, adapted from Climate View. [Innovative Cities Use ClimateOS To Build Zero Carbon Economies](#).

What steps could be taken to help MSMEs develop a more conducive and resilient economic recovery in the post-pandemic period? Figure 2 provides an illustration of the MSME ecosystem transition process. An important step is an assessment of the baseline, with MSMEs given a voice in identifying the critical challenges they face and in designing the transformational policies to assist them. This assessment could take the form of a mapping of business ecosystems in regional communities to build better understandings of the complex mix of variables that impact on MSME operations, strategies, and behaviors. This exercise can also help determine which factors are more likely to promote economic growth and MSME developments. A baseline can help create joint understandings and a shared visions where the needs of MSMEs are prioritized to ensure a strong alignment to a common goal.

The full potential of transition opportunities for sustainable, inclusive pandemic recovery needs to be understood by all, including where MSMEs are in local economies and what they need to transition. Important factors may include the following:

- **Focus on providing personalized business assistance to micro, small, and medium-sized enterprise operators.** MSME management is strongly driven by the owner-manager’s own personal goals, skills, and knowledge, which is often based on individual networks, experience, resources, contacts, and family. Recognizing this, many countries now provide business

information centers for MSMEs, typically staffed by persons with first-hand business experience and business facilitation skills. A challenge is providing such services in regional communities, with digital and mobile advice services offering potential solutions.

- **Provide adaptation strategies for coping with changing climate and environmental conditions.** Small regional firms in the Mekong River system will face challenges as climate change continues.²⁰ Many smaller enterprises have limited risk mitigation strategies, such as insurance, and are only inclined to prepare for extreme weather events after a natural disaster. MSMEs need support, advice, and financial assistance from governments to understand new trends and successfully adapt.
- **Develop mitigation approaches for managing personal and commercial risk.** Calculated risk-taking lies at the heart of all entrepreneurial ventures. All small business operations are inherently risky, but modern economies have measures to help mitigate risk and manage the consequences of business failure. Business insolvency regulations have proven themselves useful tools in allowing businesses to close, reducing the owner’s personal liabilities while still protecting the interests of creditors. Affordable insurance is another important measure. GMS economies should review their existing insurance and liability frameworks and reform as required.

²⁰ M. T. Schaper. 2022. *SME Responses To Climate Change in Southeast Asia. Trends in Southeast Asia*. Issue 2 (TRS 2/22), Singapore: Institute of South East Asian Studies-Yusof Ishak Institute.

- **Provide better protection for the self-employed.** Solo operators often trade in some of the most marginal, highly competitive fields where financial returns are low and risk of failure is high. They typically have few resources to fall back on if they cease trading. It is appropriate that self-employed persons should also be given the opportunity to participate in social insurance schemes, retirement provident funds, and other contributory schemes.

Better partnerships will enable the government and MSMEs to co-design more appropriate regulations that drive progress on goals. Enhancing the regional voice of MSME industry associations in this process is important. Small firm operators should have a voice when national, provincial, and local governments decide on economic policies. It may be worthwhile fostering the creation of MSME associations in regions where these entities do not yet exist. Where they already exist, local and national policy makers should ensure they are invited to participate regularly in consultative forums.

There is tremendous scope for local planning processes to identify opportunities for delivering innovative solutions to help MSMEs contribute to shared development goals. Effective implementation requires planning and capacity, including setting transition targets that will support a range of targeted change, solution-oriented innovation planning, and deployment. Developing capacity within MSME associations is important to achieve progress, as many such

associations have limited financial resources and few staff. This makes it difficult for them to professionally develop policy ideas, expand their members, and develop dissemination networks for sharing information on public policies.

A good evaluation system is needed to track progress to shared goals. Such a system can help foster a regional data-driven approach for greater transparency and agility in public policy. The current shortage of easily accessible, reliable, and common statistics across the GMS poses a greater challenge than may be obvious. Without data, it is difficult to compare, measure, and critique policy initiatives. It also means that the MSME sector is not well-understood. Critically, nations should consider adopting standardized MSME definitions and data collection methodologies.

In September 2021, the Association of Southeast Asian Nations (ASEAN) and the Organisation for Economic Co-operation and Development (OECD) jointly published a discussion on the need for robust and comparable business statistics, pointing out the potential gains to be made if accurate, standardized information can begin to be collected and published.²¹ This initiative should be supported. Further, moving to a common classificatory model with recommended standard definitions among member states has shown itself to be a powerful tool for understanding local and national trends, and in evaluating the effectiveness of different policy programs, including those related to the promotion of entrepreneurship, skills, and regulatory environments for supporting better livelihoods for all.²²

²¹ ASEAN and OECD. 2021. *Strengthening Evidence-based MSME Policymaking in ASEAN Building Up More Robust, Timely, Comparable and Accessible Business Statistics*. Jakarta.

²² European Union. 2022. *Small and Medium-Sized Enterprises (SMEs)—Structural Business Statistics*. Brussels (accessed 30 June 2022).

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