SME ACCESS TO FINANCING: ADDRESSING THE SUPPLY SIDE OF SME FINANCING

REPSF Project No. 04/003

Author:

RAM Consultancy Services Sdn Bhd

FINAL MAIN REPORT
July 2005

INTRODUCTION

This is the Main Report for the Project "SME access to finance: Addressing the supply side of SME financing". The Report contains several parts organised in the following manner.

I. Overview of SME Sector in ASEAN
II. Status of SME Financing – A Review of Facilities and Infrastructure
III. Review of Legal and Regulatory Environment – Constraints and Shortcomings of the Institutional Support Framework
IV. Credit Scoring as a Tool for SME Financing
V. Recommendations for Regional and National Strategies.

This document summarises the key research findings of the main impediments to SME access to financing for the member ASEAN countries. The detailed findings of each country can be found in the respective Country Reports.

This page has intentionally been left blank.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF BOXES

ABBREVIATIONS

ADB	Asian Development Bank
APEC	Asia Pacific Economic Corporation
ASEAN	Association of South East Asian Nations
CCRIS	Central Credit References Information System
D	Vietnamese Dong
DFI	Development Financial Institutions
EU	European Union
FDI	Foreign Direct Investment
GBP	Great Britain Pound Sterling
GDP	Gross Domestic Product
GLC	Government Linked Corporation
IFC	International Finance Corporation
JBIC	Japan Bank for International Corporation
MET	Federal Ministry of Economy & Technology
MFI	Micro Finance Institution
MPDF	Mekong Project Development Facility
NPL	Non-Performing Loan
RM	Malaysian Ringgit
Rp	Indonesia Rupiah
S$	Singapore Dollar
SIFC	Small Industrial Finance Corporation
SME	Small and Medium Enterprise
SMI	Small and Medium Industry
SMIDC	Small and Medium Industry Promotion Corporation
SMIDEC	Small and Medium Industries Development Corporation
UEAPME	European Association of Craft, Small and Medium-sized Enterprises
UNCTAD	United Nations Conference on Trade and Development
US	United States of America
US$	United States Dollar

ACKNOWLEDGEMENT

This study and fieldwork survey would not have been possible without the kind assistance and contribution of the following institutions and focal points. The authors wish to record each of them a word of thanks. And not in the least, the invaluable guidance of Dr Ramonette Serafica and Ms Thitapha Wattanapruttipaisan and the assistance of the ASEAN Secretariat are also fully appreciated.

A. BRUNEI DARUSSALAM

Organisations
Baiduri Bank Berhad
Economic Planning and Development Department (JPKE)
Financial Institution Section, Ministry of Finance
Hongkong and Shanghai Banking Corporation Ltd (HSBC)
Islamic Bank of Brunei (IBB)
Islamic Development Bank of Brunei (IDBB)
Ministry of Industry and Primary Resources (MIRP)
National Chamber of Commerce and Industry (NCCI)
Registrar of Companies
Standard Chartered Bank
The Brunei Economic Development Board (BEDB)
Young Enterprise Association of Brunei (YEAB)
Women Business Council of Brunei Darussalam

Special thanks to Dr. Joselito F. Santiago, and Mr. Sidup Hj Belaman (Promotion & Entrepreneurial Development Division, Ministry of Industry and Primary Resources)

B. CAMBODIA

Organisations
ACLEDA Plc
Cambodia Chambers of Commerce & Industry (CCC)
Cambodia Commercial Bank
Canadia Bank Plc
Foreign Trade Bank of Cambodia
Mekong Private Sector Development Facility (MPDF)
Ministry of Industry, Mines and Energy (MIME)
Rural Development Bank

Special thanks to Mr. Chea Dara and Mr. Hun Sang (Department of Small Industry and Handicraft, Ministry of Industry, Mines and Energy)

C. INDONESIA

Organisations
Ministry of Cooperatives & SMEs
Bank Internasional Indonesia (BII)
Bank Lippo
Bank Mandiri
Bank Negara Indonesia (BNI)
Bank Rakyat Indonesia (BRI)

Organisations
Induk Koperasi Kredit

Special thanks to Mr. Munzi H.A. Djalil, Mr. Meliadi, Mr. Sambobo Widjokongko, and Mr. Samady Singarimbun (Ministry of Cooperatives and SMEs)

D. LAO PDR

Organisations
Agricultural Promotion Bank
Banque pour le Commerce Exterieur Lao
Department of Industry, Ministry of Industry and Handicraft
Joint Development Bank
Lao Development Bank
Lao Women's Union

Special thanks to Mr. Somdy Inmyxai and Mr. Manohack Rasachack (Department of Industry, Ministry of Industry & Handicrafts).

E. MALAYSIA

Organisations
Affin Bank Berhad
Alliance Bank Malaysia Bhd
AmBank Berhad
Bank Pembangunan & Infrastruktur Malaysia Berhad
Bank Muamalat Malaysia Berhad
Bumiputra Commerce Bank Berhad
Hong Leong Bank Berhad
Maybank Berhad
RHB Bank Berhad
Small and Medium Industries Development Corporation (SMIDEC)

Special thanks to Puan Hafsah Harun, Ms. Suraya K.A. Rahman (SMIDEC) and SME Unit, Bank Negara Malaysia.

F. SINGAPORE

Organisations
Association of Small and Medium Enterprises (ASME)
SPRING Singapore

Special thanks to Mr. Melvin Lee and Ms. Melissa Goh (SPRING Singapore)

G. THE PHILIPPINES

Organisations
CIBI Information, Inc
Development Bank of The Philippines
Land Bank of The Philippines
Metropolitan Bank & Trust Company
National Credit Council Secretariat
Philippines Business Bank
Philippines National Bank

Organisations
Philippines Savings Bank
Planter Development Bank
Quedan and Rural Credit Guarantee Corporation
Rizal Commercial Banking Corporation
Small Business Guarantee and Finance Corporation (SBGFC)

Special thanks to Ms. Alicia Opena and Ms Ginna A. Go Policy (Planning and Research Division, Bureau of Small and Medium Enterprises Development)

H. THAILAND

Organisations
Bank for Agriculture and Agricultural Cooperatives (BAAC)
Bank Thai
Bualuang Finance Co. Ltd.
Export-Import Bank of Thailand (EXIM Bank)
Krung Thai Bank
Office of SMEs Promotion
Siam City Bank
Siam Commercial Bank
Small Industry Credit Guarantee Corporation (SICGC)
SME Bank
Thai Credit Bureau
Thai Venture Capital Association
The Government Saving Bank (GSB)

Special thanks to Dr. Wimonkan Kosumas, Ms Attanisa and Ms Chanpen (Office of Small and Medium Enterprise Promotion)

I. VIET NAM

Organisations
Agency for SME Development (ASMED)
Asia Commercial Bank (ACB)
Bank for Investment and Development of Vietnam
Business Promotion and Services Centre (BPSC)
Central Institute of Economic Management (CIEM)
Hanoi SME Association (HASMEA)
Industrial and Commercial Bank (Incombank)
State Bank of Vietnam – Credit Information Centre (CIC)
Vietcombank
Vietnam Chamber of Commerce (VCCI)

Special thanks to Mrs. Bui Thu Thuy (Ministry of Planning and Investment, Agency for SME Development).

J. MYANMAR

Organisations
Myanma Investment and Commercial Bank

Special thanks to Mr. Khin Maung (Directorate of Myanma Industrial Planning)

This page has intentionally been left blank.

ABSTRACT AND EXECUTIVE SUMMARY

Small and medium scale enterprises (SME) are the backbone of many successful developed nations such as Japan, Chinese Taipei, Germany and the Republic of South Korea. ASEAN countries too have touted SME as the new engine of economic growth and development. In the last decade or so, various ASEAN governments have formulated national agendas and development polices addressing all aspects of demand and supply to promote the SME sector. However, ASEAN SMEs' contribution to the economy has not reached a level on par with SME in developed countries. Various challenges and impediments prevent SME from developing to their full potential. One of which is the access to formal sector financing.

This study seeks to discover the factors that inhibit SME lending by financial institutions by examining the institutional, legal and regulatory framework present in ASEAN member countries. Concurrently, the research also examines the viability of credit scoring in improving access to finance for SME and surveys the interest of financial institutions to undertake credit scoring for SME loans. The report draws on the findings of the research and fieldwork survey to recommend appropriate strategies to improve access to financing.

SME in ASEAN draw financing primarily from internal funds and the informal sector. Formal sector financing makes up less than 25% of funding needs. This figure is even lower in the transition economies where banking intermediation is still relatively low. A survey of financial institutions throughout ASEAN revealed that many banks and non-bank institutions are generally keen to lend to SME as they realise that on a portfolio basis, SME loans provide higher returns and lower risk compared to large corporate loans. However, these funding institutions face several impediments in financing SME. Naturally, financial institutions attribute most of the impediments to either the government, the prevailing legal and regulatory framework, or the SME. The objective view is that no party is entirely free from blame.

Governments in ASEAN have generally been supportive of SME development by initiating various financing programmes and support measures. These have taken the form of interest subsidies, grants, credit guarantee schemes, loan quotas, export financing, development finance institutions, specialised institutions and the like. By and large, the general consensus is that these government supported initiatives have not been as successful as intended, as indicated by the low rate of formal sector financing achieved by SME. Many have argued that despite the good intentions of government, public sector measures have generated negative trade-offs and encouraged the emergence of a dependency syndrome, which more than off-set the massive subsidies committed to the sector. More often than not too, financing programmes for SME have been compromised by the lack of coordination of governments' development policies or their ad-hoc implementation.

The legal and regulatory framework existing in many ASEAN countries also fails to provide the right support infrastructure to facilitate SME lending by the formal sector. The lack of protection for creditors and enforcement of collateral rights, lack of commercial dispute settlements and arbitration, archaic laws which are not business friendly, lack of fiscal incentives for small enterprises, strict prudential regulations which restrict flexibility of banks, unduly complex or onerous administrative procedures and even simply the lack of a consistent definition or enabling law for SME are some of the impediments to SME financing. It has been pointed out that SME are actually caught between a rock and a hard place: they are large enough to be regulated yet not large enough to enjoy the benefits that are reaped by large enterprises.

As for financial institutions, the study found that some are risk adverse to lending to informationally opaque SME, while others simply do not have the skills needed to understand and evaluate SME. In some large banking institutions, the prevailing mindset is still one of 'bigger is better'. As a result, they demand for collateral, require onerous documentations and subject the SME to the same evaluation criteria as they would large and structured corporations. The poor information environment in many ASEAN countries does not help either. Non-bank financial institutions (such as finance or credit companies) and smaller boutique banks are usually found to be more perceptive and knowledgeable about SME financing than their larger cousins. However, a positive trend is appearing among financial institutions – armed with the lessons learnt from the Asian Crisis and faced with greater competitive pressure, they are increasingly looking to increase lending to medium and small sized enterprises. The availability of newer technologies such as credit scoring has facilitated the progress of some banks' foray into this segment.

As such, most financial institutions are supportive of applying credit scoring to SME loans. In fact, more than 70% of survey respondents in ASEAN-6 economies have implemented some form of rating or scoring for SME loans. However, only a handful of financial institutions are deploying objective scorecards that do not require subjective inputs. Notwithstanding the positive feedback of survey respondents toward the use of credit scoring for SME loans, this report poses the question of what is the real benefit of credit scoring in this context. The benefits of credit scoring are obvious for high volume low value loans and in the risk management of such portfolios. But if SME generally do not have high disclosure standards and are informationally more opaque by nature, would the use of credit scoring really make a difference to the loan decision?

The research concludes with several recommendations that could facilitate greater access to financing by SME at the national level. According to their respective needs, countries could consider to, among other measures, improve the outreach of credit guarantee programmes, promote greater engagement by non-bank financial institutions, standardise SME definition and promote informal debt workout mechanisms for SME while banks in the region could facilitate SME financing by improving the credit evaluation skills of their officers, establish specialised SME units and consider greater interaction with SME associations. The detailed recommendations for each country are found in the individual country reports.

Given the diversity in the economic development and institutional framework of ASEAN member countries, it is quite difficult to recommend regional initiatives that are practical and yet readily adopted for action. Regional initiatives that will materialise into tangible actions require more than mere talk but great effort and real commitment on the part of the respective stakeholders. As such, the recommendations made in this report for regional initiatives are necessarily high level but will hopefully plant a seedling for a practical idea to take off in the near future. The plausible regional initiatives that ASEAN members could perhaps consider include capacity building of newer ASEAN members, organising regional financial forums, establishing a common regional SME definition, creating a reporting framework for SME statistics, creating a regional database for SME in ASEAN and procuring national governments to consider a simplified accounting standards for SME.

July 2005

CONTACT PROGRAMME SUMMARY

Fieldwork

The fieldwork for the Study was conducted between 5 December 2004 and 22 January 2005. Each country visit averaged between four and five working days. All countries except for Myanmar were included. Due to circumstances beyond our control, the fieldwork team was unable to gain access to the focal point in Myanmar despite repeated tries. Consequently no fieldwork visit was made to Myanmar and no country report could be generated.

The fieldwork in each country involved interviewing a number of financial institutions from both the private and public sector. Discussions with regulatory agencies or government ministries involved in SME development and/or financing were also conducted in most countries. In some instances, some interviews were conducted via telephone or just faxed replies. In addition, the fieldwork included interviews with several credit information providers where appropriate. We were able to gain access to financial institutions in most countries except for Singapore and Myanmar.

77 respondents were successfully interviewed and answered the questionnaire for this Study, with their composition as follows.

Survey Respondents

Country/Group	Financial Institutions	Regulatory Agencies	Credit Information Providers	Total
Brunei Darussalam	4	7	-	11
Cambodia	6	2	-	8
Indonesia	5	-	-	5
Lao PDR	4	2	-	6
Malaysia	8	1	-	9
Myanmar	1	-	-	1
Singapore	-	2	-	2
Thailand	10	2	1	13
The Philippines	10	1	1	12
Viet Nam	4	5	1	10
Total	**52**	**22**	**3**	**77**

Survey Questionnaire

Three sets of questionnaires were distributed to cater to financial institutions (FIs), regulatory agencies and credit information providers. For the FI group, the survey used semi-structured questionnaires containing 62 questions based on three main areas of focus namely the banks' general policy and practices on SME financing, credit rating/scoring of SME loans and a quantitative survey of SME lending by FIs. For the regulatory agencies, which included a diverse set of entities such as government ministries in charge of SME affairs, chambers of commerce and SME associations, the survey had 21 open-ended questions based on SME funding schemes, information database, channels of SME financing, bank financing of SME and initiatives to improve SME financing. The final set of survey questionnaires was for credit information providers and contained 11 open questions with respect to the facilities and service provided by the respondents in relation to SME.

In total, we distributed 143 questionnaires to survey respondents. A total of 77 questionnaires were subsequently completed and returned to us. This represents an overall response rate of 54%. The findings of the fieldwork for this Study are tabulated and analysed from this number of respondents.

In conclusion, the fieldwork programme was generally successful in obtaining the cooperation of the various stakeholders with interest in SME development and financing. All the respondents interviewed were cooperative and generous with sharing their knowledge and information on SME financing and expressed a common interest to further promote SME financing. The focal points in each country played a critical and much appreciated role, without whose help this fieldwork and Study would not have been possible.

Appendix 2 provides further details of the Study's contact programme.

I. OVERVIEW OF SME SECTOR IN ASEAN

A. SIZE AND CHARACTERISTICS OF SME SECTOR

SME are considered the engine of economic growth in most Asian economies by virtue of their sheer number and significant economic and social contributions. The role of SME in industrial development in Asia is more pronounced than in the West. In countries such as Japan, Taiwan, South Korea and China, SME are the backbone of the industrial and manufacturing sectors. Their number and contribution to total employment in these economies are well over 95% and 70% respectively. Likewise in the ASEAN economies, SME generally account for upwards of over 90% of establishments, between 20-40% of total domestic output and employ between 75-90% of the domestic workforce.

Different definitions of SME are used in each country but for the purpose of this report, the general definition of a small enterprise employing less than 100 people and a medium enterprise employing less than 250 people are adopted. Table 1.1 shows a snapshot view of the SME sector in ASEAN and selected East Asian countries (for comparison). There is an (rough) estimated total of some 21 million non-agricultural SME in ASEAN in the period leading up to 2004. In the wider realm of APEC, there was an (rough) estimated 49 million non-agricultural SME in 2000. For more detailed information on statistics of the SME sector, please refer to the ASEAN Blueprint Policy, and the APEC Profile of SME.

Table 1.1: Size of SME sector in ASEAN and selected countries in East Asia

Country	No. of non-agri SME in 2002 or later or best guess ('000)	SME as a % of	
		All Firms	Workforce
Brunei Darussalam	30[c]	98	92
Cambodia	26	99	45
Indonesia	16,000[h]	98	88
Lao PDR	22[e]	-	-
Malaysia	205	84	32.5[f]
Myanmar	34[e]	96	78
Singapore	60 – 72[a]	90	44
Thailand	1,640	96	76[f]
The Philippines	68[b]	99	99
Viet Nam	2,700[d]	96	85
East Asia[g]			
China	8,000	99	75
Chinese Taipei	1,050	98.1	78.1
Hong Kong	292	98	43.4
Japan	6,140	99.7	69.5
South Korea	2,700	99.2	75.3

Notes:
a – est. active ; b – excludes 744,000 micro enterprises (2001) ; c - est. active (2004) ; d – excludes 10 million household enterprises, better categorised as micro enterprises ; e – 1998/9 ; f - manufacturing sector only; g – best guess for 2000 ; h – includes micro enterprises. Estimated actual SME is closer to 700,000 firms.

Sources: Profile of SMEs and SME Issues in APEC 1990-2000; ASEAN Policy Blueprint, Malaysian Economic Report 2003/4; Information from fieldwork survey; various country reports

B. CONTRIBUTION OF SME TO THE ECONOMY

In spite of the significance of these indicators, the SME sector's value added contribution to the economy for most ASEAN countries has yet to commensurate with the sector's size and socioeconomic potential. In Singapore, the most developed of the ASEAN member countries, the value added of SME is only 24% of the economy's total value added and 16% to export earnings while their productivity is half that of large establishments. Malaysian SME contributed only about 26% to manufacturing value added and 6% of value added to GDP. In Thailand, commonly cited as a successful model for SME development in ASEAN, the SME contribution is more significant at just below 40% of GDP and total industrial export.

As noted by Wattanapruttipaisan (2004), SME in ASEAN contribute a disproportionately limited share of 20% to 30% to gross sales value or manufacturing value added and only between 10% and 20% to export earnings. Comparatively in the developed nations, SME contribute 50% of total value added in the European Union (for example, in Germany, SME contribution to Gross National Product is 57% and 30% to direct exports), between 40% and 50% of manufacturing output in Japan, Republic of Korea and Taipei, China and in the United States, 30% to sales value.

This reflects the 'hollowness' or dualistic nature in the ASEAN industrial structure that impedes higher productivity and graduation of local SME into large(r) scale enterprises. SME play strategic roles in private sector development in Asia, especially in the aftermath of the 1997 Asian Financial Crisis. As economies modernise and industrialise, SME provide the much-needed inter-firm linkages required to support large companies to ensure that they remain competitive in the world markets. SME are also the main generator of employment in Asia, creating employment of up to 90% of the domestic workforce in many countries. With support from all stakeholders, not least the financial sector, a competitive and innovative SME sector will hold out much gain in terms of higher income growth, fuller domestic employment, gainful integration into the global economy and greater equity in terms of wealth distribution (ASEAN Policy Blueprint).

In the light of fiercer global competition triggered by trade liberalisation, investment flows and technological advances, regional co-operation in support of the development and integration of SME is more urgent now than ever if the SME sector were to yield the much social and economic returns within and across ASEAN.

II. STATUS OF SME FINANCING: A REVIEW OF FACILITIES AND INFRASTRUCTURE

Introduction

SME financing (especially by the formal sector) has always remained an intractable problem in ASEAN. Financing resources are typically in short supply in developing economies, support measures for SME have limited outreach at high cost and financial intermediaries favour large enterprises. Further, institutional limitations such as underdeveloped or inefficient legal framework and regulatory infrastructure pose significant barriers to effective financing. This is especially so in the transition economies of ASEAN where social perceptions and administrative attitudes are not yet wholly judicious to private enterprise. As a result, SME' share of available financing resources is disproportionately less than their relative contribution to employment, value added and economic growth.

Recognising the importance of the SME sector, governments in ASEAN have initiated various programmes to assist and strengthen SME development, including access to financing. Some countries such as Singapore and Thailand have SME master plans that attempt to address the entire gamut of SME development issues from both the demand and supply perspectives. There are few initiatives that are solely private sector driven since SME are generally perceived as higher credit risk by financial institutions. In the transition economies of ASEAN-4, the lack of private banking intermediation and the poor state of public finance, among other constraints necessitate key roles by supranational bodies such as the World Bank, IFC and the Asian Development Bank.

Chapter Organisation

Given varying degrees of economic development and financial sector intermediation among ASEAN member countries, it is more pragmatic to discuss the status of SME financing with respect to the two major groupings of ASEAN-6 (Singapore, Malaysia, Thailand, The Philippines, Indonesia and Brunei Darussalam) and ASEAN-4 (Viet Nam, Cambodia, Lao PDR and Myanmar). This is because many of the aspects of SME financing facilities and infrastructure ranging from sources of funding, types of programmes and their implementation, tools and technologies of financing, information access, and their outcomes are influenced by the stage of development of each country's financial and economic systems.

This chapter will review these issues with respect to the two groups. The outcomes and impact of these supply side issues will be examined to identify the lessons learnt and best practices for SME financing.

A. SOURCES OF SME FINANCING

SME draw financing from a variety of sources. Around 75-90% of ASEAN SME rely on internal savings, retained earnings and borrowing from family, friends and money lenders (collectively known as 'informal sector') as opposed to the 3-18% which have access to formal sector finance (banks, capital markets, venture capitalists etc) (ASEAN Policy Blueprint). For start-up companies, the rate of funding from the formal bank sector is even lower. For example, only 12% of SME in Indonesia had access to bank financing while in Singapore, it is estimated between 20-25% from one source (Association of SME) and 49% from another survey source (DP Infocredit, 2004). In Malaysia, 47.3% of SME had access to bank funds compared to 32.4% that relied on internal funds and 11% from family and friends (Bank Negara Malaysia 2002 Survey).

These figures generally compare poorly against the SME contribution of 20-40% to total domestic output and 75-90% of the domestic workforce in ASEAN. Wattanapruttipaisan's report provides a more complete read on these patterns and characteristics of SME financing. Suffice to say that SME in ASEAN, like their counterparts in other developing countries, generally have not been successful in tapping funds from the formal financial sector. If they did, it is usually at relatively high cost.

Within ASEAN, the dominant sources of SME financing vary between ASEAN-6 and ASEAN-4 due to differences in financial sector development and regulatory environment. The formal banking and to a lesser extent the capital markets of Singapore, Malaysia, Thailand, The Philippines and Brunei Darussalam are relatively well developed to support financing. Table 2.1 shows the ratios of bank loans/GDP in these countries range from 38% to over 400%, indicating the high mobilisation of funds by the banking sector. By comparison, the capital markets (except for Malaysia which has a relatively large debt market vis-à-vis equity market) mobilise only a fraction of the funds in the system. Amongst the ASEAN-6 countries, both the public and private sectors (including financial institutions, non-bank institutions such as leasing, credit and finance companies, cooperatives, credit unions and venture capitalists) are actively involved in private business financing offering their services through a myriad of commercial credit programmes, fiscal programmes and capital market initiatives.

ASEAN-4, by contrast, rely on informal channels and international donor agencies for SME financing, given the lack of banking intermediation, weak legislations and state of the public finance. Even though state-owned and to a lesser extent, private banks prevail in Viet Nam, Cambodia, Lao PDR and Myanmar, the banking sector's role in mobilizing funds (as shown by the low bank loan/GDP ratios) is very limited. Neither the public nor the private sector provides funds for SME financing other than what is channelled through donor agencies. Most banks are also not well equipped in terms of capacity and infrastructure and less willing to offer the needed services to private sector SME.

Table 2.1: Financial Sector Contribution as % of GDP in ASEAN

Financial Sector Contribution as % of GDP				
Country	**Bank Loan/ GDP[1] (%)**	**Bond Market/ GDP[2] (%)**	**Equity/ GDP[3] (%)**	**Total Deposit/ GDP[4] (%)**
ASEAN 6				
Brunei Darussalam	474	-	-	950
Indonesia	1	0	23	12
Malaysia	15	89	16	190
The Philippines	38	35	15	54
Singapore	96	24	20	108
Thailand	94	10	8	101
ASEAN 4				
Cambodia	7.3	-	-	11.7[5]
Lao PDS	11.1	-	-	-
Myanmar	-	-	-	-
Viet Nam	-	-	-	-

Notes:
[1] Figs as at 2004 except for Cambodia and Lao PDR as at 2003
[2] As at 1999 except for Singapore and The Philippines as at 1998
[3] As at 2004 except for Thailand as at 2003
[4] As at 2000
Sources: Individual country statistics; ABA Journal of Banking & Finance Vol XV, No 2, 2000

1. Government Programmes for SME Financing

The public sectors in the six countries of ASEAN-6 have been actively promoting SME development in the last two decades, though not all with the same degree of success. Common commercial credit programmes initiated by the public sector and implemented throughout ASEAN-6 include interest subsidies, credit guarantees, insurance schemes, loan quotas, export financing, and in the case of Thailand, promissory notes. These programmes are delivered to the SME either via private bank and non-bank institutions such as cooperatives and associations and/or state-owned bank institutions and government line agencies. Direct intervention efforts by the government take the form of grants, tax breaks and holidays, creation of dedicated development financial institutions and various business development services to enhance the competitiveness and skill level of SME. Some of the countries also have a one-stop agency to coordinate efforts for SME development, including financing programmes.

The degree of banking intermediation in the ASEAN-4 countries is low. Cambodia and Lao PDR have one of the lowest rates of banking intermediation in the world, with total bank loans to GDP estimated at about 7.3% in Cambodia and 11.1% in Lao PDR in 2003 (Table 2.1). The banking sector in ASEAN-4 is dominated by state-owned banks. Given the four countries are still in transition to market-based economies, the low level of formal financial sector development and poor legislative and regulatory infrastructure, among other constraints, the economic landscapes of ASEAN-4 are presently dominated by state-owned and micro enterprises (comprising mostly households and cottage industries). SME development is not a priority area given the industrial structure in these economies. As such, there are limited programmes to address SME financing. Governments lack the financial capacity to provide internal funding for SME development, are not experienced to manage such programmes and/or are pre-occupied with financing state-owned enterprises while the private sector banks are reluctant to do so due to insufficient legislations to protect their interests. It is the informal sector that plays a paramount role in these four countries.

Table 2.2: Types of Government Programmes and Schemes for SME in ASEAN

Country	Grant/ Incentives	Loan/ Fund Scheme	Guarantee Scheme	Tax Breaks	Devpt Fin Ins (DFI)	SME Bank
Brunei Darussalam	-	x	x	x	-	-
Cambodia	-	-	-	-	x	-
Indonesia	x	x	x	x	x	-
Lao PDR	-	-	-	-	x	-
Malaysia	x	x	x	x	x	-
Myanmar	-	-	-	-	x	-
The Philippines	x	x	x	x	x	-
Singapore	x	x	x	x	-	-
Thailand	x	x	x	x	x	x
Viet Nam	-	x	x	-	x	-

Source: RAM Consultancy Services 2004

Outcomes

By and large, the general consensus is that the government's programmes and support measures have not been as successful as originally intended, as indicated by the low penetration rate of less than 20% in formal financing and the 20-30% contribution to value added. It has been argued that these government measures have generated unfavourable trade-offs and negative externalities such as crowding out of private sector banks and viable businesses, and the emergence of a dependency syndrome and non-repayment culture, to more than off-set the massive subsidies and resources committed to the sector.

There are success stories however. Singapore reports that its loan schemes are well subscribed and attribute their success to appropriate risk sharing, are targeted at specific areas and tap on the private financial institution network to roll out the programmes. A successful example of a Singapore government promoted scheme for start-up companies is the Start-Up Enterprise Development Scheme, or SEEDS, for encouraging private sector investments in innovative seed-stage start-ups through matched equity financing by the government. Government support for start-ups is critical for their survival. In The Philippines government funds, which used to be directly implemented by government line agencies but are now channelled through state-owned and private lending institutions have met with much higher repayment rates than previously experienced.

The most successful type of financing programmes in the ASEAN-4 are the ones funded by international agencies. The international community provides credit, guarantees and equity investment to support SME development in the ASEAN-4 countries. These agencies work in conjunction with government ministries and agencies to administer various lending programmes to SME. In Viet Nam, these include the EU SME Development Fund, JBIC SME Finance Programme and the SME development programme that is administered by the Asian Development Bank (ADB). Funds are channelled through the state-owned banks and private commercial banks. In Cambodia, most of the assistance is focused on infrastructure development and technical assistance to SME. Financing programmes by the Cambodian public or private sector are limited. In early 2004, The German Bank for Reconstruction and Development provided EUR2.5 million for provide financing for SME. This fund is disbursed through a special division of one of the commercial banks.

Numerous credit guarantee schemes (including export financing) have been in operation in East Asian economies for many decades (Malaysia, The Philippines, Singapore, Korea and Thailand). Guarantee schemes are important means to facilitate access to financing for viable SME without adequate collateral. In the case of interest subsidy and credit guarantee

schemes, the government either provides the subsidy or guarantee to SME loans made by private banking institutions (as practiced in Thailand, The Philippines and Malaysia) or the SME loan is insured by private credit insurers but the risk premium is co-shared between the SME and the government (as practiced in Singapore).

However, the common experience is that these guarantee schemes enjoy limited success in many developing economies. As noted by Levitsky and Prasad, there are certain success criteria which must be met in order for these schemes to be effective: an optimal level of risk sharing (70-80%), independent credit appraisal of guarantee covers, sufficient capitalisation of guarantee fund, and transparency and efficiency in processing and honouring guarantees. For example, the national guarantee and financial institution (SBGFC) in The Philippines has limited capacity to provide guarantee as it is self-funding (in addition to providing loans directly as well). Moreover, financial institutions are wary of SBGFC's counterparty risk as its liabilities are not guaranteed by the government in spite of government ownership. Nevertheless in spite of the mixed success of guarantee schemes, it has been argued (by UEAPME) that public money spent for supporting credit guarantee systems is a very efficient instrument and has a much higher multiplying effect than other instruments. The multiplier effect was 1:30 compared to 1:2 for venture capital funds.

Programmes which involve pure grants and export financing have tended to be less successful. Pure grants have tended to fail due to the lack of discipline and willingness of the recipient to repay what they consider is their right to 'free money'. Brunei Darussalam is a case in point. Its Enterprise Facilitation Scheme has a default rate of over 40%. The element of risk sharing is critical for success and sustainability of a scheme. Without which recipients will develop a non-repayment attitude that will only discourage private financial institutions from lending to them. To encourage effective lending by banking institutions and at the same time responsible repayment behaviour among SME, government initiatives should contain a risk sharing element.

Export financing schemes have long been practiced in Malaysia, The Philippines and Indonesia though with limited success (in terms of outreach and non-performing loans). Most SME are not capable of exporting yet, and the schemes are usually administered by state-owned banks which lack commercial credit experience (resulting in misallocation of funds to non-viable businesses), are less efficient (resulting in long processing time), and/or adopt commercial banking principles for lending to SME (resulting in low approval rates).

Loan quotas have met with mixed successes. The mandatory loan quota of 8% imposed by the government on banking institutions in the Philippines is fairly well subscribed. On the contrary Indonesia which imposed a mandatory quota of 20% stopped this practice in 2001 following banking sector reforms and to stem abuse.

Development financial institutions (DFIs) have played only a minor financing role. As reported by Urata (2002) and Regnier (2000), DFIs account for only 4% each of SME credit for working capital and long-term investment in 1999 in Malaysia and 4% and 2% respectively in Thailand. This is not surprisingly given the limited outreach and lack of capabilities of DFIs. An exception to this is the SME Bank in Thailand (see Box 1.0). The Thailand model of having a dedicated state-owned SME bank is a successful one. As an indication of its popularity, the bank had nearly 11,700 customers in 2004 (6,200 customers in 2003 and 1,800 customers in 2002). All of them fall under the SME category. Perhaps in a bid to emulate Thailand's success, Malaysia recently announced in February 2005 its intention to start an SME bank.

Box 1.0: SME Bank of Thailand

The Small Industrial Finance Corporation (SIFC), the forerunner of the SME Bank, was established in 1992 as a state-owned financial institution under the Ministries of Finance and Industry. It is responsible for the promotion and development of Thai SME and as the main funding arm of the Thai government for SME. Besides low-interest financing for business expansion and joint ventures, it also offers consultancy services and supports the SME with venture capital fund. In addition, it is the government's policy-loan vehicle for loans to energy saving projects, SME entitled to ISO standards, research and development projects, and in promotion of particular target sectors[1].

In Dec 2002, the SIFC was re-established as the SME Bank of Thailand with the passing of the SME Development Bank of Thailand Act to offer SME full financial services. Its mandates are "to conduct business with the aim to develop, promote, and assist SME in the establishment, operation, expansion or improvement of their businesses through the provision of loans, guarantees, venture capital, counselling and other necessary services as prescribed by the Act".

The SME Bank has 80 branches in operation in 2004. It operates under both the Ministry of Finance and the Ministry of Industrial Development. It defines a SME as one having between 15 and 200 employees and an asset value of between B30 million and B200 million. In this context, the loan size provided to the SME ranges between B0.5 million and B100 million.

The Bank offers business development training services such as its New Entrepreneur Creation (NEC) programme and Market Research and New Product Development Training alongside financing products that include general loans for a term of not more than 15 years for business expansion and upgrading purposes; factoring; leasing; letter of guarantee and packing credit. The SME Bank also provides joint venture funding to support SME projects so that SME may be free from the burden of interest-bearing loans in funding their projects. The joint venture funding is less than 49% of the equity or project value, subject to a maximum of B50 million for each SME[2].

Due to the need to follow Government instructions to lend at low interest rates to the SME, the SME Bank's profit margin is less than the commercial banks. There is also the additional expense of developing and guiding the entrepreneur, due to its status as a policy-based institution. The default rate of the SME loans registered 26% in 2004 (21% in 2003 and 19% in 2002). As an indication of the popularity of the bank among SME, the bank had nearly 11,700 customers in 2004 (6,200 customers in 2003 and 1,800 customers in 2002). All of them fall under the SME category.

2. Banking Sector Financing

Notwithstanding the low rate of penetration, financing by banking institutions form the most important source of external financing for SME. This is due to the dominance of the banking sector as the main intermediary in the financial systems of ASEAN, notably ASEAN-6 (see Table 2.1). The average share of bank financing for SME in Indonesia, Malaysia, Singapore and Viet Nam is about 25%. In Thailand, indications from our fieldwork suggest an average range of over 40% (2004) with steady improvements made from year to year. In Cambodia,

[1] Refer to the website www2.mof.go.th/state_enterprises.htm
[2] See www.smebank.co.th

Lao PDR and Myanmar, though estimates are not available, fieldwork findings suggest that it is probably in the single digit range given the exorbitant bank lending rates and tight lending requirements.

Each of the ASEAN country has a fair number of state owned and private financial institutions providing financing including to SME. Indonesia and The Philippines have well over 200 and 900 bank institutions respectively (although size is by no means an indication of success in SME financing). There are also numerous non-bank financial institutions (NBFIs) such as finance companies, credit & leasing companies, cooperatives and thrifts, credit unions etc that are involved in SME financing. These banks and NBFIs also participate as conduits for government funds for SME.

Financing Programmes and Tools

The banking sector of ASEAN-6 has available a wide range of generic short, medium and to a lesser extent, long term credit and various supplementary financing instruments including trade credit, export financing, factoring and discounting. Some banks also provide special loans targeted at priority sectors and key segments of the population as identified by the Government.

In Viet Nam, the commercial banking sector comprises of state-owned commercial banks (SOCBs), joint stock banks (JSBs), joint venture banks (JVBs) and representative offices or branches of foreign banks. There are also several credit cooperatives/credit funds, microfinance Institutions and financing companies. Commercial bank lending, however, is dominated by the SOCBs, which command 70% of domestic lending market share in 2002. The JSBs are believed to be an important source of credit to SME. One such example is the Viet Nam EXIM Bank, which supports export business in Viet Nam. JSBs and JVBs offer a wide range of banking services including provision of credit to private enterprises. Letters of credit are offered by some commercial banks to facilitate trade financing but the SME are unlikely to be the main beneficiaries.

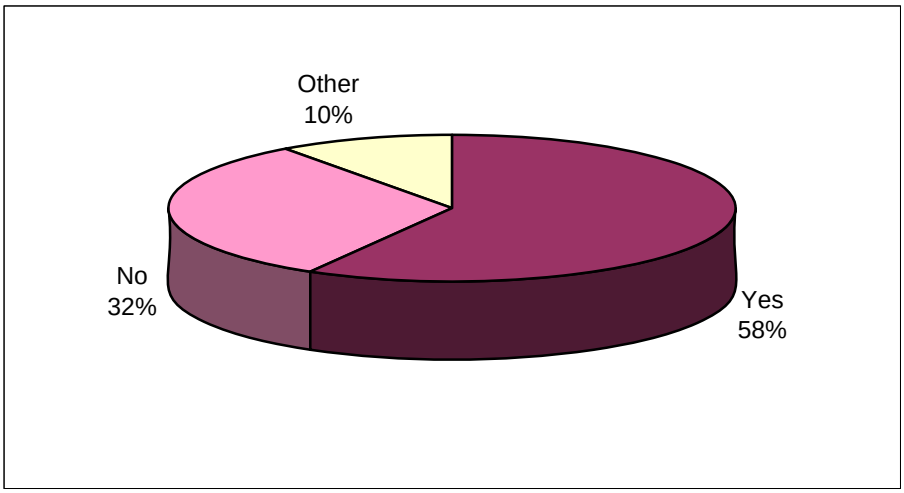
In Cambodia, a special government linked corporation, the Rural Development Bank (RDB), which autonomously supports retail financial institutions by delivering credit for the promotion of (agricultural rural) enterprises and the development of the rural areas of Cambodia, will negotiate and get loans from international agencies and channel the funds to commercial banks and Micro-Finance Institutions. These funds however are always imposed with restrictive covenants, thereby resulting in less flexibility for the RDB in managing the funds. Despite this, the RDB has been creatively managing these funds with encouraging results.

Main Characteristics of Bank SME Lending in ASEAN

Findings from the study's survey revealed the following main characteristics about SME lending practices by banking institutions in ASEAN. Where appropriate and relevant, the discussion would distinguish between bank lending in ASEAN-6 and ASEAN-4. A total of 52 bank respondents (private and government banks) across ASEAN provided the feedback for this survey.

Special/Dedicated SME lending unit (with/out preferred industry sectors). 71% of the banks interviewed in ASEAN-6 have a unit specializing or focusing on SME financing, with some banks wholly devoted to SME lending. By contrast, 70% of banks in ASEAN-4 do not have a special unit dedicated to SME. The difference is a result of a few reasons, namely the very low penetration rate of bank financing for SME and the dominance of large state-owned enterprises and micro enterprises in ASEAN-4.

Figure 2.1: Dedicated SME Lending Unit in ASEAN Banks



Source: RAM Consultancy Services 2004

Of the banks that provide funding to SME, lending to SME is guided by the official Decree/Act (such as in Thailand, Viet Nam and The Philippines) or by certain government agencies (such as in Malaysia, Singapore and Indonesia). As discussed elsewhere in this report, having an official definition cemented by an act of parliament is a critical first step to coordinated efforts to SME development and to effectively facilitate financing programmes for the sector.

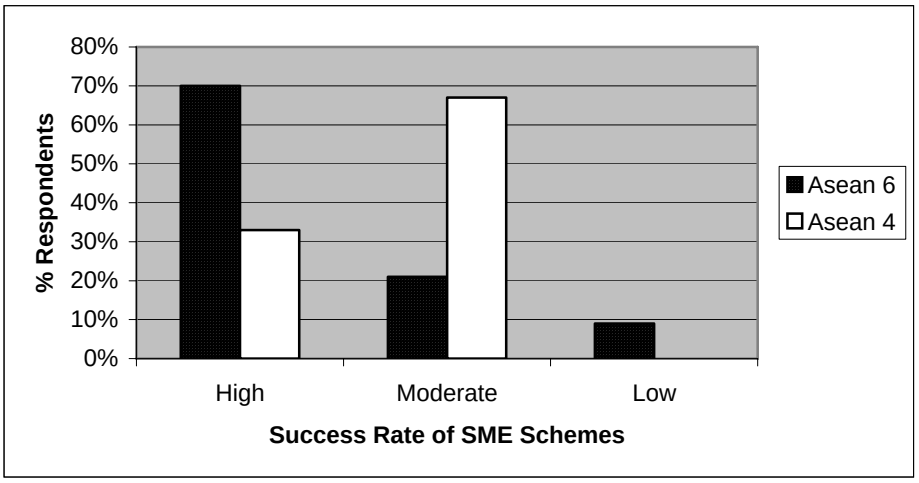
Industry sector plays an important role in influencing the overall bank lending direction. Banks usually target or avoid industries in accordance to the prevailing economic performance. More than 60% of all banks interviewed have preferred sectors of industry that are targeted. While 70% of banks in ASEAN-6 avoided certain industries, 62% of their counterparts in ASEAN-4 do not have such policy. In The Philippines, Thailand, Malaysia and Indonesia, banks generally prefer manufacturing and trading and are adverse to real estate related sectors. In Viet Nam, banks favour export oriented manufacturing over construction related sectors.

Specific Financing Schemes and Government sponsored Schemes and Outcomes. Almost 90% of respondents in ASEAN-6 participate in SME financing through government-sponsored schemes. In ASEAN-4 countries where currently there are no local government-sponsored schemes, banks participate in financing SME through funds channelled by international agencies. There are a few banks in the region that have developed and funded their own specific schemes for SME.

Of those that participate in government financing schemes in ASEAN-6, 70% rated their success as being high. The key indicators of success include high approval rates of over 80% for some banks, low rate of non-performing loans (averaging 10% in the case of Thailand) and high growth rate in the SME portfolio (more than 20% in the case of some Thai banks). The main drivers of success as cited by respondents include having a specialised SME lending unit and the lower interest rates of government-sponsored programmes. For respondents who cited moderate to low success, reasons attributed include the bank being a newcomer to SME financing, SME are not fully aware of available schemes, there are too many restrictive conditions imposed by the schemes on borrowers, and in the case of the transition economies, SME is a relatively new sector of the economy and banks have to

comply with government policies in SME lending. Some banks in Brunei Darussalam cited the poor discipline of borrowers to repay as being the key driver of failure of SME financing schemes.

Figure 2.2: Success of SME Schemes as rated by ASEAN Banks



Source: RAM Consultancy Services 2004

The commercial banking sector deploys a variety of financing instruments/facilities for SME financing. Common financing facilities include term loan, trade financing, revolving loans/overdrafts, factoring and leasing. The first three are regular/common facilities (with term loan being most popular) of banks in ASEAN-6 while revolving loans and factoring are more popular in ASEAN-4. This reflects the underlying institutional structures of each country. In ASEAN-6, the financial markets are sufficiently developed to mobilise medium to long-term funds. The under-development of both the financial markets and legislative framework make the same instruments less viable in the transition economies. Hence, the bulk of funding types available is of short duration and trade-based. Over 70% of financing instruments in Lao PDR are short term while in Viet Nam, 55% is short term compared to 22% medium term instruments. In contrast, near 70% of financing instruments are medium to long term in Malaysia and over 75% are medium term instruments in Indonesia. In Thailand, the financing instruments are well distributed in terms of duration, with a higher propensity toward medium to long term financing.

Table 2.3: Distribution of Loans by Duration in ASEAN Banks

		ASEAN 6					
		Brunei	**The Philippines**	**Malaysia**	**Singapore**	**Indonesia**	**Thailand**
SME	Overdraft/ Revolving	-	-	19.0%	-	-	28%
	Short-Term	-	41%	13.3%	-	16.46%	13%
	Medium-Term	-	46%	36.0%	-	76.39%	24%
	Long-Term	-	13%	33.0%	-	7.15%	31%
	Other	-	-	-	-	-	4%
All Other Loans	Overdraft/ Revolving	-	-	-	-	-	-
	Short-Term	-	90%	-	-	2.57%	-
	Medium-Term	-	5%	-	-	58.89%	-
	Long-Term	-	5%	-	-	38.54%	-
	Other	-	-	-	-	-	-

		ASEAN 4			
		Lao PDR	**Viet Nam**	**Cambodia**	**Myanmar**
SME	Overdraft/ Revolving	-	-	-	-
	Short-Term	77%	55%	20%	-
	Medium-Term	18%	22%	80%	-
	Long-Term	5%	15%	-	-
	Other	-	-	-	-
All Other Loans	Overdraft/ Revolving	-	-	-	-
	Short-Term	80%	53%	80%	-
	Medium-Term	20%	18%	20%	-
	Long-Term	-	30%	-	-
	Other	-	-	-	-

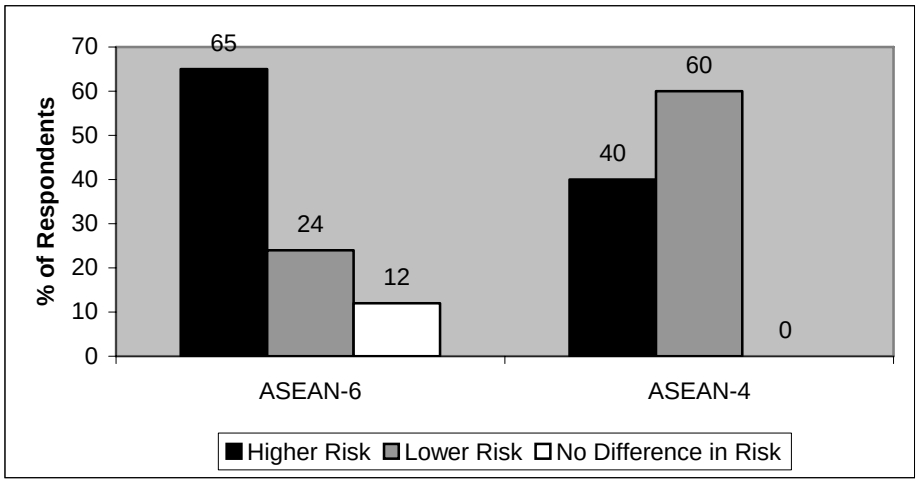
Source: RAM Consultancy Services 2004

There is no compelling evidence, not least where our survey is concerned, to conclude that SME in ASEAN have limited access to longer duration funds compared to large businesses. The ability of SME to access long or short-term funds is probably dictated by the risk preference of individual banks and the existing banking structure over that of any inherent bias toward SME in general.

Opinion on SME financing. 65% of respondent banks in ASEAN-6 opined that SME loans have higher risk. In ASEAN-4, 40% considered SME as higher risk while 60% did not. The common reasons for regarding SME loans as higher risk include lack of capital, skills and professionalism, poor transparency and limited market access.

The main reason that some other banks treat SME as lower risk is due to the diversification and risk lowering effect of a large number of small SME loans in the portfolio (the risk of small numbers). Moreover SME loans are usually secured. Further, in Lao PDR for example where SME loans are akin to large corporate loans, the lower risk is attributed to more scrutiny and monitoring given to such loans.

Figure 2.3: Opinion of ASEAN Banks on SME Risk relative to Large Borrowers



Source: RAM Consultancy Services 2004

Consequent of the perception of higher risk, banks tend to compensate by charging higher margins for their SME loans in comparison to large corporate customers. 60% of bank respondents revealed this to be true. In ASEAN-6, the margin spread can reach as high as 15% in the case of Indonesia while in ASEAN-4 economies, interest rates of as high as 36% per month are not uncommon.

It is interesting to note that despite popular opinion (of SME being higher risk), our survey findings did not establish any significant difference in the rate of default between SME loans and other types of loans. In fact, the default rates are marginally in favour of SME loans.

Share of Credit Extended to SME. The share of credit extended to SME by respondent banks varies widely. For dedicated SME banks, the share is 100%. On average, SME loans constituted between 15-52% of total loans in 2004 for respondents in ASEAN-6 (with a rising trend from 2002-2004). Banks in Malaysia and Thailand had a consistent portfolio of about 40% SME loans vis-à-vis total loans while in The Philippines it is about 60%. In ASEAN-4, the reported figures range from 30-50% (rising trend from 2002-2004).

The rising trend in SME loans indicate that though many SME programmes in ASEAN have not met with their objectives, some promotion activities of the various governments have not totally been in vain. If at all any meaningful trend can be deduced, the number of SME borrowers of respondent banks increased from over 6,700 in 2002 to 15,000 in 2003 and 12,000 in 2004.

Table 2.4: % of SME Loans to Total Loans in ASEAN Bank Respondents

	ASEAN							
	Brunei Darussalam	**Cambodia**	**Indonesia**	**Lao PDR**	**Malaysia**	**The Philippines**	**Thailand**	**Viet Nam**
2004	15%	27%	52.00%	53%	39%	52%	39%	35%
2003	-	23%	19.10%	44%	39%	65%	34%	22%
2002	-	10%	16.34%	42%	38%	61%	29%	20%

Source: RAM Consultancy Services 2004

In terms of the average loan size, survey findings indicate that for The Philippines the range was between US$18,000 to US$180,000 while in Thailand, the range was US$52,000 to US$900,000. There were too few responses from the other countries to deduce any meaningful findings. Our own experience in Malaysia suggested an average of US$250,000 and below. In Singapore, findings from another survey in 2004 indicated that 30% of SME loan sizes were below US$60,000 and 20% between US$60,000-US$600,00 (DP Information Group, 2004).

Table 2.5 shows the key characteristics of SME loans extended by a commercial bank and government DFI in Malaysia in 2004.

Table 2.5: Characteristics of SME Lending By A DFI And Commercial Bank

	DFI	Commercial Bank
% of SME loans to total loans	58%	20.2%
No of SME customers	2,162	5,691
Average length of bank relationship with SME in years	5	8
Average size of SME loan	RM1 million	RM4 million
Security		
- % of SME secured loans	80%	65%
- % of total loans secured	37%	-
% of loans guaranteed by a Government Scheme/ Fund	52.5%	18%
Average premium charged to SME for		
- Secured Loans	2.5%	1.5% + BLR
- Unsecured Loans	3.5%	2.5% + BLR
Default Rates		
- % Defaulted SME to total SME loans	19.7%	6.7%
- % All defaulted loans to total loans	3.1%	28.2%
% of SME loans secured by		
- Home mortgage	-	1%
- Plant and property	-	49%
- Cash	-	30%
- Stock/ inventory	-	-
- Receivables / debtors	-	20%
- Others	-	-
% of SME loan by facility type		
-Term / Fixed loan	75%	10%
- Trade Financing	2%	60%
- Revolving Loan	4%	30%
- Factoring	0%	-
- Leasing	5%	-
- Others	14%	-
% of SME Loan by Duration		
- Overdraft / Revolving	-	37.4%
- Short term	-	26.6%
- Medium term	40%	31.0%
- Long term	60%	5.0%
- Other	-	-

Source: Survey Questionnaire, RAM Consultancy Services 2004

Common Financing Approach/Lending Technologies. In financing SME, the most popular approaches adopted by respondent banks in ASEAN are transaction, collateral and relationship lending. Collateral lending is the most common approach of banks in ASEAN-4, while transaction lending prevails in ASEAN-6. By transaction lending, we mean the practice of treating loans in bulk not unlike retail loans. The difference in practice between the two groups can be explained by the relative development of banks in ASEAN-6 where technologies such as programme lending and credit scoring are deployed to move high volumes of small loans. Some banks in Singapore and Malaysia for example have grown to a size where it is no longer feasible for them to apply a time-consuming relationship approach to SME loans. Conversely the SME sector is still very new in ASEAN-4. Hence, such

technologies as used by big banks elsewhere are not yet available nor applicable in ASEAN-4. As discussed elsewhere in this report, the supplementary form of financing such as factoring and trade credit are less commonly used for SME lending.

Regardless of the lending technology adopted, banks in ASEAN are still demanding collateral from SME. On average throughout ASEAN in 2004, 85% of SME loans were secured (2003: 91%, 2002: 86%). A discouraging fact, notwithstanding the declining trend. By contrast in the same period of 2004, 71% of all loans were secured. This revealed that banks were less willing to lend on a clean basis to SME compared to large businesses. In fact, SME loans made by respondent banks in Indonesia and Cambodia are 100% secured! In Malaysia, 73% of SME loans were secured as opposed to 37% for large loans in 2004 while in Viet Nam, it was 77% and 40% respectively.

Table 2.6: % of Secured SME Loans Vs Unsecured SME Loans in ASEAN Banks

		2004		2003		2002	
		Secured	**Unsecured**	**Secured**	**Unsecured**	**Secured**	**Unsecured**
ASEAN 6	Brunei Darussalam	-	-	-	-	-	-
	The Philippines	85%	15%	80%	20%	50%	50%
	Malaysia	73%	28%	80%	20%	80%	20%
	Indonesia	100%	0%	100%	0%	100%	0%
	Thailand	93%	7%	93%	7%	94%	6%
ASEAN 4	Lao PDR	67%	33%	-	-	-	-
	Viet Nam	77%	23%	94%	6%	92%	8%
	Cambodia	100%	0%	100%	0%	100%	0%
Average		85%	15%	91%	9%	86%	14%

Source: Survey Questionnaire, RAM Consultancy Services 2004

Table 2.7: % of Secured Total Loans Vs Unsecured Total Loans in ASEAN Banks

		2004		2003		2002	
		Loans Secured	**Loans Unsecured**	**Loans Secured**	**Loans Unsecured**	**Loans Secured**	**Loans Unsecured**
ASEAN 6	Brunei Darussalam	-	-	-	-	-	-
	The Philippines	85%	15%	85%	15%	70%	30%
	Malaysia	37%	63%	-	-	-	-
	Thailand	96%	4%	100%	0%	100%	0%
ASEAN 4	Lao PDR	65%	35%	-	-	-	-
	Viet Nam	40%	55%	-	-	-	-
	Cambodia	100%	0%	100%	0%	100%	0%
Average		71%	29%	95%	5%	9%	10%

Source: Survey Questionnaire, RAM Consultancy Services 2004

The most common form of security is plant and property, followed by home mortgage pledged by the entrepreneur. Trade receivables and stock in trade are not popular forms of security for SME loans, in line with the less common practice of factoring, trade credit and other supplementary forms of financing for SME in ASEAN.

Table 2.8: Most Common Type of Collateral of SME Loans in ASEAN Banks

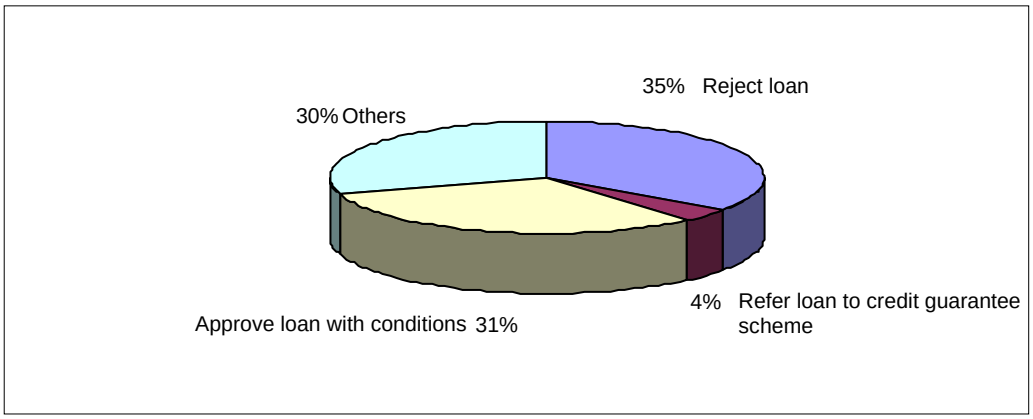
Collateral Type	Cambodia	Indonesia	Lao PDR	Malaysia	The Philippines	Thailand	Viet Nam
Home Mortgage	45%	33.33%	0%	1%	18%	41%	35%
Plant and Property	55%	33.33%	89%	49%	76%	29%	60%
Cash	0%	33.33%	1%	30%	4%	8%	0%
Stock/ Inventory	0%	0.00%	10%	0%	1%	0%	0%
Receivables/ Debtors	0%	20.00%	0%	20%	1%	6%	0%
Others	0%	0.00%	0%	0%	1%	16%	5%

Source: Survey Questionnaire, RAM Consultancy Services 2004

Processes and Documentation. In evaluating SME loans, banks require various documentation, chief of which are the business plan, financial statements and bank statements. Other documents include proof of income, asset ownership, contracts and proof of payment habits. The survey findings indicate that upward of 50% of SME are able to supply the required documents. For those that cannot do so, the respondent banks indicate that they do not automatically reject the application. Instead the normal practice is to approve the loan with conditions, find alternative evidence of credit worthiness or to assist the borrower to prepare the necessary documentation. Presumably, this is only done for SME for which banks have conducted preliminary checks and are found to be bankable.

For SME with insufficient collateral, under 5% of bank respondents will refer the loan to a credit guarantee scheme. This dispels the notion that banks tend to refer unbankable credit to the government guarantee scheme. Further, credit guarantee schemes in ASEAN have not been as effective in outreach as generally believed.

Figure 2.4: Action of ASEAN Banks with SME Borrowers that cannot meet Documentation Requirements



Source: Survey Questionnaire, RAM Consultancy Services 2004

In appraising SME loans, banks rely on various sources of information. Informal checking with other banks is a popular means of verification. In some countries such as Malaysia, Thailand and The Philippines, banks can check through some form of central database either maintained officially or by private information providers. Perhaps the existing sources of information in ASEAN can be improved upon given that most banks rated the accuracy, reliability, ease, and cost of obtaining such information as only average.

The average processing time for an SME loan varies significantly from bank to bank. Evidence suggests that commercial banks are faster in processing a loan compared to state-owned banks. This could be due to the greater flexibility of private banks. In countries that rely on international agency funding, the processing time could be prolonged by the need to seek approval from various levels of committee both internal and external.

Table 2.9: Average Loan Processing Time of Financial Providers in ASEAN (2004)

Country	Average Processing Time (range in months)
Brunei Darussalam	1-2
Cambodia	3 days – 3 months
Indonesia	-
Lao PDR	0.5 – 2
Malaysia	0.5 – 3
Myanmar	NM
Singapore	NM
Thailand	Less than 1
The Philippines	1 – 1.5
Viet Nam	0.25 – 2

Note: NM – not meaningful due to small number of respondents
Source: Survey Questionnaire, RAM Consultancy Services 2004

Common Problems/Impediments faced by Financial Providers. From our fieldwork and survey findings, the main impediments faced by respondent banks in financing SME include lack of collateral, lack of bankable business plan, lack of experience, poor financials, lack of track record of the firm or owner, bad credit record, and lack of information on SME. Not surprisingly, few banks admitted to not being familiar or lacking the appropriate expertise to evaluate SME.

Table 2.10: Main Impediments faced by ASEAN Banks in Financing

Impediments Faced by Banks in SME Financing	% Respondents
Lack of quality/ sufficient collateral	17%
Lack of bankable business plan	16%
Lack of/ no track record of firm or owner	16%
Lack of/ poor financials of SME	16%
Lack of accurate and comprehensive information	14%
Lack of information/ published data	13%
Not familiar/ lack expertise to evaluate SME	5%
Others	2%

Source: Survey Questionnaire, RAM Consultancy Services 2004

The impediments faced by banks are the same reasons why SME loans are rejected. The rejection rate can go up to as high as 60% in some countries, giving some anecdotal evidence to the proposition that there could be some credit rationing on SME (or transfer of resource to large businesses) by the banking sector.

Table 2.11: Average Rejection Rate of SME Borrowers by Financial Providers in ASEAN (2004)

Country	Average Rejection Rate (%)
Brunei Darussalam	<10
Cambodia	20-30
Indonesia	-
Lao PDR	<50
Malaysia	10-50
Myanmar	NM
Singapore	-
Thailand	10-50

Country	Average Rejection Rate (%)
The Philippines	10-60
Viet Nam	10-40

Note: NM – not meaningful due to small number of respondents
Source: Survey Questionnaire, RAM Consultancy Services 2004

3. Capital Markets

A move away from bank intermediation in favour of capital markets has long been considered by several Asian countries. This promising approach seems to address the chronic lack of long-term credit available to SME. Nevertheless, given the onerous legal, regulatory and administrative requirements on firms targeting the capital markets, the lack of support from the investment community (brokers, dealers etc) and the generally nascent capital markets in ASEAN with significant imperfections (e.g., high transaction costs, lack of liquidity, and depth of instruments), this move has many challenging hurdles from an implementation aspect. Table 2.1 shows that for most economies in ASEAN, the capital markets lag far behind bank loans as a source of funding.

Equity Market. Though not as advanced as the developed markets in terms of depth and liquidity, a few equity markets in the ASEAN-6 group are sufficiently adequate for these countries to tap this source of funding for SME. Small-cap equity market exists in Thailand (MAI) and Malaysia (Second Board of Bursa Malaysia and MESDAQ) to cater to medium-sized and start-up/high technology enterprises respectively. The MAI is a much-needed avenue to facilitate SME equity financing in Thailand. As of 23 Nov 2004, there were 21 listed companies on the MAI. As for the Second Board and MESDAQ in Malaysia, some 351 medium sized and start-up companies have been successfully listed as at year end 2004. According to SMIDEC of Malaysia, a 2003 survey on SME performance in manufacturing indicated that 20.2% of SME source financing through the sale of equity. However, it is not known how much of this is channelled through the public stock exchange. The two exchanges in Thailand and Malaysia are still evolving. Weak financial market sentiments, tightening of listing requirements and perhaps the lack of quality companies intending to list on the bourse may have constrained growth since their establishment.

Bond Market. The bond markets in ASEAN are not yet viable avenue for SME financing. Given the relatively high transaction and administrative cost involved, the appetite for high-grade bonds (resulting in high premiums for lower-rated bonds), and the general reticence of SME to ‘open up’ their books to agency scrutiny, the bond market will remain the domain of large and strong corporations in the near future.

Loan Securitisation for SME. One plausible option to tap into the capital markets without being stymied by the challenges is loan securitisation of SME loans, on the assumption that there exists a viable bond market. Singapore has been exploring the idea of asset securitisation for SME loans. The government plans to launch a pilot Loan Securitisation Scheme for SME amounting to S$300 million to tap the capital markets in January 2005. SME loans will be packaged into tradable bonds that offer competitive yields and sold to institutional investors. The government will effectively take on the first-loss risk. It is hoped that the new scheme will not only pave the way for SME to tap the capital market but also provide alternative financing for SME which do not qualify for existing loan schemes. SME that are targeted for this scheme are those with little or no track record or collateral as well as those seeking small loan amounts or requiring loans to venture abroad.

In ASEAN-4, equity financing is limited and even less developed than commercial bank lending. Of the four, only Viet Nam has an equity market. The first stock exchange centre was established in Ho Chi Minh City only in 2000 to deal in treasury bonds and shares of listed companies. Among the private domestic enterprises, only the large ones are likely to

meet the qualifying capital requirements. They comprise a small portion of the private sector firms in Viet Nam. As at May 2004, total market capitalisation from 24 listed companies and some 135 Government and bank bonds listed is D3.9 trillion and D16 trillion, respectively[3].

Outcomes. The equity market route has not made much headway with SME financing due largely to tight listing and disclosure requirements, relatively high transaction and administrative cost (at listing and on-going basis) and reluctance of SME (especially family run businesses) to go public.

Though the bond market is directly out of reach for most SME, there is potential for tapping this source of fund via asset securitisation programmes. Banks, non-bank financial institutions and even government agencies with sufficiently large SME portfolios could issue asset-back securities against their SME loans. This will then free up funds in these institutions for further lending to the sector. Another option would be to establish a national securitisation entity to purchase SME loans from banks for resale in the bond market. Nevertheless, the fundamental issue of access to financing is still not resolved. Securitisation can only address the funding problem for SME in so far as the country's bond market is sufficiently developed and banks are willing to channel the funds back to the SME sector. In the long run, the sustainable avenue is for SME to be nurtured to a stage where they can directly tap the bond market. Simultaneously, the bond markets of Asia need to be made more accessible to smaller companies.

4. Venture Capital

There are venture capital schemes in many Asian countries. Japan, Korea, Hong Kong, and Singapore are the centres of venture capital activities in the region. For instance, a US$1 billion fund was set up to attract high technology companies to Singapore under the Technopreneurship21 programme (T21). Since the implementation of T21, more than 500 technopreneurial companies and over 50 incubator companies have been formed in Singapore since 1999. The Association of Small and Medium Enterprises estimated that some 35% of SME in Singapore meet their funding through venture capitalists.

The availability of venture capital in the ASEAN-4 economies is limited. Mekong Capital Ltd is a private cross-boarder investment company that undertakes equity investment in Viet Nam, Lao PDR and Cambodia. Mekong Capital manages a US$18.5 million Mekong Enterprise Fund launched in April 2002. The fund is co-financed by the Asian Development Bank (ADB), the Northern European Development Fund, the Swiss Economic Department, the Norwegian Industrial Cooperation Fund and the Belgian Investment Company. It is set up to operate over 10 years, with 65% of its investments to be made in Viet Nam. The Fund aims to invest in private export oriented businesses that are well managed and with impressive track records. In Viet Nam, a second venture capitalist is Vietnam Enterprise Investment Ltd (VEIL) managed by Dragon Capital. VIEL has US$53 million in 2003 and intends to raise its capital by another US$50 million[4]. Both funds seek to invest in larger SME.

As a whole however, this financing modality suffers from a poor track record in developing countries due principally to lack of viable exit routes for the venture capitalist (ASEAN Blueprint, UEAPME paper). Venture capitalists typically look at investments that yield a minimum of 30% return on investment per annum. According to the Venture Capital Association of Thailand, out of the 700 companies that applied for venture capital funds, only 26 companies (3.7%) were successful. This was due to a combination of factors like stringent requirements on the part of the venture capitalists, the lack of innovative ideas and the weak markets their products were destined for. Unlike banks, the venture capitalists do not require

[3] www.vietnampanorama.com/stk/StockMarket.html
[4] The SME Roadmap. Asian Development Bank, 2003.

stringent documentation from the SME. Instead, they rely more on the evaluation of the ideas and concepts of the SME.

Outcomes. With the exception of Singapore, the venture capital industry has not been very successful in ASEAN due to the lack of viable exit routes and the reluctance of the SME to invite venture capitalists to sit on the management team, which is a requirement of the investment process. Investments that yield a minimum return of 30% per annum, as preferred by the private venture capitalists may be quite unrealistic given the soft domestic and world economic environments in the past few years. Despite this, theory (pecking order hypothesis) and evidence suggests that equity financing is an important instrument especially for start-ups and tech-based industries (e.g., biotech, IP businesses) and therefore should be developed further (PECC report, PWC).

5. Trade Financing

Trade financing in the form of trade credit, equipment leasing and to a certain extent, factoring are popular with SME in Europe and are also available in most ASEAN countries.

In terms of the portfolio composition by facility type, term loan is the dominant facility offered to SME in ASEAN (comprising almost 50% of all facilities to SME in The Philippines, Malaysia, and Thailand and 65% of SME loans in Viet Nam banks). There is no data to draw conclusions for the other countries.

Generally, factoring, and leasing are less common facilities offered to SME. From general trends of our survey findings (see Table 2.12), we observed that trade financing is more popular than factoring in both ASEAN-6 and ASEAN-4 and that both facilities are more widely used in ASEAN-6. 14% and 9% of ASEAN-6 respondents offer trade financing and factoring respectively (compared to 10% and 5% for ASEAN-4). This is not surprising given the higher degree of banking intermediation and development in ASEAN-6.

Table 2.12: Types of Financing Facilities offered by ASEAN Banks

			Term Loan	Trade Financing	Revolving Loans	Factoring	Leasing	Others
ASEAN 6	The Philippines	SME	55%	32%	9%	1%	1%	4%
		Other Loans	70%	10%	10%	1%	1%	8%
	Malaysia	SME	43%	31%	17%	0%	3%	7%
		Other Loans	10%	60%	30%	0%	0%	0%
	Thailand	SME	50%	5%	37%	2%	0%	6%
		Other Loans	26%	0%	64%	0%	0%	10%
Average		**SME**	**49%**	**23%**	**21%**	**1%**	**1%**	**6%**
		Other Loans	**35%**	**23%**	**35%**	**0%**	**0%**	**6%**
ASEAN 4	Lao PDR	SME	10%	20%	45%	25%	0%	0%
		Other Loans	0%	10%	20%	70%	0%	0%
	Viet Nam	SME	65%	8%	25%	0%	2%	0%
		Other Loans	-	-	-	-	-	-
Average		SME	38%	14%	35%	13%	1%	0%
		Other Loans	-	-	-	-	-	-

Source: Survey Questionnaire, RAM Consultancy Services 2004

Trade financing and in particular, factoring solves the informational opacity problem that many banks faced with SME and may be valuable tools in countries with weak lending infrastructures (Berger and Udell, Bakker, Klapper and Udell,). Moreover, in the example of factoring, it may help SME expand, improve credit ratings, and achieve some internal cost savings (Borgia, Burgess and Shank). Another important aspect of trade financing is that it

tends to be countercyclical, which could be useful in times of distress and credit crunch in the banking sector (Bakker, Klapper and Udell). These short-term financing instruments represent viable, albeit more expensive and short-term options for SME.

6. Informal Sector Financing

The informal sector comprises lending between family and friends, savings and credit associations, and moneylenders (alternatively known as grey or black markets). The informal sector is the main channel of credit for SME in ASEAN-4 and to a lesser extent, ASEAN-6.

Obtaining accurate statistics in this matter is understandably difficult. From our fieldwork discussions and available findings, we are able to gather the following information.

In Viet Nam, informal channels fund up to 70-80% of SME needs compared to 20-30% funded by the formal channels (as estimated by Hanoi SME Association). SME are also known to pay a "commission" to third parties that are able to obtain a bank loan on their behalf[5]. Furthermore there is anecdotal evidence that the state-owned enterprises have been on-lending the credit obtained from the state-owned banks to the SME[6].

In Cambodia and Lao PDR, family and friends are the main channels of funding as they provide the 'cheapest' funds compared to either banks or moneylenders. The latter which are not licensed entities charge exorbitant rates of up to 20% per month for unsecured loans.

In ASEAN-6, the banks are the main channels of external financing while friends and family is the preferred choice of funding from the informal sector. In Malaysia, friends and family and supplier credit meet 11% while internal funds account for up to 32.4% of financing needs (BNM Survey). In Singapore, friends and family make up 30-40% of financing source (as estimated by Association of SME) as SME prefer funding from 'friendly' sources.

B. AVAILABLE CREDIT INFORMATION FACILITIES

The significance of access to credit and business information for SME financing cannot be understated. Financial providers rely on this information to assess the creditworthiness of potential borrowers, price loans and manage their portfolio. In ASEAN, financial providers rely on various sources to obtain and/or verify information on their borrowers. Our survey findings indicate that checking (whether formal or informal) among banks is an important source of information. Some countries such as Malaysia, Thailand, Indonesia, and Viet Nam have established central credit bureaus to provide the required information to financial institutions.

It would seem to suggest that even though some countries have established central credit bureaus, the respondent banks' preference for peer checking may indicate a lack of trust on the reliability of information stored in these central databases. From our survey findings, on average, the majority of banks rated the reliability and accuracy of available credit information as average/medium (56% and 62% respondents respectively) as opposed to over 30% and 10% who thought it was high, in ASEAN-6 and ASEAN-4 respectively.

Therefore, it would appear that there is ample room for improving the availability, reliability, and accuracy of credit databases in most ASEAN countries. It is encouraging to note that

[5] World Bank (2004). Firm Dynamism: Beyond Registration. How Are Vietnam New Domestic Private Firms Faring. World Bank, June 2004.
[6] World Bank (2002). Banking Sector Review: Vietnam. World Bank, June 2002.

several governments have or are in the midst of establishing or overhauling a centralised database for SME.

1. Singapore

There are several private sector consumer credit bureaus. However, currently no specific central database of information on SME exists. Banks rely on various means to obtain information including the banking network, court records, consumer credit bureau, registrar of companies & businesses (which is a central information hub of all registered businesses and companies in Singapore) and their internal databases.

To improve the access to information on SME, the Association of SME is launching a SME credit bureau targeted to be operational by June 2005. We understand that the SME credit bureau will provide independent credit scoring for a small fee. Preliminary surveys on private financial institutions reveal a positive response toward this initiative.

2. Thailand

There are currently two credit bureaus, the Central Credit Information Service Co. Ltd, sponsored by the Thai Bankers Association which focuses on company information and the Thai Credit Bureau, sponsored by the Ministry of Finance which focuses on individual data. Established in 1999, the Thai Credit Bureau, which has 47 members presently, owns the most extensive database on debtors, including some SME, in Thailand. The database is estimated to cover approximately 80% of the debtors' information in the country. The bureau disseminates both positive and negative information. Members can obtain information on most SME from the Thai Credit Bureau, provided that they have some sort of credit facilities with the financial institutions. The merger of the two credit bureaus over the next 12 months is expected to improve their commercial viabilities.

3. The Philippines

Currently there is no central credit bureau for SME. The government under the Department of Finance will establish a central credit information bureau with the Central Bank to provide credit information and possibly scoring services for SME. The soft launch is expected April 2005.

The Philippines has a private credit bureau CIBI Inc., which provides business and consumer credit and enterprise data and other related services to its subscribers who include financial institutions, private corporations and other non-bank entities. The database includes basic business, legal, payment, financial, and operating information.

4. Indonesia

Although the central bank maintains a database on borrowers called the Debtor Information System (DIS), the database is limited in its coverage of SME. The reporting of information is restricted to commercial banks and branches of foreign banks only. Borrowers of other NBFI such as credit cooperatives and rural banks who number in the tens of thousands are not included. Only loans of Rp50 million or more need to be reported. Many SME that have some form of credit facilities with other lending institutions or that are below the limit required for reporting are not registered in the DIS.

In view of the shortcomings, Bank Indonesia is in the process of establishing a more reliable and comprehensive credit bureau (which is benchmarked to international standards) to replace the DIS. The targeted completion date of the new credit bureau is 2005. The new credit bureau is expected to provide significant benefits to both financial institutions and SME.

5. Malaysia

The central bank established the Credit Bureau in 1982 to collect credit information on borrowers and to furnish the information to lenders. Information is sourced from the various financial institutions in Malaysia. The Bureau collects credit information on borrowings of private individuals and businesses that have borrowings with banks. In 2001 the Central Credit Reference Information System (CCRIS) was established by the central bank to provide a comprehensive credit database of all borrowers in the banking system. At present, the CCRIS has information on approximately 5 million borrowers in Malaysia that is stored in a computerised database system. Credit reports can be made available to the financial institutions upon request.

The government is in the process of establishing a comprehensive national SME database and directives have been given to the relevant authorities to enhance the management and publication of SME statistics.

There are also several private sector credit information providers in Malaysia. As a first line of defence, banks usually check with CTOS, a company that undertakes bankruptcy checks on businesses and individuals. In addition, various private entities and trade and commerce associations (such as the Federation of Malaysian Manufacturers) and the Companies Commission of Malaysia are available sources of information on businesses.

6. Viet Nam

The Credit Information Centre (CIC) was established in 1999 as an independent unit under the State Bank of Vietnam (SBV). The functions of the CIC include providing data to SBV as well as to support credit institutions in credit decision-making. The CIC tracks the following information: customers' legal profile, financial status, outstanding loan, loan guarantee, loan security and bad debt. The CIC has 600,000 customer profiles of which 20% are enterprises and remainder is individuals. The main users of CIC information are the banks, Government and government agencies, the SBV and other financial institutions.

In addition, there are various databases on SME that are maintained by private or public agencies and which are accessible to the public, some at a minimal fee. Available databases include those maintained by the Agency for SME Development, Viet Nam Chamber of Commerce and Industry, Hanoi SME Association and the Business Promotion and Service Center.

7. Cambodia/Lao PDR/Brunei Darussalam

Currently there are no central credit bureaus operated by either the government or private sector in these countries. Databases maintained on SME or industries by certain government agencies in Lao PDR (e.g., Department of Industry) and Brunei Darussalam (Economic Planning and Development Department, Ministry of Industry and Primary Resources) are neither shared nor accessible to financial institutions or the public.

C. ADEQUACY OF FINANCING SOURCES AND TOOLS

Governments have increasingly played a proactive role in SME financing in ASEAN via banks (loan quotas, interest subsidies, tax breaks, and guarantees), specialised development financial institutions (usually state owned), and direct funding under various schemes and programmes. Generally there are adequate financing programmes and initiatives by governments of most ASEAN-6 countries. The issue does not pertain to quantity but to the appropriateness and success of implementation of these initiatives.

From our fieldwork and ASEAN Policy Blueprint report, not all these financial support measures and massive subsidies have been as successful as intended. This applies in terms of outreach, cost efficiency, and sustainability. Inasmuch as government's role is important for SME development, there is evidence that government practices and intervention (e.g., lending subsidies for state-owned financial institutions, restrictions on foreign institutions) appear to 'crowd-out' more efficient financing by private-sector institutions and could lower overall credit availability to SME (Berger and Udell).

Although the banking sector is the largest and most important source of external financing for SME, by and large, it is believed to be under-serving the needs of this sector. Although financial institutions serve the SME sector through a myriad of financial tools and instruments, many SME are constrained in terms of access to medium to long term funds and by virtue of size, have less flexibility and bargaining power to negotiate competitive interest rates and terms for their loans. Moreover, the range of financing instruments offered by financial institutions is limited and many SME do not have access to trade financing facilities such as factoring or leasing, which are not dependent on the underlying creditworthiness of the SME.

This combined with the under-development of alternative formal financing channels have resulted in the over-reliance of SME in ASEAN on internal funds and informal sector financing. Reliance on accumulated retained earnings is a slow process through which to grow the business.

Generally, the equity and venture capital markets in ASEAN are not sufficiently developed to allow SME of all sizes to access these potential viable sources of long-term funds. Equity financing is particularly valuable for start-ups as it enables firms to fund investments that involve high initial costs and risks without carrying the burden of debt servicing. In this respect the recent introduction of government-funded venture capital and the launch of the small-cap stock exchanges in some countries such as Malaysia and Thailand are a start towards providing alternative avenues for external financing. However, a strong institutional and regulatory framework for capital market development and greater promotion of venture capital are required to further encourage the growth of equity financing.

Firms require a continuum of funding, as they grow from start-up to eventually large corporations. A diverse set of financial institutions offering a range of financing instruments would be best suited to meet the financing needs of each growth stage. While short-term loans and trade financing are beneficial in that they can expand and contract in relation to the need for working capital, equity financing and long-term debt instruments are more appropriate to finance fixed capital investments with longer gestation periods. Matching the right type of financing to the financial life cycle of the SME is hence crucial to their subsequent survival and growth. Further, the level of economic and financial development (where for example in ASEAN there is a wide diversity) must be considered in adopting appropriate financing schemes and tools (Small and Medium Enterprise Working Group report, March 2004).

D. IMPACT ON SME DEVELOPMENT

The shortage of financing and poor implementation of funding programmes could well have impaired SME competitiveness in terms of their ability to capitalise on business opportunities. SME require working capital and investment funds to sustain production and expand capacity. Without adequate formal financing options, SME are forced to rely on internally generated profits and retained earnings that can take considerable time to accumulate. The inability to expand production capacity results in missed opportunities that in turn limit the rate at which firms can grow. Continued reliance on informal financing can be too costly for

working capital and longer-term investment needs. This in turn inhibits firm growth and further delays much needed income and employment generation.

The lack of financing opportunities could also have widened the gap between the modern sector, driven by much larger private sector establishments in the manufacturing exported oriented businesses, and the traditional sector, characterised by smaller outfits in localised industries. Unequal access to funding makes it more difficult to deepen the broad base, or in the case of transition economies to modernise the economy and foster industrialisation via developing inter-firm linkages.

The many issues require time and determination on the part of all stakeholders to resolve. Public-private sector partnership remains an important factor in developing successful and effective polices and tools to assist SME development and financing.

E. SUPPLY-SIDE SHORTCOMINGS AND CONSTRAINTS IN SME FINANCING

From the supply side perspective, ASEAN countries share some common shortcomings and constraints that have effectively impeded the ability of SME to access needed funds. However, due to differences in economic and financial development, many constraints as discussed below are unique to either ASEAN-6 or ASEAN-4.

1. Public Sector Constraints

Crowding out of private sector. Inasmuch as government's role is important for SME development, there is evidence that government's involvement and intervention (e.g., lending subsidies for state-owned financial institutions, state-owned development institutions, restrictions on foreign institutions) appear to 'crowd-out' more efficient financing by private-sector institutions and could lower overall credit availability to SME (see also Berger and Udell).

Throughout ASEAN for instance government banks and even line agencies compete with private financial institutions for the same customer base whether knowingly or otherwise. In The Philippines for example, the credit guarantee corporation also provides loans directly to SME in spite of the existence of some 900 bank and non-bank institutions in the country. Development financial institutions (DFIs) in Malaysia for example, also compete directly with private banks in search of lower risk businesses given that some of these DFIs are now responsible for loan performance and their own funding. In Indonesia, even the central bank is involved in lending.

In Viet Nam, the state-owned commercial banks (SOCBs) are perceived to favour large state-owned enterprises over SME in terms of credit accessibility and allocation. This is because these SOCBs perceive the former as being lower risk given the government's stake, among other factors. The dominance of the SOCBs in the banking sector creates a market distortion where overall credit available for lending to SME is lowered and further impedes fair competition among the players. Many public sector initiatives that are implemented through state-owned financial institutions also have limited outreach.

To resolve the issue of crowding out by the public sector, perhaps the government should just play a facilitator role in areas of lending where the private bank intermediation infrastructure and facilities are sufficient. Also, effective public-private partnerships where government funds are channelled through private financial institutions may also reduce this problem.

Implementation Issues. Various shortcomings and barriers hamper the effectiveness of government initiatives. These include coordination difficulties between numerous agencies and between programmes with overlapping objectives (this is especially relevant in countries without a one-stop centre for SME); cumbersome procedures leading to delays in disbursement (although this is also a common compliant against private financial institutions); and narrow target of specific sectors to support which create an unequal access to financing which may affect the development of broad-based and linkage-driven industry clusters.

2. Private Banking Sector Constraints

Collateral Requirements. From our survey findings, 85% of loans made by ASEAN financial institutions to SME in 2004 are secured for various reasons including higher risk perception and legal barriers with respect to loan recovery. SMEs face difficulties in meeting banks' collateral requirements. Not only are valuation methods conservative (where it is common for banks to ask for 167% collateral coverage), due to the higher risk perception of SME, some banks will not accept from SME the same type of collateral as they would from large borrowers e.g., sales or project contracts. With the lack of supplementary financing instruments such as factoring and leasing available to SME that would alleviate the need for collateral, banks' insistence on collateral requirements is a major impediment to financing.

Weak Credit Skills and Practices. From our discussions with regulatory agencies and industry players, the lack of credit skills to evaluate SME is a common problem throughout ASEAN, though not many bank respondents in our survey would admit to this.

Prior to the Asian Financial Crisis, many financial institutions in Asia pursued large corporate loans as their main clientele. This was because large loans enable banks to grow their market size and profitability more rapidly. In contrast, SME loans are seen as less attractive because a bank would occur substantial amount of cost to process the loan, while the absolute dollar returns are much smaller compared to large corporate loans. This is a subtle incentive within the system that bank managers themselves may not be entirely aware of. Hence, pre-crisis, many a banking portfolio in Asia was skewed to large borrowers. It was only in the last decade that SME development and financing have come to the foreground. But loan officers have only been trained and equipped to manage and evaluate large borrowers with proper accounting records and information. Many lack the knowledge and necessary skills required to manage SME, which are more informationally opaque. Applying the same techniques of large corporate evaluation to SME obviously result in many SME not being able to meet bank lending criteria.

In some countries in ASEAN-4, such as in Viet Nam, loan officers of dominant SOCBs are not well-equipped nor inclined to conduct proper risk assessment on private enterprises given their entrenchment in lending to state-owned enterprises (which are perceived to be lower risk). At the same time, the relatively short time that the banks have been operating in a market based environment has prevented the credit institutions and bank staff from fully developing expertise in credit assessment, credit extension and borrower monitoring practices and credit and risk management.

It is worth noting that the commercial banking sector in the transition economies is still in the basic stages of development. Inexperience and the relatively short time frame for the evolution of more sophisticated financial instruments and lending technologies have hindered commercial banks from meeting the expectations of modern corporate banking in a market based economy. At its most basic level, the commercial banking sector is lacking considerable experience even in mobilizing savings effectively let alone have the skills required for credit risk assessment, adequately pricing risky investments and assets and monitoring corporate performance.

Cumbersome Loan Processing and Documentation. The loan procedures in many financial institutions may be quite complicated, onerous and lengthy for SME. This is especially the case for borrowers requiring small loan amounts. The SME has to produce a business plan that can be costly to prepare, produce other documentations and then wait, from weeks to several months as the case may be, for the loan to be approved. For all that trouble, in the transition economies, the SME has to repay the loan in one year! All this adds to the cost of business which can be substantial relative to the size of the enterprise.

Legacy of High NPL levels. At the peak of the Asian Financial Crisis in the late 1990s non-performing loans (NPL) in the banking sector in many ASEAN countries nearly doubled their pre-crisis levels. NPL levels have fallen significantly since 2001 but still remain sizable in such countries like Thailand, Indonesia and Lao PDR (World Bank and ADB estimate of 50% in 2000). The high levels of NPLs have weakened banks' capitalisation levels and limits overall capacity to lend, and coupled with weak economic sentiments in the past few years, this has created an air of risk-adversity among financial institutions.

3. Structural Constraints

SME Definition. The definition of SME varies widely among ASEAN countries and within each country, differs between financial and other lending institutions. Any regional strategy to address SME financing must contend with this issue first. Countries with formalised/legalised SME definition include The Philippines (BMBE Act 2002), Thailand (SME Act 2000) and Viet Nam (Decree No.90/2001). In others, definitions though not ratified as law are provided by government/agencies and this includes Indonesia (central bank and Central Bureau of Statistics), Singapore and Malaysia. Yet there is also the situation where there is no official or unofficial definition as in Cambodia. In the absence of a consistent definition for SME, all stakeholders have and could adopt different eligibility criteria for SME intending to apply for lending programmes or financing. This hampers the effectiveness of programmes. More will be discussed in the following chapter.

Lack of Depth in Financing Sources. With perhaps the exception of Singapore, bank financing remains the main source of external financing. Alternative sources of financing such as venture capital, equity and capital markets are not yet sufficiently developed in ASEAN-6 much less ASEAN-4. These are viable sources of long-term stable funds that will allow businesses to match their long-term funding needs and to establish an optimal debt-equity capitalisation structure. As discussed earlier, the over-reliance of SME on internal and informal sources of funding would result in the slow development of the firm.

Lack of Information on SME. Except for Viet Nam, the other three transition economies and Brunei Darussalam lacked a centralised and comprehensive information database on SME which is accessible to lending institutions. Although some government agencies in these countries maintain certain databases on SME, they are not accessible to the public. Hence, the lack of information hampers banks' lending to this sector. Still in other countries such as in Indonesia where there are centralised databases on SME, the lack of accurate and up-to-date information also posed a barrier to effective lending by financial institutions.

Weak Savings Mobilisation in Transition Economies. In the transition economies, there is an apparent lack of public confidence in the banking sector and in the national currency. Domestic households are holding cash savings in foreign currency and or in precious metals kept in safe-boxes at home[7]. Estimates in 2001 suggest that in Viet Nam for instance, over US$2 billion is in circulation in the informal market. Some believe that an additional US$8

[7] World Bank. Banking Sector Review, 2002.

billion to US$10 billion in hard currency and gold is hoarded by local consumers[8]. The lack of confidence in the banking institutions has resulted in the banking sector's small deposit base which is very short term. This in turn limits the banks' ability to extend medium to long-term loans to borrowers including SME.

In ASEAN-4, the most common loan facility extended to SME is short-term credit that is due in less than one year whereas SME may be more in need of medium and long-term loans for investment purposes. The lack of alternative financing facilities such as factoring, leasing and trade financing (which even if they are available are rarely extended to SME) further hampers SME growth. Due to the small depositor base and the lack of local government funds, banks rely on international agency funding for their lending activities. Some funds however have restrictive covenants which impede banks' flexibility to undertake appropriate lending programmes.

Over-banked Situation. In Indonesia and The Philippines, coupled with stringent banking laws, the banking sector is too fragmented to be effective conduits for SME lending. As of September 2004, The Philippines has nearly 7,000 financial institutions which are regulated by the central bank while in Indonesia, there are over several hundreds of private and state-owned commercial and rural banks. Without sufficient resources and economies of scale, the private sector may be unable to introduce any significant and widespread lending programmes to effectively meet the requirements of the SME sector. Nevertheless, the Asian Development Bank contends that this is not a concern. The issue instead is collateral, or rather the lack of it.

Other than these key constraints, there are many other constraints unique to the individual countries (see individual country reports). Further, there are the institutional constraints presented by the regulatory and legal framework which have been slow to change to promote SME development and hence inherently caused some of the shortcomings discussed above. These will be discussed in the next chapter.

F. OVERVIEW OF DEMAND SIDE CONSTRAINTS

The study's findings of the difficulties faced by banks in financing SME in ASEAN are all too familiar. The main problems are the lack of (quality/sufficient) collateral, bankable business plan, track record of firm or owner, poor financial condition or performance of SME, and lack of knowledge and information on SME and their industries.

In addressing the supply side of SME financing, the discussion would not be balanced without addressing the demand side constraints. Although a full discussion is beyond the scope of this study, the information gathered from the fieldwork indicate the following difficulties faced by SME in accessing bank financing:

(i) Banks' insistence on collateral (up to 85% of SME loans are secured)
(ii) Lengthy and tedious loan processing (in some banks, the process from approval to drawdown could take several months)
(iii) Stringent documentation requirements
(iv) Complicated procedures in applying for loans, including from government schemes (many SME entrepreneurs are not formally educated nor have the resources to help them with bank procedures)
(v) High interest rates

[8] Vietnam Country Commercial Guide FY2002, Jul 2001. US Embassy Hanoi Vietnam.

(vi) Inability (knowledge and financial means) to prepare required business plan
(vii) Lack of knowledge about available financial assistance schemes for SME (this could be due to lack of publicity by the promoters)

Based on the overview of the problems faced by both the demand (SME) and supply (bank) sides, it would appear that the problems are intractable: SME cannot meet the requirements of banks, without which banks are unable to lend.

Banks tend to treat small businesses as they would large business borrowers by exacting the same degree of due diligence and standards of compliance. This may be argued as rightly so since all business borrowers regardless of size are risky assets to banks. However, SME are not the same as large enterprises. Needless to say, SME would fail to meet the grade of what is essentially the broiler plate meant for large businesses. Which leads to the perception that SME are riskier than large enterprise. And so which justifies the need for additional safeguards in the form of collateral, higher interest rates and so forth. From our survey findings, 85% of all SME loans in ASEAN are still secured compared to about 70% for all other loans. This is despite the fact that the average default rates of SME loans are not any higher than all other loans and over 60% of surveyed banks in ASEAN (over 70% in ASEAN-6) have in place risk scoring/rating systems to evaluate and filter SME borrowers.

To bridge this gap in financing, governments step in with mechanisms such as interest subsidies and guarantee schemes for banks to fund SME. However, the banking sector is by far the most developed and would likely remain the main source of external financing for SME in the near future. All other factors aside, banks must examine their internal structures and processes to treat SME as distinct business entities if they are to benefit from the sector's potential.

G. BEST PRACTICE MODELS

Outside of ASEAN, Japan, Taiwan, Republic of South Korea, and Germany have often been cited as best practice models in SME development[9]. All these countries share several key success factors that underpin the achievements of their SME, including:

(i) The government has crafted a structured and comprehensive approach to SME development – in terms of enabling polices, coordination and implementation, established and well-defined support infrastructure and good linkages between public and private sectors in supporting SME;
(ii) Fostering of strong support and relationship between SME and the private sector e.g., chambers of commerce, trade association and large companies;
(iii) Enabling access to financing;
(iv) Commitment to training, and
(v) Strong entrepreneurship culture and work ethics.

In terms of available financing sources and programmes, there are various channels and sources of funds to cater to the different needs of SME in these countries. Appendix 5 provides more details on the framework practiced in these countries.

[9] The following summary brief on best practice countries is sourced from "A Comprehensive Framework for the Development of Small and Medium Enterprises in Malaysia", Bank Negara Malaysia, January 2003.

1. Japan

Japanese SME contribute to over 55% share of GDP and almost 70% of total employment. Financing is available from government financial institutions (e.g., Japan Finance Corporation for Small Business); private sector financial institutions and cooperatives (which contribute 90% of total financing to SME) and venture capital companies. SME loans are guaranteed by credit guarantee corporations (there are 52 CGCs throughout Japan) that provide 100% guarantee cover. The CGCs are funded by local government, industry organisations and financial institutions (whose contributions are tax deductible). The CGCs are further supported by a government funded credit insurance system that is implemented by the Japan Small and Medium Enterprise Corporation (JASMEC). All SME loans guaranteed by CGCs are insured by JASMEC which provides between 70% to 90% coverage. Japan is the only country that provides reinsurance on credit guarantee schemes.

2. Chinese Taipei

In Chinese Taipei, SME constitute over 98% of all enterprises, contribute to nearly 30% of total sales and outstanding loans to SME comprised over 26% of total loans in the banking system. Chinese Taipei not only has established a comprehensive assistance system encompassing the following eight areas: (i) financing system, (ii) management system, (iii) production technological system, (iv) research and development system, (v) information management guidance system, (vi) industrial safety system, (vii) pollution prevention system, and (viii) market guidance marketing system, it also has established certain key supporting systems and organizations; for instance: (i) a credit guarantee fund for SME, ii) specialized export processing zones, (iii) a "central-satellite plants" system, (iv) an SME development company and an SME development fund (APEC Survey on SME).

The government provides two main types of funding to the sector: (i) the SME Development Fund which is used for various purposes including to finance the various assistance programmes, provide loans, invest in SME companies or SME development corporations and establish SME incubator centres, (ii) the Executive Yuan Development Fund which is used to provide for guarantee funds. The Small and Medium Business Credit Guarantee Fund provides guarantee (up to 100%) for SME loans generated by banks. Another guarantee fund is the Mutual Guarantee Fund which is based on a mechanism of co-sharing risk between the government, SME, financial institutions, convenors and insurance companies. Other than the financial institutions, another important channel of financing in Chinese Taipei is the venture capitalists.

3. Germany

The government’s assistance in financing SME takes the form of low interest/subsidised loans. These funds are channelled through state banks and are provided to SME on fully commercial basis and terms. The state banks also channel funds to commercial banks on a refinancing basis for relending to SME. For most programmes, the commercial banks will assume at least 50% of the risk while the state banks bear the balance.

4. Republic of South Korea

The Small and Medium Industry Promotion Corporation (SMIPC) is a non-profit autonomous organization established in 1979 in accordance with the Small and Medium Industry Promotion Act for the purpose of implementing various programmes to promote the Small and Medium Industry (SMI) sector in the Republic of South Korea.

The programmes include, among others, the provision of:

(i) Financial assistance and field services to the SMI on a selective basis;
(ii) Industrial extension services concerning management and technology;
(iii) Industrial training services for managerial and technical manpower of the SMI from top Management to the level workers; collection, analysis, processing and dissemination of Industrial information for SMI; and
(iv) Internationalisation support for their industrial partnership with foreign counterpart industries.

These countries are successful in the promotion of their SME sectors due to the adoption of a holistic approach to SME development. Programmes are well structured with adequate support from all stakeholders. The government's role in facilitating access to financing is crucial as seen in these countries. Similar to development programmes, financing programmes for SME in these countries are not just developed in isolation or on an ad-hoc basis. They form part and parcel of the government's overall agenda for development.

This page has intentionally been left blank.

III. REVIEW OF LEGAL AND REGULATORY ENVIRONMENT: CONSTRAINTS AND SHORTCOMINGS OF THE INSTITUTIONAL SUPPORT FRAMEWORK

A. INTRODUCTION

The regulatory and policy frameworks and institutional support infrastructure exert a direct impact on the financial markets, its players and hence financing access and efficiency of funding by SME (World Bank, Berger and Udell). These framework and infrastructure include the legal, judicial, bankruptcy, accounting, tax, regulatory and information environment. Equally important is the enforceability of such laws. For example, strong accounting and legal enforceability standards are necessary conditions for the feasibility of loan contracting, a condition which if present can be used by banks to offset the problem of information opacity of many SME. Berger and Udell also revealed several interesting findings about how the institutional infrastructure (and shortcomings) affect the lending technologies deployed by banks and prevent them from capitalizing on their comparative advantage in lending to SME. Empirical evidence suggests a statistically important link between the existence of third-party information exchanges and credit availability. Specifically countries with stronger formal information sharing exhibit greater bank lending relative to GNP (Berger and Udell). With the exception of the US, many efforts to undertake information pooling to create information exchanges and industry benchmarks for SME have failed, including the efforts by Bundesbank for the German “Mittelstand” (Bartels, J).

The ASEAN Blueprint enunciates that the design of policies, regulations and institutions must meet several requirements, namely coherence, consistency and transparency in order to have an enabling environment for SME. However in practice this is difficult for many developing countries in ASEAN as governments pursue various agenda and are often faced with numerous and often conflicting priorities in the quest for competitiveness and economic development. Some of the problems cited by the Blueprint include complexity of rules and regulations and “perverse incentive syndrome” which relates to size. Indeed the ineffective implementation of policies is often cited as the reason for the failures of SME schemes (Leopairote). Nevertheless, efforts must still be made to crowd in, not crowd out SME in the design and implementation of policies, regulations and institutions. In the Asia-Pacific region, the Leopairote report cited Japan (considered to have the most comprehensive promotional policies and measures for SME embodied in various laws), The Philippines (e.g., mandatory allocation of funds to SME by banks), Singapore (e.g., bankruptcy law for technology companies) and Thailand as best practice models in creating enabling environment for the promotion of SME (Leopairote).

We concur with the APEC report that there is no ‘ideal’ business environment in the sense of a ‘best practice’ or ‘one size fits all’ set of policy conditions suited to all economies at all times under all conditions. Adapting it to local and global conditions is a more sensitive approach.

The purpose of the legal and regulatory overview in this chapter is to identify the major institutional support framework shortcomings in each country and where relevant, the common barriers, that hinder measures to improve SME financing by the financial sector in ASEAN.

B. INDONESIA

Indonesia still relies heavily on laws and regulations that were issued during the Dutch colonial era to regulate such fundamental matters as contracts and evidence. In line with Dutch law, Indonesian courts do not apply the principle of precedent, a fundamental doctrine in common law jurisdictions.

Land Title. Most lending to SME in Indonesia is collateral based and the banks rarely accept as collateral anything other than a fixed charge on titled real estate. However, ongoing land reform in Indonesia is still incomplete. Accordingly, many landowners do not possess legal title to the property they own or occupy. What they hold are various forms of proof of occupancy. Therefore the lack of legal title to the property offered as collateral is a major impediment to SME accessing bank financing.

Registry of Charges. Even if the banks could be persuaded to take other forms of property as security, at present, there is no way to legally perfect a floating charge due to the lack of a centralized registry as provided for under common law jurisdiction. It would be helpful in the development of lending on security of various types of property if the rules pertaining to fiduciary transfer agreements, assignments of accounts receivable and pledges were codified and if a security registration system was put in place to record such security interests over movable and intangible property as a means of perfection of security interests in these types of assets.

Court Litigation and Recovery. The legal infrastructure for bankruptcy falls under the Indonesian Bankruptcy Law. There are two ways to settle insolvency in Indonesia, through court proceedings or through informal mechanisms. Creditors may file a bankruptcy petition or submit a lawsuit to the district court based on breach of contract. However, the enforcement of bankruptcy and collateral is an extremely lengthy and costly affair.

Banking Regulations. One inhibiting factor is the regulation requiring a bank to obtain from a borrower, a business license and tax registration number (NPWP) for lending over Rp50 million. As discussed in the next point, the problems inherent in the registration and licensing process in Indonesia makes it difficult for businesses to obtain these and therefore makes it difficult for banks to lend to these businesses. As for the NPWP, not all businesses have the number as it is issued to companies and individuals who are registered taxpayers. Another inhibiting regulation is associated with suitable collateral, which some banks say has been exacerbated since the due diligence audits by the central bank force banks to restrict the collaterals they would take (Timberg, 2000).

Registration and Licensing Requirements. Three regulatory authorities maintain files on Indonesian businesses. The information held by these may be duplicated among one another. Company registrations remain valid for five years and must be renewed thereafter. Registration fees range from Rp5,000 to Rp100,000. There is no single comprehensive centralized register covering all business or company registrations. At present, the government believes there are approximately 3 million businesses that should be legitimately recorded in the Registry – the actual number is only 1.5 million (ADB, 2001).

All companies are required to obtain a range of business licenses and permits (totalling more than six or seven) from the government to enable them to operate. Similarly banks will not approve a loan to a business that cannot produce all relevant trading licenses. However, the various authorities, which process these licenses, may not issue them to a company that has not been registered. As there are many unregistered businesses in Indonesia, this control system can be overcome by payment of bribes and unofficial fees to officials. As such, the licensing process is plagued by irregularities and officials often create artificial delays in

processing licenses in order to extract bribes. Estimates (by Asia Foundation) of time spent and actual fee paid for obtaining various licenses range from several weeks to months (against the official time of one week to two weeks) and from hundreds of thousands to a few million rupiah in various parts of districts in Indonesia. The Asia Foundation is providing technical assistance to revamp and streamline the licensing process.

High Cost of Doing Business. The various registration requirements, poor coordination, and administration lead to a high cost of doing business in Indonesia.

C. THE PHILIPPINES

Land Title. Most lending to SME is collateral based and the banks rarely accept as collateral anything other than a fixed charge on titled real estate. However, in The Philippines, land reform is ongoing and still incomplete. Accordingly, many land owners do not possess legal title to the property they own or occupy. What they hold are various forms of proof of ownership such as tax declaration, realty tax receipts, deed of sale etc. Therefore the lack legal title to the property offered as collateral is a major impediment to SME accessing bank financing.

Registry of Charges. Even if the banks could be persuaded to take other forms of property as security, at present, there is no way to legally perfect a floating charge as there is no centralized Registry of Charges as provided for under a Common Law jurisdiction.

Default Enforcement Proceedings. The process is well defined. However, the defendant's right to appeal all the way to the highest court at each stage of the enforcement proceedings means that debt recovery through court sanctioned sale is unduly burdensome and lengthy.

Banking Regulations. The central bank's requirement that borrowers must execute a Promissory Note with the lending institution for each drawdown increases the cost of servicing a loan from the lending institution perspective and results in unnecessary delays in the borrowers' access to their drawdown proceeds.

The central bank's latest requirement that borrowers must furnish audited accounts to obtain financing will be another constraint as most of the SME lack proper financial records and it will only add on to their financial cost. Moreover, the central bank imposes a 5% loan loss provision on loans, which in the opinion of central bank loan examiners do not have complete loan documentation. However, what constitutes completeness is a subjective matter. A minimum and standardised documentary list for use by all banks will be useful to overcome this issue.

Registration Requirements. Efforts to provide an enabling environment for SME are hampered by the high cost of doing business and the lack of information. Current regulations on SME businesses are onerous and complicated. A number require streamlining and simplification. The SME Development Plan has identified several areas that merit closer review including:

(i) Business name registration and renewals – involving cumbersome paperwork and multiple agencies.
(ii) Complex registration and licensing requirements for certain industries such as food processing and fertiliser and pesticides.

D. SINGAPORE, THAILAND AND MALAYSIA

Singapore and Thailand (generally, so also Malaysia and Brunei Darussalam) have sufficiently well developed and adequate institutional support framework to support SME financing. Laws relating to bankruptcy, land registration and regulations relating to accounting and taxation and prudential banking are well in place to enable clear and speedy enforcement of interests of both creditors and debtors. Thailand has in place various laws and regulations pertaining to SME in its bid to promote the sector. Likewise, Singapore has one of the world's most efficient and sound legal framework and favourable tax regime for businesses.

Malaysia has a fairly well developed legal, regulatory and commercial support framework to promote SME financing and development. The Malaysian government has been supportive of creating an enabling environment for SME to access funds. Recently, more initiatives to strengthen the regulatory framework (e.g. the establishment of SME Council and standardising the SME definitions) have been announced by the government. In addition, the budget for SME financing has been increased, an SME bank will be established by the second half of 2005 and more financing instruments are in the pipeline.

E. LAO PDR

The legal environment lacks transparency and is saddled with informal red tape, inefficiencies and ambiguous practices that allow abuse. In line with its reforms, the government has started to upgrade the legal and regulatory framework to provide an enabling environment for business and investment. However, various obstacles are present in the current legal framework, including:

Weak Secured Transactions Law and other Commercial Laws. The absence of well-defined secured transactions law and other commercial laws (such as bankruptcy law, contracts law, business laws) to protect creditors rights in the event of default discourages banks from lending. Similarly the lack of mechanisms for commercial adjudication and dispute resolution (such as commercial courts and other informal channels of dispute settlement) also makes banks extremely vulnerable in the event of default.

Lack of Land Titles to Property. As the land reform is still ongoing, many landowners do not have title to their property. Without an indefensible rights that can be pledged as collateral, firms or landowners have difficulty providing acceptable collateral to obtain bank loans.

Absence of Secured Transactions Registry. The lack of a centralised registration system prevents banks from lending, as the collateral rights cannot be registered.

Registration and licensing processes. Currently there is a large number of unregistered small businesses in the country. The registration process of enterprises is handled by several government agencies (Department of Domestic and Foreign Investment, Ministry of Commerce, Ministry of Finance), which makes coordination, and cross-referencing difficult. The criteria for registration are ambiguous and cumbersome and involve high cost for businesses.

Legal Constraints. Access to bank financing by the SME is hampered by the difficulties in the enforcement of the Bankruptcy Law and the Secured Transaction Law in the court system. There is no national system for registration of property, making it difficult for banks to accept property as collateral as they cannot register nor value the collateral. Even so, in the

event of a default, the courts are often unwilling to dissolve personal residences pledged as collateral. These problems of the tedious court process and the inability of SME to provide collateral other than personal property hamper most small businesses access to bank financing, especially from private commercial banks.

There is a lack of regime for the resolution of default that hampers both investment and lending. This includes the implementation of voluntary, out-of-court debt resolution framework, streamlining civil procedures and amending foreclosures and bankruptcy laws to strengthen debt collection and restructuring, accelerating land title issues and registrations, and enhancing the capacity of the judiciary and courts to adjudicate commercial laws promptly. In addition, there are inadequate regulatory, accounting and disclosure standards, coupled with weak enforcement.

Others. At the broad level, government interference, lack of transparency in applying regulations as well as the high time-cost of registering companies are major impediments to businesses in Lao PDR. These factors hamper the overall development of SME in the country.

F. CAMBODIA

The current Cambodian legal system, regulations and policies are weak in enforcement, outdated and inadequate in keeping with the growth of the economy. Lenders are not protected with sufficient legislations and unclear and lack of transparency in regulations and serious corruption cause confusion for businesses and keep investors away. The main legal shortcomings relate to the weakness of the existing Land Law (2001), Contract Law (1988) and the absence of Company Law and Bankruptcy Laws.

Absence of SME Definition. There is no formal definition of SME in Cambodia. In the absence of a clear and standardised definition, banks and regulatory agencies devise their own definition and criteria for lending to SME. Any intention to improve the financing to SME sector will be compromised by such practices.

Absence of Bankruptcy and Company Laws. The absence of a Bankruptcy Law is a major impediment to financing as lenders are reluctant to lend given the risk of default and its consequences. The process of default and recovery enforcement is a lengthy one in Cambodia given the weak and lack of transparency of the court systems. In the absence of a Company Law, lenders have no confidence in making loans to businesses as there is no regulation on corporate activity and behaviour. There are no proper regulations governing creditors rights or their hierarchy in the event of liquidation.

Land Law. The existing Land Law needs to be reviewed. Currently the process of title transfer on a mortgaged loan is time consuming and complicated, adding on to the cost of financing.

Commercial Court/National Court of Arbitration. Currently the Commercial and Arbitration courts for disputes are in the process of being passed. The draft laws for a Commercial Court and National Arbitration Court have been prepared with assistance from the Canadian Government. However, the draft law on the Commercial Court is not in line with the civil code. Unfortunately, there will be no adjustment given that funding has been fully exhausted. The draft Law on Arbitration has been submitted to the National Assembly for approval in 2003. A Competition Law which is funded by the UNCTAD would be able to assist in resolving private sector disputes if and when it is passed.

Law of Investment. The existing Law of Investment is inadequate, as it has not been implemented with sub decrees, which are required to establish a consistent framework to create a conducive investment environment. Under this law, for example, companies are exempted from import duties on machineries and equipment. However, SME capitalised with less than US$500,000 cannot enjoy this benefit as they are too small to quality for registration under the Law of Investment. This creates higher costs for SME that need to import.

Bureaucratic Constraints. The bureaucracy is a major deterrent in SME development. Various ministries and government agencies have a say over SME issues, with many holding divergent views and priorities. The infrequency of meetings of the National Assembly, the body which approves laws and regulations in Cambodia, also hampers the passing of much need laws for reform. Approximately 50 proposed drafted laws are still pending at the National Assembly, some of which were drafted seven years ago.

Weak Law Enforcement. The enforcement of laws and regulations is weak in Cambodia. This leads to a proliferation of smuggling activities in the country. Due to the illegal and unfair competition posed by cheaper smuggled goods, investors are discouraged from investing in Cambodia. As a result, this has stifled economic growth, impeded the competitiveness of local businesses and restricted the financial sector's willingness to lend to businesses.

Business Registration. Several studies reviewed that the cost of doing business in Cambodia to be higher than most of its neighbours. Our fieldwork research discovered that the unofficial cost of registering a company can be as high as US$1,400, an exorbitant price in one of the world's poorest countries.

Complicated Accounting Standards. The newly established accounting standards are complicated and yet to be fully understood, much less complied with, by businesses in Cambodia. While it is important to adopt an International Accounting Standard for progress and future development, it is more important to implement standards that are applicable and easily adopted by local businesses. SME face difficulty in preparing their financial accounts with the new standards and consequently have difficulty meeting lenders' requirements for the same.

G. VIET NAM

While Viet Nam has made considerable progress in the transition from a centrally planned economy, there are still several shortcomings. These include weak regulatory guidelines governing the banking sector and the SOCBs' lack of autonomy to make commercially viable decisions; many supporting facilities and or laws that enable credit guarantee, facilitate asset registration and the realisation of collateral, promote corporate governance and financial transparency have either only been recently introduced or still do not exist. Land titling is a complex issue and without land use rights most firms have difficulties obtaining credit.

The Role of the Central Bank. There are several concerns with the regulatory framework governing the banking sector that may indirectly impact SME financing. The US Embassy in Hanoi reports that the central bank is not an independent entity. It operates under government guidance. Besides those of regulator, the central bank has management as well as shareholder roles in the SOCBs. As discussed earlier, the SOCBs dominate the banking sector. While the Government has removed obstacles for the private sector to operate and have access to bank credit, various forms of regulatory prejudice still remain, particularly in prudential regulation. Policy biases still tend to favour state-owned enterprises over SME in terms of access to credit.

Weak Banking Regulations. The guidelines and laws on supervision and monitoring of the banking sector are underdeveloped. The central bank does not have clear standards/guidelines for monitoring many aspects of credit operations. This includes banks' credit risk management system, underwriting standards, delegation of authority, adequacy of collateral, division of responsibilities to ensure adequate checks and balances and adequacy of provisions and assessment of counterpart risks. As a result, the large private commercial banks are unable to operate with autonomy, risk prudence or in a coherent manner.

Land Titling. The issue of land titling is a complex issue in Viet Nam. Land-use rights are registered at the People's Committee of the commune, ward or township where the land is located. Land-use right certificates are then issued by the General Department of Land Administration (GDLA). The Government is presently attempting to unify the land registration system in the country, a step which is critical to encourage SME lending as titling enables banks to realise collateral related to land.

Leasing. Some concerns regarding the provision of leasing are the lack of insurance for leased assets, enforceability of the breach of leased contracts and laws regarding asset seizure in the case of default are weak. The ADB reports that registration processes need to be improved to safeguard the interest of secured party financiers over lessees for leased assets.

Laws on Insolvency, Debt Recovery and Realisation. The present laws on insolvency, debt recovery and realisation of collateral are under-developed and should be revised to provide for clearer, consolidated and comprehensive rules on the recovery process. There is need to improve the skills and capacity of the judiciary to handle insolvency issues. Outside of insolvency, there is a need to establish a mechanism for predictable, transparent and affordable enforcement of both unsecured and secured credit claims.

This page has intentionally been left blank.

IV. CREDIT SCORING AS A TOOL FOR SME FINANCING

A. AN OVERVIEW OF DIFFERENT LENDING TECHNOLOGIES

There are several different lending technologies available to lending institutions to assess the creditworthiness of their borrowers. These different lending technologies can generally be grouped into two types: transaction lending and relationship lending. The main difference between the two is that the former technologies are primarily based on 'hard' quantitative data or data that can be easily quantified (e.g., financial statements, bank account details, credit scores etc.) whilst relationship lending is based on 'soft' qualitative data or data that can be observed through time but not easily quantified (e.g., track record, management capability, market share, banking relationship etc).

The different types of transaction technologies include financial statement lending, credit scoring, asset-based lending, factoring and trade credit. These various types of lending technologies can be distinguished by the type and source of hard information that is the main basis for the underwriting decision.

Briefly, financial statement lending involves underwriting loans based on the strength of the borrower's financial statements. Credit scoring is based on hard information about the firm and its owner, which is usually derived externally, often from credit bureaus. Asset based lending is an extension of credit based primarily on the value of the assets pledged as collateral rather than the underlying creditworthiness of the borrower. Factoring is a narrow form of asset based lending where the lender purchases the borrower's accounts receivables. Trade credit lending involves financing of an underlying trade transaction between the borrower and its suppliers or customers.

Berger and Udell discussed how each lending technology may be appropriate for SME financing depending on the borrower characteristics and the financial institution structure and lending infrastructure. Financial statement lending is limited to informationally transparent SME in countries with strong information environment particularly accounting and auditing standards. So it is not likely to be very widely used in developing countries. On the other hand, asset based lending, factoring and trade credit are suitable for funding informationally opaque SME and/or in countries with weak lending infrastructure. Subject of course, to the underlying assumption of good quality assets. Credit scoring is suitable for information rich environment. In circumstances where neither borrower information nor lending infrastructure is robust, relationship lending appears to be most appropriate.

Berger and Udell (2004) provide a more detailed read on the different lending technologies and their application in a more complete conceptual framework for SME financing. For the purpose of this report, our focus is on credit scoring and its suitability as a lending technology for SME financing.

B. CREDIT SCORING AS A TOOL FOR SME FINANCING

As discussed earlier, credit scoring is actually one of several different lending technologies available to lending institutions to assess the creditworthiness of their borrowers. In actual practice, financial institutions deploy a combination of technologies in loan evaluation. For example, a credit score may make use of information consisting of both the borrower characteristics and its financial statements or the credit score is used in conjunction with relationship or asset based lending.

From our fieldwork and survey observations, many bank respondents in ASEAN apply the term 'credit scoring' more liberally than its actual definition. They generally understand credit scoring as any methodology that involves risk ranking (whether cardinal or ordinal) or grading of the borrower based on factors that may or may not include hard or objective information about the firm and its owner but which would still eventually distil into a single grade or 'score'. Whether this process of 'scoring' is manual or automated is secondary for most respondents. In the true sense of the word therefore, we suspect that not all financial institutions in our survey who indicated that they already deploy credit scoring in credit evaluation have the same meaning in mind as we do.

As such, in the context of this Study the generic term "credit rating or risk grading" may be more appropriate (and hence used interchangeably in this Study) when discussing banks' credit assessments that involve a combination of credit scoring, risk grading and/or other technologies. It is not the intention of this Study to debate what constitutes real credit scoring. Of greater relevance is the interest and capability of financial institutions to undertake a consistent, objective and systematic risk assessment of SME that is based on the general precepts of credit scoring.

1. Definition

Credit scoring is the set of decision models and their underlying techniques that aid lenders in granting credit by assessing the risk or creditworthiness of borrowers. Small business credit scoring is based on hard information about the SME and its owner. The information on the owner is primarily personal consumer data (e.g., personal income, financial assets, home ownership) obtained usually from consumer credit bureaus and/or other data gathered from bank records. The data are entered into a loan performance prediction model to yield a score for the loan. Based on the score, the bank makes a decision (in some cases, this process is automated) to approve or reject the loan (Berger and Udell).

2. Practice of Credit Scoring for Small Businesses

Credit scoring for consumer loans started in the 1950s but extended to small businesses only in the mid 1990s in the U.S. The main type of information used in small business scorecards is the personal credit history of the owners. As such, credit scoring may be applied to informationally opaque SME given that much of the score is determined by the personal history of the owner not the SME. However, in countries where consumer credit bureaus are not available or where information is insufficient, inclusion of other hard information such as the firm's business and financial statements have been featured in many risk scorecards developed by financial institutions. The practice of credit scoring for SME appears to be associated with an increase in lending to opaque SME in the U.S (Berger and Udell). Research also suggests that large banks adopted this technology earlier than small banks.

3. Pre-requisites of Credit Scoring

The pre-requisites to develop a credible credit scoring model for SME are as follows:

(i) A sufficiently sizable sample of previous borrowers and their repayment history
   a) Sample must be representative of SME who are likely to become borrowers in the future
   b) Sample should contain sufficiently adequate portion of 'good' and 'bad' outcomes to make it possible to identify characteristics that reflect these outcomes (Thomas, Edelman, Crook).

(ii) Information on borrower (e.g., age, residential status, education, income) for application scoring and transaction data (average account balances, value of

transactions, repayment patterns). In the case of SME, one could also consider the financial statements of the firm which are usually distilled into financial ratios for analysis.

4. Process and Methodologies for Building Scorecards

Credit scoring systems are based on the past performance of borrowers who are similar to those who will be assessed under the system. The aim of a credit scoring system is to predict risk. This is usually done by taking a sample of past borrowers with their application details and subsequent performance history and trying to identify the connections or common predictors that differentiates a 'good' from a 'bad' borrower. This process leads to a scorecard where the main differentiating characteristics or predictors are given scores, which will aggregate into a total score to indicate the risk of a borrower going bad. There are two main types of scorecards, application scorecards, developed using only data available at the time of loan application and behavioural scorecards which utilise information gathered from after the borrower becomes a customer of the bank.

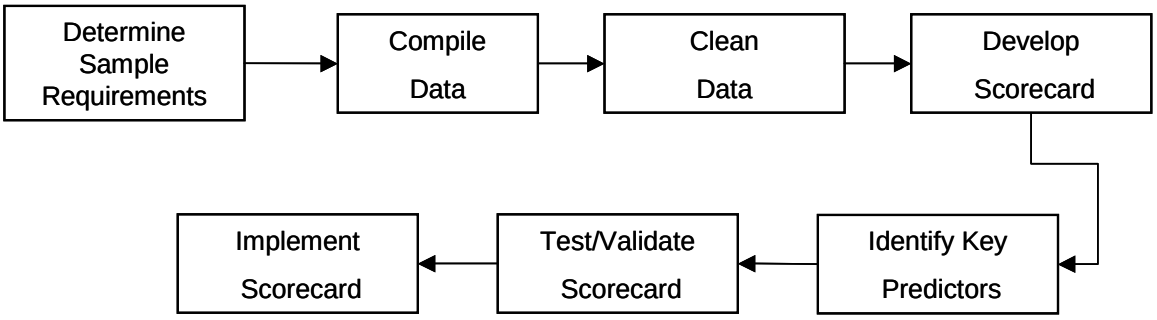
In developing a credit scorecard, the underlying techniques used to identify the common predictors of an outcome range from non-statistical methods such as expert judgement, linear programming, and neural networks to statistical methods such as discriminant analysis, logistic regression and classification trees (Thomas, Edelman and Crook).

When a scorecard is built, it is by necessity built on historical data. But once developed, the scorecard will be applied to new borrowers (application scorecard) and/or on existing borrowers (behavioural scorecard) whose risk may have changed over time. Validation of the scorecard (at time of development and monitoring on an on-going basis after deployment) is important to ascertain how representative the sample used in the scorecard is to the current profile of borrowers. This can be performed with various tests, which compare the prediction of the scorecard with actual outcome. Once the validation is complete, the cut-off scores to trigger the various loan decisions will have to be made.

The credit scorecard can be implemented at loan application time and/or as a monitoring tool during the life of the loan. New borrower is scored at application and is accepted or rejected based on the credit score and/or other considerations in conjunction with the credit score. Subsequently re-scoring can be conducted at regular intervals to monitor the borrower's risk profile.

The process of scorecard development is summarised in the following diagram.

Box 4.1: Process of Credit Scorecard Development



Box 4.2: Sample Credit Scorecard for SME Borrower

Predictor	Score	Predictor	Score	Predictor	Score
Age		Income		Debt-Income	
18-25	20	<5,000	15	0-10%	30
26-35	25	<15,000	18	11-30%	25
36-43	35	<35,000	26	31-40%	15
44-52	40	<70,000	36	41-60%	10
>53	50	>70,000	55	>61%	5
Score	25		26		25
Total Score	**76**				
Loan Decision	**Accept**				

C. CAPABILITIES AND INTERESTS OF FINANCIAL INSTITUTIONS FOR CREDIT SCORING OF SME

The findings on the interests and capabilities of financial institutions to undertake credit scoring are distilled from 46 bank respondents, 32 of whom are from ASEAN-6 and the balance, ASEAN-4. Due to the small sample from ASEAN-4, the response should be interpreted with caution. Nevertheless, the findings do provide a telling indication of the status of credit scoring in these countries.

1. Existing Practice of Risk Grading/Scoring of SME

23 out of 32 banks or over 70% surveyed in ASEAN-6 risk grade/ascertain the creditworthiness of their SME borrowers through some type of rating/scoring system. Further country analysis revealed that banks in Malaysia, The Philippines and Thailand are fairly familiar with and have systems for the risk rating of SME loans. Some rating systems are more than 10 years old. The reverse is true in ASEAN-4. Only five out of eight (38%) have some kind of risk grading system for their loans. This is not surprising given the current status of the financial institution structure, weak lending infrastructure and poor information environment in the transition economies.

However, of those with risk grading systems, not many banks (less than half of respondents) have a separate (from corporate) one to cater specifically for this segment of borrowers.

Table 4.1: Usage of Risk Grading/Credit Scoring of SME by Banks in ASEAN-6, 2004

Country/Banks	Yes	No	Total
Brunei Darussalam	1 (25%)	3 (75%)	4
Indonesia	2 (50%)	2 (50%)	4
Malaysia	7 (100%)	0	7
Thailand	7 (78%)	2 (22%)	9
The Philippines	6 (75%)	2 (25%)	8
Total Banks	**23**	**9**	**32**

Source: Survey Questionnaire, RAM Consultancy Services 2004

Table 4.2: Rating Technique Deployed by ASEAN Banks on SME Loan

Rating Technology	ASEAN 6		ASEAN 4		Total	
	# Resp	%	# Resp	%	# Resp	$
Credit Scoring	5	15	2	33	6	18
Subjective Assessment	0	0	0	0	0	0
Hybrid	22	81	4	67	26	79
(Quantitative+Subjective)	1	4	0	0	1	3
Others						
Total	**27**	**100**	**6**	**100**	**33**	**100**

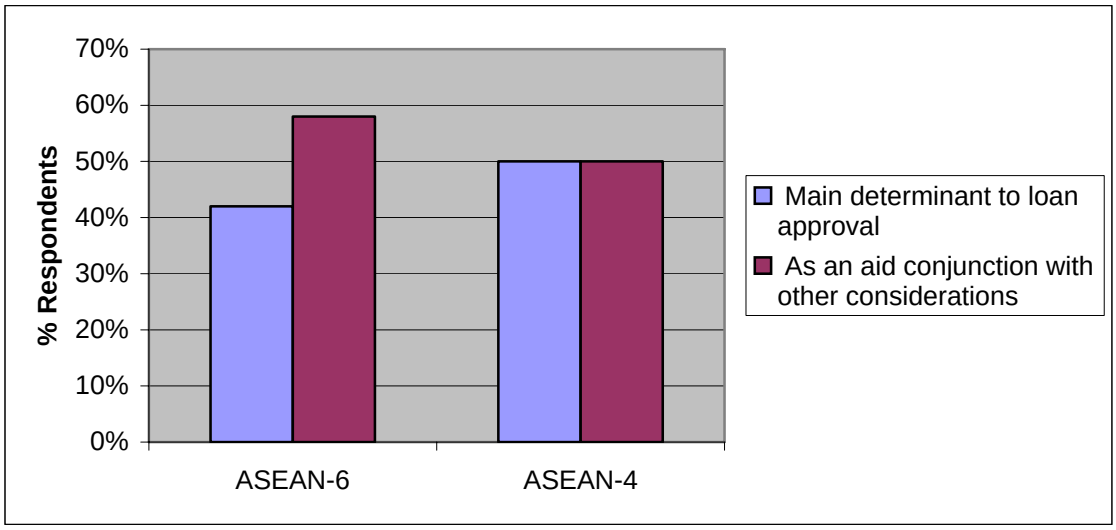
Source: Survey Questionnaire, RAM Consultancy Services 2004

Rating Technique Deployed. The majority (near 80%) of surveyed banks' rating systems, even those in relatively developed economies such as Malaysia and Thailand deploy a hybrid of technologies. Usually this is a combination of quantitative techniques (which may include credit scoring) with qualitative assessment of 'soft' factors such as industry prospects, management track record, credibility etc. The sole use of credit scoring technique comes a distant second (only six out of 33 banks use a purely quantitative approach to rating/scoring SME).

Possible reasons that lenders are not comfortable in putting their total trust into a machine generated credit score could be that the SME portfolio of local banks in ASEAN are relatively small enough to manage with relationship lending and that the practice of credit scoring is still in its infancy in ASEAN. Berger and Udell suggested that size of financial institution has a role in influencing lending technology deployed. However, our survey results indicate that banks in ASEAN have not reached a stage where the volume of loans and cost savings from lower processing time is compelling enough to fully deploy transaction lending technologies such as credit scoring for their SME loans.

Role of Risk Rating/Scoring Systems. The risk grading/rating systems in use in banks are not the key determinant to loan approval. Respondents (58% in ASEAN-6 and 50% in ASEAN-4) indicate that the rating/score is used as an aid in conjunction with other considerations. Such considerations could include type and quality of collateral, conduct of borrower's bank account, character of entrepreneur, banking relationship etc. Nevertheless there are others (42% ASEAN-6 and 50% ASEAN-4) who would consider the rating/score as the main determinant to approval. On average, about 20-30% of applicants fail to achieve a 'passing' grade based on the rating/score.

Figure 4.1: Importance of Risk Rating/Credit Scoring Systems in ASEAN Banks



Source: Survey Questionnaire, RAM Consultancy Services 2004

For the SME that cannot achieve a 'passing' grade, 10 out of 26 banks in ASEAN-6 would automatically reject the loan (compared with 3 out of 5 in ASEAN-4). The rest would either refer the loan to higher authority or consider the loan with additional conditions such as requesting for additional collateral or a new business plan.

Table 4.3: Consequences of SME not being able to achieve Pass Grade

Consequences	ASEAN 6		ASEAN 4		Total	
	# Resp	%	# Resp	%	# Resp	$
Loan is automatically rejected	10	38	3	60	13	42
Loan is referred to higher authority	4	15	1	20	5	16
Others	12	46	1	20	13	42
Total	**26**	**100**	**5**	**100**	**31**	**100**

Source: Survey Questionnaire, RAM Consultancy Services 2004

Effectiveness of Rating System/Credit Scorecard Deployed. The majority of surveyed banks that deploy rating system/scoring for SME reported that their systems/scorecards have been effective in reducing default risk. Clearly, the rating systems/scorecards that are deployed are at least able to risk rank the credit risk of borrowers. Rating/scoring has also contributed to reducing loan processing time for 71% of the surveyed banks and to a lesser extent, increased profitability for 58%. To the extent that the rating/scoring process is automated at the bank, this would result in a shortened processing time (and perhaps made the loan approving process more systematic and faster). Consequently, many banks responded that lending to SME has increased. The impact on profitability is less obvious as there are many other components that influence the bottom line of banks.

Table 4.4: ASEAN Banks' Opinion of Effectiveness of their Rating System/Scorecard

Effectiveness of Rating/Scorecard	Reduce Default Risk (%)	Reduce Loan Processing Time (%)	Increase Profitability (%)
Effective	70	71	58
Moderate	5	10	21
Not Effective	25	19	21

Source: Survey Questionnaire, RAM Consultancy Services 2004

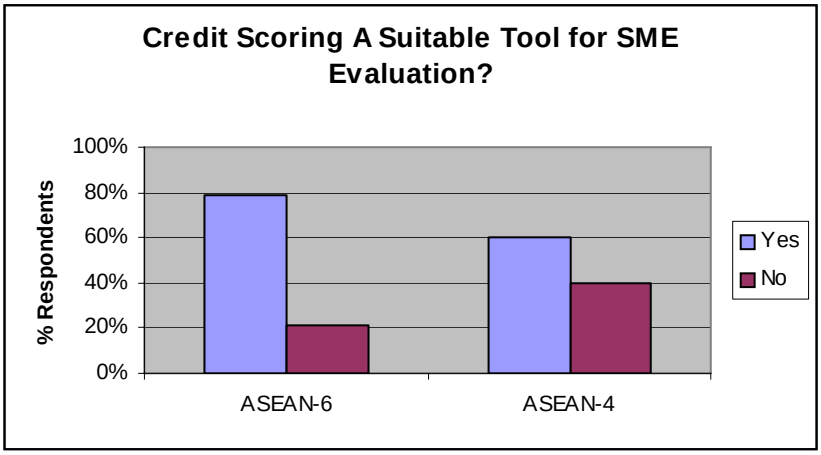
Problems Encountered with Rating Systems/Credit Scoring. Banks reported on a number of problems and constraints faced when deploying the rating system/credit scorecard for SME. Common issues include the following.

(i) Lack of historical data on SME for validation and benchmarking
(ii) Reliability, timeliness and frequency of financial information supplied by SME
(iii) Difficulty of quantifying soft factors

The main problems relate to data availability and reliability. Given that SME in many countries are not required to have their financial statements audited, verifying the accuracy and reliability of such information can be difficult.

Interest in Deploying Credit Scoring in Future. Of the respondents who do not currently deploy any rating or credit scoring technology for SME, 14 out of 18 were of the view that credit scoring is a suitable tool for the evaluation of credit risk of SME and that they would be interested to deploy the technology in the future. The others hold divergent views that credit scoring may not be suitable for SME given the lack of 'hard' information required for scoring to work effectively. A hybrid type of rating system that takes into account quantitative factors would be more appropriate for SME for these banks.

Figure 4.2: Opinion of ASEAN Banks on Credit Scoring for SME



Source: Survey Questionnaire, RAM Consultancy Services 2004

Main Concerns of Impediments to Credit Scorecard Deployment. The key concerns expressed by respondents in ASEAN are as follows. Surprisingly, cost is of little concern.

Availability of information	25%
Lack of credit bureau/central database for SME	18%
Insufficient infrastructure	18%
Lack of in-house expertise	15%
Banking regulations	15%
Cost concerns	7%

Notwithstanding these concerns, the majority of respondents were confident that they could overcome the impediments of deploying a credit scorecard as they believed that scoring will improve bank lending to SME. Scoring will be useful for handling large volume but low value

loans hence reducing the processing time and cost for banks. Moreover, credit scoring will be able to assist in expediting loan approvals and enable decision makers to evaluate loans with less subjectivity.

Feasibility of Third Party Credit Scoring? If an independent third party which is accredited by the regulatory authorities and financial community were to provide SME ratings/credit scores, 71% of surveyed banks would consider using such service while 29% would not. Those that agreed conditioned that the credit scores/ratings should be accurate. For those that would not, they fear that information used by the third party may not be accurate, the model used by the third party may not be representative of the banks' loan portfolio and that a 'one size fits all' model cannot be applied to all SME.

D. IMPLICATIONS AND IMPACTS OF CREDIT SCORING ON SME DEVELOPMENT

1. Impacts and Implications

The advent of credit scoring for SME has resulted in a paradigm shift in SME lending by banks. It is generally anticipated that large banks which usually lead in adopting this technology will become more competitive in the market for SME lending and the addition of credit scores in the lending decision will lead to improve SME loan availability and performance (Cowan, Fetherston, Nail).

Credit scoring also enables banks to overcome the barrier posed by information opacity of SME since banks can still score SME (hence lend to them) with the assistance of a credit model calibrated on similar SME. Another benefit of credit scoring is that banks that use credit scoring will tend to have higher profitability rates, as the academic literature and our survey findings generally indicate. This is as a result of allocative gains from providing loans to 'good' borrowers (Astebro et. al). As shown by the results of this study's survey, the banks that have implemented credit scoring (or a variation of it) reported on its positive impact on loan volume (increasing), default risk (lower), loan processing time (reduce) and consequently profitability (higher). Even those that have yet to implement credit scoring are of the view that with increasing volume, credit scoring would be a suitable tool for risk management for which they would consider deploying.

From our survey findings, it is clear that banks in ASEAN, if they have not already done so, are interested in and capable of implementing credit scoring for SME. Nevertheless, a pre-requisite to effective implementation of credit scoring is a database with a sizable sample size and long histories. Unlike developed countries possessing a rich data environment and high disclosure standards, such as in U.S., data adequacy and availability are the main hurdles to effective credit scoring in emerging and transition economies. Data sharing and banking regulations issues are also critical issues if credit scoring is to be implemented in a cost effective manner in many countries especially in ASEAN-4. Some banks in the region have purchased generic credit scorecards from global vendors in a bid to overcome the data constraint. But generally, these scorecards have been found to be less robust in their predictive ability.

2. Basel II implications

The UEAPME Position Paper on future of SME finance (July 2004) highlighted that the new capital requirements and higher risk awareness demanded by Basel II may impede SME access to finance and increase the cost of external finance. Basel II translates into the need for new rating systems and credit scoring (principally for SME as large clients already have

ratings) which in turn requires better information disclosure from SME, switch from 'relationship' to 'transactional' approach to lending, and possibly higher costs as banks try to pass on the additional cost incurred in Basel II compliance to their clients. Indications from our survey support the latter opinion, although some banks do not think this is a concern given that the savings from making bad loans will off-set the cost of rating SME. Moreover, banks with large SME portfolios may be encouraged to focus on increasing their portfolio given the preferential capital treatment accorded to SME.

A report by J. Bartels highlighted that SME fear that even a proactive move to obtain a rating may prompt banks to withdraw credit lines as rating could turn out worse than expected. Moreover, SME are not familiar with the rating process, and banks do not have sufficient knowledge or valid industry benchmarks to properly assess SME. Naturally bankers may not share this concern. A survey by PWC (Bank Lending Practices to SME, Ministry of Economic Development, New Zealand, July 2003) surmised that banks view Basel II as a non-impediment to SME lending but as a positive development since it promotes the alignment of interest rates with true economic cost.

In the context of ASEAN, many banks are still in the process of developing or fine-tuning their credit scoring or rating models and thus exercise some flexibility in assigning credit scores or grades to their borrowers. Our survey results showed that banks that deploy some form of credit scoring/rating for SME reported rather benign rejection rate of 20-30% on average. Moreover, many banks also consider 'soft' factors in assigning final credit scores to SME. Hence, having to comply with Basel II's higher risk awareness may not necessarily impede access to finance for SME, though it could lead to higher cost of finance if SME are scored poorly by banks' risk systems.

At this stage, it may be premature to conclude whether the overall impact of Basel II on SME is positive or otherwise.

E. CONCLUSION ON FEASIBILITY AND IMPACT OF CREDIT SCORING ON SME LENDING BY BANKS

From our survey and discussions with respondents, the general conclusion is that credit scoring has its merits and would allow banks to improve turnaround time, reduce default rates and thus increase profitability. As economic performance improves across ASEAN (which in turn leads to greater lending) and the market becomes increasingly competitive, most banks realise these benefits, which can be reaped from credit scoring, not only for their consumer lending but also for their SME lending. However, while most banks agree that credit scoring for SME would be beneficial for the above reasons, the volume of SME loans that filter through the banking system is still comparatively low and does not warrant wide spread use of credit scoring at present. This is especially so for banks in the transition economies.

Moreover, a more important point is that credit scoring may not necessarily increase access to financing for SME. Given the relatively poor information environment, lack of centralised credit bureaus and disclosure standards in ASEAN, it is doubtful if credit scoring will do better to improve lending for SME than the incumbent method of relationship banking. The findings of the survey insinuate that it is not so much the methodology of credit evaluation that hamper lending to SME but more often than not, the problems are caused by policy and fundamental institutional barriers. Applied in isolation, credit scoring or any other methodology for that matter would not result in improving access to financing for SME. This is even more obvious in instances where there is a poor repayment culture and dependency

syndrome – resulting in the un-willingness of borrowers to repay their loans. No methodology can be used to overcome these types of problems.

Our conclusion on credit scoring for SME is that for banks that have the capability to implement it, it may lead to a greater lending especially at banks where loan volumes are high. This would seem to suggest that implementing credit scoring in ASEAN-6 banks may bring about this benefit, if the other impediments to financing do not significantly hamper financing or are resolved at the same time. For banks that do not have the volume and/or where there are fundamental impediments to financing, credit scoring would not be a tenable solution at this present time, even if banks agree it is feasible or beneficial.

V. RECOMMENDATIONS AND STRATEGIES

At the national level, the following are some of the practical recommendations that may be appropriate for adoption by member countries as they see fit.

A. STRATEGIES FOR EXPANSION OR DIVERSIFICATION OF APPROPRIATE FINANCING FOR SME

1. Improve outreach of credit guarantee mechanism

In many of the countries with successful SME financing programmes (such as Japan, Chinese Taipei, Germany), credit guarantee mechanisms are a strong feature of the development framework. These guarantee schemes are usually well supported by government or industry funds. In Japan for instance, the credit guarantee corporations are present in every prefecture thus ensuring a wide outreach and there is a reinsurance mechanism to ensure their viability. Such strong support mechanisms are lacking in ASEAN credit guarantee schemes. Though not all ASEAN countries can emulate such best practices, governments can look into improving the scope and outreach of their credit guarantee schemes. The credit guarantee schemes could be made available to all institutions involved in SME financing and sufficient funding of the schemes should be a key priority. One important element though is that successful credit guarantee schemes require appropriate risk sharing.

2. Promote greater engagement of Non-Bank Financial Institutions (NBFI) in SME lending

In most ASEAN countries, efforts to improve SME financing are still being pushed through the larger commercial and development banks. This is because these bank institutions generally dominate the banking sector. While these bank institutions may have greater resources, they do not necessarily have the outreach or inclination to lend to SME. Moreover, many of the larger bank institutions are too entrenched with corporate lending practices, have little experience in the middle and lower end segment of the credit market and have a biased view with regard to SME.

On the other hand, non-bank financial institutions such as finance companies, rural or thrift banks and cooperatives may be more suited to SME lending as these NBFIs have more experience in lending to the SME sector given their traditional focus on retail and small business segments of the credit market. Moreover, many of the facilities available at NBFIs (such as factoring and leasing) are more suited to SME' funding needs. Hence, promoting greater engagement of NBFIs in SME lending may bring about increased lending to SME. NBFIs are already active in SME lending in some countries notably Indonesia and The Philippines. Authorities in the individual countries could facilitate greater involvement of NBFIs by providing them incentives such as tax deductions for certain expenses, branching privileges and capital allowances. At the same time, these incentives could also be provided to banking institutions to encourage greater SME lending. The authorities could also encourage banking institutions to link up with NBFIs where the latter can act as conduits in promoting bank facilities to SME.

3. Develop alternative markets for SME financing

ASEAN-6 countries, which have more developed financial markets can look into developing the debt and equity markets as alternative sources of funding for SME. The existing listing requirements of equity exchanges catering to smaller companies are hardly SME-friendly.

Debt markets in the region too are closed to SME. Access to these markets could be facilitated by relaxing requirements and lowering transaction costs for smaller enterprises. Alternatively, governments could assist institutions involved in SME financing (such as the credit guarantee corporations) to access capital markets for funding. If the government could provide support such as direct or indirect guarantee, subordination or liquidity lines for bond transactions, these institutions would be able to raise long-term funds at a competitive rate to fund SME loans.

Venture capital financing is another viable channel especially for start-up companies. However, in most ASEAN countries, the venture capital industry is not well promoted as such. Perhaps, more incentives could be provided to venture capital companies whether public or private sector owned, to play an increasing role in SME financing.

B. STRATEGIES FOR INSTITUTIONAL STRENGTHENING OF FINANCIAL INSTITUTIONS

1. Improve credit evaluation skills of bank officers

The feedback of most bank respondents and regulatory agencies is that bank credit officers lack understanding of SME and do not have the requisite skills to evaluate SME. Many banking institutions apply the same techniques of evaluating large companies to smaller ones without any adjustment for the inherent differences. Moreover, banks are more stringent with SME on documentation requirements. For a start, there needs to be a paradigm shift in mindset – SME have unique characteristics that differentiates them from large established corporations. Credit officers or analysts in banks must realise this. Secondly, the techniques and appraisal methods appropriate to evaluate large corporations are not relevant for small enterprises. This means that banks must adjust their evaluation techniques accordingly and apply relevant ones to suit each group of borrowers. A good reason for applying relationship banking to small and medium enterprises is that SME are not as well structured and are more opaque than larger firms. To improve their skills, banks could provide more training on SME to their credit officers. Banks should tap on internal personnel or consultants who have long experience dealing with retail and small scale lending (especially at branch level).

2. Establish SME unit in banks

To encourage lending to the sector, banks (that are not specialised in SME lending) could consider setting up an SME division or department to provide specialised services to SME. Specially trained credit officers could staff such a unit. For large financial institutions that already have such divisions, they are usually perceived to be less important or glamorous compared to corporate lending divisions. Elevating the importance or status of retail or SME divisions would encourage greater interest and focus on the SME sector. The authorities could encourage this by providing certain banking privileges to such banks.

3. Apply appropriate evaluation techniques

As discussed earlier in this report, credit scoring can improve turnaround time, reduce default risk and generally increase profitability of low value high volume and homogenous loans (particularly consumer loans). These benefits are more apparent for larger banking institutions. However, whether credit scoring in itself will improve access to financing for SME is debatable. Lack of information and weak financial capacities would still inhibit SME from gaining access regardless of the technique used by banks. Moreover, as credit scoring thrives on good information and objective assessment, informationally opaque borrowers otherwise with good credit standing may be denied access to loans. Hence, our

recommendation is for financial institutions to apply evaluation techniques that are appropriate to their circumstances. In this regard, relationship banking would seem to be more appropriate in ASEAN-4 where there is a weak information infrastructure.

4. Promote greater linkages and dialogue between financial institutions and SME/Trade associations/SME centres

Financial institutions in ASEAN do not have strong linkages with SME/Trade associations or chambers of commerce. As a result, the financial services provided by financial institutions may not be adequate or appropriate to meet the needs of SME. Forging greater linkages and dialogue between financial institutions and SME associations would promote better understanding and facilitate financing for SME. In this respect, banks (as a group or individually) could organise road shows to various SME associations or chambers of commerce to introduce their services. Conversely, seminars or trade exhibitions held by industry associations could include banking institutions. The authorities could support these activities with their presence and/or sponsorships.

C. STRATEGIES FOR CHANGES TO THE LEGAL AND REGULATORY ENVIRONMENT TO IMPROVE SME FINANCING

1. Consistent and legalised definition of SME

In countries that do not have consistent or legal definitions of SME, it would greatly improve the effectiveness of development and financing programmes (especially if implemented by different line agencies or institutions) if different definitions can be standardised and legalised. This would also facilitate better planning and targeting of sectors by financial institutions.

2. Improve information access to SME

Although the information infrastructure in ASEAN-6 is better than in ASEAN-4, there is little in the way of sharing and access to the available information by the different stakeholders. Credit or trade information developed by government agencies, central credit bureaus, national registries and financial institutions are not freely shared due to regulations restricting access to such information. The lack of information access is a significant barrier to initiatives to improve SME financing. For instance, the ability of banks to develop good credit models for the SME segment is impaired by the lack of data. In this respect, one recommendation to improve information access is for central banks (who are usually owners of credit information databases) to facilitate disclosure of data on a composite or group basis and without disclosing the identity of the SME. The availability of such data would greatly assist studies, model calibration and research by financial institutions and others in developing a better understanding and risk profile of the SME sector.

3. Conduct studies and publish information on SME

At present, there is a dearth of information in respect of SME financing in each ASEAN country. More studies on SME financing should be commissioned by governments and regulatory authorities in charge of SME financing and the findings should be made available to the public. Research and surveys on sources of funding, funding trends, facilities utilised, cost of capital, problems with financing etc should be conducted and published on a regular basis. This information would be very valuable for all those involved in SME financing.

4. Provide incentives for banks to lend to SME

To promote greater SME lending, the regulatory authorities could consider granting certain incentives to financial institutions that actively promote SME financing and have achieved a sizable SME loan book. To maintain prudential banking standards, such incentives could be for a certain period of time and in non-financial form e.g., branching privileges, tax deductions on certain expenses etc.

5. Promote informal debtor-creditor workout mechanism for SME

Various countries have commercial courts and arbitration centres to settle commercial disputes. However, the process is not necessarily less time consuming or onerous than the court process. Many financial institutions are reluctant to lend to SME not only because of lack of creditors protection and enforcement of collateral rights, but also due to the lengthy process of arbitration and settlement. This skews the profitability of a small loan against its potential risks. Perhaps the attractiveness of SME lending can be enhanced by establishing informal workout mechanisms for SME loans. Such a mechanism could be implemented through a special agency that is empowered to act to an intermediary between debtor and creditor.

D. REGIONAL INITIATIVES

On a regional scale, there are not many feasible initiatives that could be appropriately adopted by all ASEAN countries given the diversity in economic and financial sector development. The following plausible regional initiatives are necessarily high level. They are listed in the order of ease of implementation in the near to medium term.

1. Capacity Building of Newer ASEAN-4 Member Countries

One of the key difficulties of implementing regional initiatives in ASEAN is the difference or disparity in the level of development in the banking sector and the corresponding legal and regulatory framework between the newer and older member countries. Thus before any regional initiative can be realistically and successfully implemented in the near future, it would be necessary to establish some common grounds and actions which can contribute to a more homogenous state where initiatives relevant across the region can take shape.

The effort of continuous capacity building especially of the newer ASEAN-4 member countries is an important means to achieve some homogeneity. Several regional bodies are already doing this. The SME Working Group under the auspices of the ASEAN Secretariat is one such body that meets regularly to discuss and discuss common issues and ideas that affect SME development in the region. In the area of banking, for example, the ASEAN Bankers Association (ABA), an association of banks in ASEAN, instituted a “one-on-one” mentoring system several years ago whereby a more advanced member extends training assistance to a less developed member. The ultimate goal of the ABA is to establish a bank training institute in each of the newer ASEAN countries. In respect of improving access to bank financing for SME, ASEAN countries could leverage on these existing efforts, for example ABA’s efforts, to provide the requisite training for banks to assess SME credit, to exchange ideas on alternative techniques and tools to finance SME, good practices, and so on.

2. Organise Annual Regional Financial Forum for SME Associations and Financial Institutions and NBFI

Maintaining a network of relevant bodies or contacts where resources and ideas can be shared regularly would go a long way toward promoting capacity building and enabling access to finance. One of the initiatives would be to organise an annual regional financial forum to bring together all those involved in SME financing to exchange ideas and information, air views and promote respective programmes. The idea is to bring together the relevant entities from both the demand and supply side to discuss specific issues relating to SME financing. This is important as many present regional forums or meetings typically involve one or two parties to discuss their views of perceived problems and perhaps in isolation to actual problems on the ground. The agenda of such meetings also usually tend to be general covering a wide-range of issues to be discussed. Under the proposed regional financial forum, a representation of all relevant stakeholders would allow specific issues to be discussed in the right perspectives and priorities for action to be set accordingly.

One suggestion for a possible grouping of this forum would be as follows:

- The ASEAN Bankers Association (ABA) can act as the focal for financiers
- The ASEAN Secretariat can act as focal for the region's regulators and government officials
- The respective lead SME Agency or SME Association can act as country focal point for SME.

The ABA has indicated its willingness to either host (at its annual meeting) or participate in such a forum under the patronage of a regional organisation such as ASEAN Secretariat.

It is suggested that the issues to be discussed at each annual forum be limited to a manageable number so as to encourage in-depth discussion and formalisation of concrete action plans.

Examples of possible topics include:

<u>Topics for bank improvement:</u>

- Actions or programmes to improve credit skills of bank officers in understanding SME
- Alternative technology/tools to evaluate SME credit, including credit rating and scoring services for SME
- Financing instruments suitable for SME
- Simplification of loan procedures and documentation
- Review of collateral requirements for SME
- National level recommendations highlighted in this section of the report

<u>Topics for regulatory improvement</u>

- Appropriate regulatory initiatives to enhance bank lending
- Appropriate risk sharing for government
- Promotion of micro financing techniques to certain member countries
- National level recommendations highlighted in this section of the report

<u>Financing instruments for SME</u>

- Using financial intermediaries for fund raising
- Improving the credit standing of SME
- Improving cash flow through receivables
- Types of credit management tools and financing for growth and expansion
- National level recommendations highlighted in this section of the report

Possible follow-on programmes to foster better understanding of all stakeholders could be organised through this forum, for example financial fairs, conferences or dialogue sessions to bring together SME with financiers and regulators.

As a start, the first annual forum could lay out the goals, basic guidelines and establish the priority for issues to be discussed at subsequent meetings.

3. Common Regional SME Definition

Currently, there is no common regional SME definition in ASEAN. In most countries, the prevailing national definition is one based on assets and/or number of employees. While the lack of a regional definition in itself does not hamper national level policies and their implementation, it is difficult to compare information and data across countries, formulate common or regional policies and implementation of the same.

Therefore, ideally to enable the effective formulation of regional SME policies and initiatives, there should be a standardised definition of SME to apply separately for ASEAN-6 and ASEAN-4. Though further thoughts need to be given to what would constitute the right regional definition for each grouping, a standard one based on either assets or employees would be appropriate to ensure the majority of SME in each country are captured in the definition.

Issues that need to be thought through include:

- Whether or not to include land and property as part of the definition of assets primarily because most countries have not separated physical assets from working capital in their respective definitions of SME
- How to treat information or IT companies and whether they should be classified as manufacturing or services in the definition

A further study may be required to formulate a common regional definition for ASEAN.

4. Establish A Reporting Framework for SME-specific Statistics

Currently many financial institutions in ASEAN do not maintain banking data on SME as a category distinct from other companies as most central banks do not require such reporting. From our survey, there are some banks that make a distinction between SME and large companies and maintain their internal database accordingly but most do not due to there being no regulations for such compliance and systems which are not designed to collate data in such a manner. As a result, it is currently difficult to analyse data and make any meaningful conclusions for SME lending from statistics provided by banks or the authorities.

However, moving forward, if SME-specific statistics or reporting were required of the financial sector (and any other authority with purview over SME financing), it would result in:

- More accurate measurement of the effectiveness of SME policies in specific and the performance of the banking sector as a channel for SME financing in general
- Enable regulators to accurately identify shortcomings and craft more relevant and appropriate financing programmes for SME
- More consistent and accurate representation of the actual situation in SME financing
- Better comparison of the SME financing vis-à-vis financing of other sectors or entities

Thus it would be beneficial for the regulatory authorities to require bank reporting of SME statistics as a category distinct from large corporations. At the same time, other authorities/entities having any purview over SME financing programmes should also be

encouraged to report statistics in a manner consistent with bank reporting. One of the key pre-requisite to establishing such a reporting framework is that there must be a standardised and consistent definition of SME to facilitate measurement and reporting of the right statistics.

5. Create a Regional Database on SME

Data on SME especially with respect to their financial profiling, their access to financing, their funding cost etc and regional and country banking statistics on the SME sector are difficult to obtain. Where such data or statistics exist, it is usually outdated. If the banking sector could adopt a reporting framework of SME-specific statistics as suggested in this report, it would be a major step toward improving the information asymmetry. This would also act as a precursor to establishing a regional database for SME. Once sufficient data is made available by each country, it would be possible to create a regional database on SME. Though this is a big task that would take some time to materialise, a regional database on SME would be highly useful to all countries in promoting SME financing in ASEAN. Although a regional database may not drastically increase bank financing for SME per se, it would nevertheless improve information availability on SME and encourage greater participation of financial institutions' in SME development and financing. In the future, such a regional database could be a very valuable springboard for regional credit ratings, benchmarking for regional asset securitisation and other regional debt instruments, regional banking and so forth.

The major elements involved in setting up such a regional database include:

- Data coverage, information sources and availability
- Infrastructure
- Cost and other resources

There are many possible sources of information which can be pooled to provide information on SME. Two main sources would be from (a) financial sector (central bank data depository, central credit bureau, etc) and company or business registration records (central company registration bureau). Other possible sources include relevant SME agencies and authorities that maintain data on SME and records of SME associations. These organisations would likely be able to contribute valuable data at the country level.

The type of data that could be compiled and tracked include:

- Macro level – Bank lending statistics to SME (e.g. loan amount by sector/industry/type of products etc, Non performing loan statistics, lending rates etc), number of establishments by industry sector, location, principal activity, number of employees etc
- Firm level – Corporate financial statements (tracking key parameters e.g. turnover, profitability, assets, liabilities, equity, borrowings etc)

The main difficulties of establishing such a regional database would be on how to obtain such data and who will maintain the database. A regional entity such as the SME Working Group could facilitate such an exercise by coordinating with the respective national governments to obtain regulatory approvals, contribute data and project funding (with possibly some assistance from multilateral agencies such as ADB). While the database can be temporarily maintained by say, the ASEAN Secretariat or APEC (as a sub menu in its ACTETSME website), the future maintenance of the database can be outsourced to a third party from the private sector. The third party's services can be funded via a regional grant or from revenue to be generated from services to be provided to customers.

Given that this is likely to be an onerous task, it would be advisable to conduct a feasibility study on the initiative to determine the project's viability first.

6. Establish SME Accounting Standards

One of the most common problems faced by SME throughout ASEAN is the difficulty in preparing financial statements and to comply with the requirements set out by the respective accounting standards in each country. Many small businesses struggle with understanding the complex requirements of the accounting standards and have little means to engage professional accountants to prepare proper accounts. As a result, lending institutions have to rely on other means to verify the financial health of the SME and this could lead to a higher risk premium being charged on the loan.

It is proposed that national governments, in conjunction with the national accounting bodies could look into adopting separate (and simplified) accounting standards or amending the existing standards to suit SME. At the World Accounting Standard Setters Meeting held in London in 2003, experts met to discuss the findings from a survey of 28 countries on accounting standards for SME. It is increasingly recognised worldwide that the Generally Accepted Accounting Principles is applicable to only a small number of (large and better established) companies that are able to fully comply with these and the International Financial Reporting Standards. While some countries have adopted separate accounting principles for SME, many others are making exemptions for these firms with the aim of simplifying financial disclosure, recognition and measurement. Examples include enabling SME to submit simplified financial statements and reduced notes and eliminating consolidated financial statements and cash flow statements. Other countries aim to assist SME, for instance, by recognising cash basis of accounting for very small companies and exempting SME from equity accounting[10].

In ASEAN, many of the member countries require SME to comply with the same accounting standards that apply to all registered companies. Simplifying or amending current standards to suit small businesses would allow more SME to comply with disclosure requirements and increase the level of their transparency.

E. CONCLUDING REMARKS

As access to finance is a product of both supply and demand side constraints, all of these recommendations would work best in the context of a comprehensive framework. Solutions to resolve financing constraints must be addressed in conjunction with supportive development polices for improving market access, industrial linkages, information facilities, harnessing technology and enhancing knowledge and skills of SME. Often, one of the key factors of success of countries with a successful SME sector is the presence of a comprehensive, well-coordinated framework (usually implemented by a one-stop agency) and pervasive support mechanisms for SME development. In addition, in many ASEAN countries, the legal and regulatory framework poses significant barriers to SME financing and is in need of updating and reform. While some countries are implementing on-going reforms, the required changes will likely take some time to materialise.

[10] International Accounting Standards Board (2003). Financial Accounting for SME. World Accounting Standard Setters Meeting, London 2003.

VI. REFERENCES

ADB, 2003. Country Strategy and Program Update (2004-2006): Lao People's Democratic Republic, Asian Development Bank, Manila.

ADB, 2002. Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grant to The Republic of Indonesia for the Small and Medium Enterprises Export Development Project, Asian Development Bank, Manila.

ADB, 2003. Technical Assistance to the Lao PDR for Advisory Assistance on SME and Private sector development, The Asian Development Bank, Manila.

ADB, 2004. *ADB to Help Develop Better Business Environment for SMEs in Cambodia,* News Release 17 December 2004 No 178/04, Asian Development Bank.

ADB, 2004. Asian Development Outlook 2004: Foreign Direct Investment in Developing Asia, Asian Development Bank, Manila, The Philippines.

ADB, 2004. Country Economic Review: Philippines.

ADB, 2004. *Key Indicator 2004,* Asian Development Bank, Manila.

ADB, 2004. *Preparing the Small and Medium-Sized Enterprise Sector Development Program,* TA No. 4179-CAM, Asian Development Bank.

ADB, 2004. Report and Recommendation of The President to the Board of Directors on a Proposed Loan and Technical Assistance Grant to the Kingdom of Cambodia for the Small and Medium Enterprise Development Program, Asian Development Bank.

Agrawal, A., 2004. Good Governance for SMEs with Special Reference to Practices in South/South-East Asian, *World SME News,* Vol.1, No.12.

APEC Centre for Technology Exchange and Training for Small and Medium Enterprises in www.actetsme.com

APEC Small and Medium Enterprises Working Group, 2002. *Profile of SMEs and SME Issues in APEC 1999-2000,* APEC.

APEC SME Working Group, 2004. Evaluation Report: APEC Symposium on Best Practices for Enhancing Financing Chain for SMEs at Different Growing Stages. Canada.

Asasen, C., Asasen, K., and Chuangcham, N., 2003. A Proposed ASEAN Policy Blueprint for SME Development 2004-2014. REPSF Project 02/005.

Astebro, T., Bennett S., and Rucker, F., 1999. Assessing Small Business Risk: Adopting Additional Credit Scoring Factors means Increased Profitability for Banks, *The Journal of Lending & Credit Risk Management,* Vol. 81, Issue 11.

Bakker, M.H., Klapper L., and Udell, G.F., 2004. Financing Small and Medium-size Enterprises with Factoring: Global Growth in Factoring and its Potential in Eastern Europe, World Bank's Private and Financial Sector, World Bank.

Bangko Sentral ng Pilippinas in www.bsp.gov.ph

Bank Indonesia, 2003. Bank Indonesia Annual Report 2003, Bank Indonesia.

Bank Indonesia, 2004. Bank Indonesia Annual Report 2004, Bank Indonesia.

Bank Indonesia, 2004. Indonesian Banking Booklet 2004, Bank Indonesia.

Bank Negara Malaysia in www.bnm.gov.my

Bank Negara Malaysia, 2003. A comprehensive Framework for the Development of Small and Medium Enterprises in Malaysia, Bank Negara Malaysia, Malaysia.

Banking Sector Review, June 2002, World Bank.

Bargon, B., 2001. The Credit Information Environment in Indonesia: Opportunities for Credit Providers and Indonesian Businesses, Asian Development Bank.

Bartels, J.C. 2002. Basel II and the survival of the SME: Are lenders and borrowers ready to comply with Basel II?, *Business Credit*, Vol. 104, Issue 10, National Association of Credit Management.

Beck T., Demirguc K. A., Maksimovic V. 2002. Financing Patterns Around the World: The Role of Institutions, World Bank Policy Research Working Paper 2905, World Bank.

Berger, A.N., and Udell, G.F., 2004. *A More Complete Conceptual Framework for SME Finance,* World Bank Conference on Small and Medium Enterprises, World Bank.

BNM, 2005. Economic & Financial Developments in the Malaysian Economy in the Fourth Quarter of 2004 Pen.02/05/59, Bank Negara Malaysia, Malaysia.

BNM, 2005. Monthly Statistical Bulletin December 2004 Pen.01/05/67, Bank Negara Malaysia, Malaysia.

Borgia, D., Burgess, D.O., and Shank, T., 2003. Factoring Accounts Receivable for Small-Business Customers, *Commercial Lending Review*, Vol.18, Issue 2, Aspen Publishers Inc.

Brunei Economic Development Board in www.bedb.com.bn

Bureau of East Asian and Pacific Affairs, 2004. *Background Note: Cambodia*, U.S. Department of State.

Bureau of Small and Medium Business Enterprise, 2004. Bureau of Small and Medium Business Enterprises Development Financing Programs for Micro, Small and Medium Enterprises, Department of Trade and Industry Philippines, The Philippines.

CIA, 2004*. The World Factbook 2004,* Central Intelligence Agency.

Companies Commission of Malaysia in www.ssm.com.my

Cowan, A., Fetherston, T., and Nail, L., 2004. A Paradigm Shift in Small-Business Lending, *Commercial Lending Review*, Vol.19, Issue 4.

Cowling, M., and Mitchell P., 2003. Is the Small Firms Loan Guarantee Scheme Hazardous for Banks or Helpful to Small Business?, *Small Business Economics,* Vol. 21, Academic Publishers.

Credit Bureau of Bank Negara Malaysia in www.creditbureau.bnm.gov.my

Cull, R., Davis, L., Lamoreaux, N., and Rosenthal, J., 2004. Historical Financing of SME, Paper presented at *World Bank Conference "Small and Medium Enterprises: Overcoming Growth Constraints,* World Bank.

Department of Finance Philippines in www.dof.gov.ph

Department of Trade and Industry Philippines in www.dti.gov.ph

Department of Trade and Industry Philippines, 2004. *Current Situation of SMEs,* Department of Trade and Industry Philippines, The Philippines.

DP Information Group, 2004. *SME Development Survey 2004*, Singapore.

Economic and Social Commission for Asia and the Pacific, 2001. Small and Medium Sized Enterprises in Viet Nam: What Are Their Needs?*, Small Industry Bulletin for Asia and the Pacific,* No.31.

EPU, 2003. Mid-Term Review of the Eighth Malaysia Plan 2001-2005, Economic Planning Unit, Malaysia.

European Network for SME Research, 2003. SMEs and Access to Finance, Observatory of European SMEs.

General Statistics Office of Viet Nam in www.gso.com.vn

GTZ SME Promotion in Viet Nam in www.sme.com.vn

Hall, C., 2002. Profile of SMEs and SME Issues in APEC 1990-2000. APEC Small and Medium Enterprises Working Group.

Harner, S.M., 2003. *Financing SMEs in Cambodia: Why do Banks Find it so Difficult?,* Report of a study commissioned by Mekong Project Development Facility (MPDF) Number 14 Private Sector Discussion.

IFC, 2004. IMF Policy Discussion Paper: Banking Reform in the Lower Mekong Countries, International Monetary Fund.

Kuala Lumpur Stock Exchange in www.klse.com.my

Lamberte, M.B., 2001. Financing for Micro enterprises, Small and Medium Sized Business and Poor Households in The Philippines, Paper presented at the *ESCAP-ADB Joint Workshop on Mobilising Domestic Finance for Development: Reassessment of Bank Finance and Debt Markets in Asia and the Pacific,* Bangkok, Thailand.

Leopairote,M.,1999. Industrial Reform to Enhance Industrial Competitiveness: Implications and Strategies for SME Development, Asia-Pacific Regional Forum on Industry, UNIDO.

Mekong Research in www.mekongsources.com

MIDA, 2004. Malaysia: Investment in the Manufacturing Sector - Policies, Incentives and Facilities, Malaysian Industrial Development Authority, Malaysia.

Ministry of Industry, Mines and Energy, 2004. *SME Newsletter,*.Issue 2, December 2004, Ministry of Industry, Mines and Energy, Cambodia.

MITI, 2002. Malaysia Policies, Incentives and Facilities for SMEs, Ministry of International Trade & Industry, Malaysia.

MITI, 1996. *Second Industrial Master Plan 1996-2005,* Ministry of International Trade & Industry, Malaysia.

Moyes and Malingstrom, A., 2004. Technical Assistance to the Republic of the Philippines for Strengthening SME Credit Management System, Asian Development Bank, Manila, The Philippines.

National Economic and Development Authority in www.neda.gov.ph

National Statistics Office in www.census.gov.ph

NUS Enterpreneurship Center, 2003. *Business Angels in Singapore,* Working Paper, National University of Singapore, Singapore.

OECD, 2003. *SME Characteristics and Statistical Needs in the Philippines,* Workshop on Improving Statistics on SMEs and Enterpreneurship, 17-19 September 2003, OECD, Paris, France.

OSMEP, 2002. *White Paper on Small and Medium Enterprises 2002*, The Office of Small and Medium Enterprises Promotion, Bangkok.

PECC, 2003. Financing Small and Medium Enterprises: Challenges and Options, Summary report of discussion at the 2nd Annual Conference of the PECC Finance Forum, Pacific Economic Cooperation Council.

Pricewaterhouse Coopers, 2003. Bank Lending Practices to Small and Medium Sized Enterprises, Report for the Ministry of Economic Development, New Zealand.

Retail Banking International, 2004. SME Banking – A very big business indeed, Lafferty Ltd., London.

Ronquillo, Ma. L., 2003. *Strategy Paper for SME Development in the East ASEAN Growth Area (EAGA),* Mindanao Economic Development Council, The Philippines.

Rudjito, 2003. Financing Challenges of SME from the Policy Perspective: the Experience of the Bank Rakyat Indonesia in SMEs financing, Paper presented at the PECC 2nd Annual Conference, Hua Hin, Thailand.

Singapore government in www.business.gov.sg

Small and Medium Enterprise Development Bank of Thailand in www.smebank.co.th

Small and Medium Industries Development Corporation in www.smidec.gov.my

Small Industry Credit Guarantee Corporation in www.sicgc.or.th

SMED Council, *SME Development Plan 2004-2010,* Department of Trade and Industry, The Philippines.

SMIDEC Secretariat, 2002. *SMI Development Plan (2001-2005),* Small and Medium Industries Development Corporation, Malaysia.

SMIDEC Secretariat, 2004. *SME Performance 2003,* Small and Medium Industries Development Corporation, Malaysia.

Socialist Republic of Viet Nam, 2001. Decree of The Government: On Supporting for Developing of Small and Medium Enterprises. No. 90/2001/CP-ND, Viet Nam.

SPRING in www.spring.gov.sg

Thai Board of Investment in www.boi.go.th

The Asia Foundation*, Unleashing Small Business Growth: The Asia Foundation Experience in Indonesia*.

The Banker, 2004. *Brunei diversifies to sustain growth,* Financial Times Business Ltd, UK.

The Edge Daily, 2005. Government to Set Up SME Bank, The Edge Financial Daily, Malaysia.

The Ministry of Industry and Primary Resources in www.industry.gov.bn

The Straits Times, 2004. Small firms in Singapore to get credit bureau by next year, The Straits Times, Singapore.

The World Bank, 2004. *Lao PDR Economic Monitor,* The World Bank Vientiane Office.

The World Bank, 2004. Summary Overview: Lao PDR Country Economic Memorandum: Realizing The Development Potential of Lao PDR, The World Bank.

Thomas, L., Edelman, D.B., and Crook, J.N., 2002. Credit Scoring and Its Applications, SIAM Monographs on Mathematical Modeling and Computation, Philadelphia.

Timberg, T., 2000. *The Supply of Credit to Small and Medium Enterprise: Without Kredit Usaha Kecil (KUK) Loan Program,* Bank Indonesia, Indonesia.

Timberg, T., 2000. *Why Isn't there more Small and Medium Enterprise Credit from Commercial Banks in Indonesia?,* USAID Indonesia Retreat.

Timberg, T., 999. *Small and Micro-enterprises finance in Indonesia: What do we know?,* Bank Indonesia, Indonesia.

UEAPME, 2004. Crafts, Trades and SMEs need better access to finance, UEAPME Position Paper on the Future of SME finance.

UNCTAD, 2004, *World Investment Report 2004, Country fact sheet: Cambodia,* United Nations Conference on Trade and Development.

UNIDO, 2000. *Socialist Republic of Viet Nam: Annual Report 2000*. United Nations Industrial Development Organization (UNIDO).

UNIDO, 2003. Lao PDR: Medium-Term Strategy and Action Plan for Further Development, United Nations Industrial Development Organization.

Urata, S., 2000. *Outline of Tentative Policy Recommendation for SME Promotion in Indonesia,* JICA.

Wattanapruttipaisan,T., 2003. Four Proposals for Improved Financing of SME Development, *Asian Development Review*, Vol.20, Number 2, ADB.

World Bank, 2004. Firm Dynamism: Beyond Registration - How Are Viet Nam New Domestic Private Firms Faring?, Viet Nam Private Sector Development Policy Note, World Bank.

This page has intentionally been left blank.

APPENDICES

APPENDIX 1: CONTACT PROGRAMME DETAILS

Date of Fieldwork

The on-site fieldwork for the study was conducted between 5 December 2004 to 22 January 2005 as follows.

Country	Date of Fieldwork	Duration (days)
Brunei Darussalam	6 Dec 2004 to 8 Dec 2004	3
Cambodia	13 Dec 2004 to 16 Dec 2004	4
Indonesia	6 Dec 2004 to 10 Dec 2004	5
Lao PDR	15 Dec 2004 to 17 Dec 2004	3
Myanmar	Did not visit	-
Singapore	13 Dec 2004	1
Thailand	7 Dec 2004 to 13 Dec 2004	7
The Philippines	19 Jan 2005 to 21 Jan 2004	3
Viet Nam	13 Dec 2004 to 16 Dec 2004	4

Coverage

For each country, the following respondents were successfully interviewed. Not all respondents interviewed however, were willing to provide written response to the survey questionnaires.

Country	Name of Organisation	Type of Organisation
Malaysia	Bumiputra Commerce Bank Berhad	Financial Institution
	Hong Leong Bank Berhad	Financial Institution
	Bank Pembangunan & Infrastruktur Malaysia Berhad	Financial Institution
	Affinbank Berhad	Financial Institution
	Bank Muamalat Malaysia Berhad	Financial Institution
	AmBank Berhad	Financial Institution
	RHB Bank Berhad	Financial Institution
	Maybank	Financial Institution
	Alliance Bank Malaysia Berhad	Financial Institution
	Small & Medium Industries Development Corporation (SMIDEC)	Regulatory Group
Singapore	Association of Small and Medium Enterprises (ASME)	Regulatory Group
	SPRING Singapore	Regulatory Group

Continued on next page

Continued

Country	Name of Organisation	Type of Organisation
Thailand	Bank Thai	Financial Institution
	Export-Import Bank of Thailand	Financial Institution
	Krung Thai Bank	Financial Institution
	Siam Commercial Bank	Financial Institution
	SME Bank	Financial Institution
	Thai Venture Capital Association	Financial Institution
	Bank for Agriculture and Agricultural Cooperatives (BAAC)	Financial Institution
	Siam City Bank	Financial Institution
	Bualuang Finance Co. Ltd	Financial Institution
	The Government Saving Bank (GSB)	Financial Institution
	Office of SMEs Promotion	Regulatory Group
	Small Industry Credit Guarantee Corporation	Regulatory Group
	Thai Credit Bureau	Credit Information Provider
The Philippines	Philippines Savings Bank	Financial Institution
	Philippines National Bank	Financial Institution
	Land Bank of The Philippines	Financial Institution
	Metropolitan Bank & Trust Company	Financial Institution
	Planters Development Bank	Financial Institution
	Quedan and Rural Credit Guarantee Corporation	Financial Institution
	Development Bank of the Philippines	Financial Institution
	Philippine Business Bank	Financial Institution
	Rizal Commercial Banking Corporation	Financial Institution
	Small Business Guarantee and Finance Corporation	Financial Institution
	National Credit Council Secretariat	Regulatory Group
	CIBI Information, Inc	Credit Information Provider
Brunei Darussalam	Hongkong and Shanghai Banking Corporation Ltd	Financial Institution
	The Islamic Bank of Brunei	Financial Institution
	Islamic Development Bank of Brunei	Financial Institution
	Baiduri Bank Berhad	Financial Institution
	Financial Institution Section, Ministry of Finance	Regulatory Group
	Economic Planning and Development Department (JPKE)	Regulatory Group
	The Brunei Economic Development Board	Regulatory Group
	Ministry of Industry and Primary Resources (MIPR)	Regulatory Group
	Young Enterprise Association of Brunei (YEAB)	Regulatory Group
	Registrar of Companies	Regulatory Group
	National Chamber of Commerce and Industry (NCCI)	Regulatory Group

Continued on next page

Continued

Country	Name of Organisation	Type of Organisation
Indonesia	PT Bank Negara Indonesia (Persero)	Financial Institution
	Bank Mandiri	Financial Institution
	Bank Rakyat (BRI)	Financial Institution
	Bank Internasional Indonesia (BII)	Financial Institution
	Bank Lippo	Financial Institution
	Induk Koperasi Kredit	Financial Institution
	Financial Ministry of Cooperative & SMEs	Regulatory Group
Viet Nam	Vietcombank	Financial Institution
	Bank for Investment and Development of Vietnam	Financial Institution
	Asia Commercial Bank (ACB)	Financial Institution
	Industrial and Commercial Bank (Incombank)	Financial Institution
	Agency for SME Development (ASMED)	Regulatory Group
	Vietnam Chamber of Commerce (VCCI)	Regulatory Group
	Central Institute of Economic Management (CIEM)	Regulatory Group
	Business Promotion and Services Centre (BPCS)	Regulatory Group
	Hanoi SME Association (HASMEA)	Regulatory Group
	State Bank of Vietnam – Credit Information Center (CIC)	Credit Information Provider
Cambodia	Canadia Bank	Financial Institution
	Rural Development Bank	Financial Institution
	Cambodia Commercial Bank	Financial Institution
	ACLEDA Plc	Financial Institution
	Foreign Trade Bank of Cambodia	Financial Institution
	Mekong Private Sector Development Facility (MPDF)	Financial Institution
	Cambodia Chambers of Commerce and Industry (CCC)	Regulatory Group
	DISH (MIME)	Regulatory Group
Lao PDR	Agricultural Promotion Bank	Financial Institution
	Banque Pour Ie Commerce Exterieur Lao	Financial Institution
	Joint Development Bank	Financial Institution
	Lao Development Bank	Financial Institution
	Department of Industry, Ministry of Industry and Handicraft	Regulatory Group
	Lao Women's Union	Regulatory Group
Myanmar	Myanmar Investment and Commercial Bank	Financial Institution

APPENDIX 2: SUMMARY TRANSCRIPT OF INTERVIEWS AND KEY INSIGHTS

A. MALAYSIA

1. General Economic Overview

Following rapid economic growth in the early to mid-1990s, the Malaysian economy has been growing at a more subdued pace post-Asian crisis.

(i) Real economic output grew around 3.0% per annum during 2001-2003 on account of a series of external shocks in the early 2000s.
(ii) During this period, economic expansion was primarily domestic driven and supported by fiscal stimulus and monetary expansion.
(iii) Manufacturing growth slowed to 1.5% while inflows of FDI contracted in tandem with a slow down in global trends.
(iv) While still somewhat significant, the level of non-performing loans in the banking system has declined in the past few years.

2. Positive Policy Developments

In view of the challenges and uncertainties facing the country in the early 2000s, the Government stepped up its efforts to build capacity in the SME sector and to increase the resilience of Malaysia's banking and financial institutions. These include implementation of the following policies and initiatives.

(i) The Government launched the SMI Development Plan in the early 2000s to spur the development of SME in the manufacturing sector. The proactive stance adopted by the Government is supported by the provision of financial, fiscal and technical assistance programmes.
(ii) The Financial Sector Master Plan was mooted in 2001 to build medium and long-term capacity in the financial sector.
(iii) Meanwhile the Capital Market Master Plan was initiated to develop an internationally competitive capital market for the efficient mobilization and allocation of funds.
(iv) In 2001 the Central Credit Reference Information System (CCRIS) was established to provide a comprehensive credit database of all borrowers in the banking system.
(v) Recently in early 2005, the government established a high level Council for SME to coordinate SME development issues among the many different agencies and announced its intention to set up a SME Bank to facilitate financing for SME.

3. Key Insights: Supply Side Issues Regarding SME Access to Finance

(i) Most manufacturing SME in Malaysia rely on internally generated proceeds to finance their operations. The main formal financing channel is the banking sector. Debt, equity and venture capital financing are mostly targeted at the larger corporations, high growth companies or those in the high tech sectors. Meanwhile many SME still do not enjoy easy access to bank credit for several reasons.
(ii) Malaysia's banks adopt various lending technologies and have access to several sources of information to evaluate the credit risks of SME.

Nevertheless the banks' lack of understanding of SME businesses and SME credit assessment skills do not help to boost credit allocation.

(iii) In order to bridge potential funding gaps in support of policy driven growth, the Government provides additional resources to support SME. However, these efforts have been hampered to some extent by inconsistent definitions. All stakeholders have adopted different eligibility conditions for firms intending to apply for SME funding programmes. The inconsistent definitions are likely to have fragmented the market for credit and created allocative inefficiencies in terms of unequal access to funding.

(iv) At the same time, the public sector faces several implementation constraints with regard to SME financing programmes. Much of these impediments are due to the lack of coordination between the various agencies tasked with SME financing.

B. THAILAND

1. General Economic Overview

Having recovered from the 1997-1998 Asian Financial Crisis, Thailand was one of East Asia's best economic performers in 2002. GDP grew 5.4% and 6.7% in 2002 and 2003 respectively. The country's economy has been greatly supported by the SME sector.

(i) SME make up a large portion of Thailand's national economy in terms of output, employment and effective utilization of regional resources.

(ii) Although the banks have benefited from the acceleration of economic activity over the past one and a half years, the non-performing loan (NPL) ratios remain in the double digits. In particular, the private commercial banks continue to be riddled with high levels of NPL.

(iii) The central bank has taken several steps to expedite the resolution of NPL by Thai banks, including tightening provision requirements on long-standing NPL and amending laws to allow the government asset management company to acquire NPL so as to free up the banking sector.

2. Positive Policy Developments

Realizing the importance of the contribution of SME to the national economy in the wake of the Asian crisis, the Thai government has established a number of initiatives to assist in SME financing including:

(i) Setting up the SME Bank, the Small Industry Credit Guarantee Corporation and the Venture Capital Fund Management under the Office of SME Promotion.

(ii) Establishing the Market for Alternative Investment (MAI) to enable access to capital for smaller companies.

(iii) Central Credit Information Service Company Limited and the Thai Credit Bureau Company Limited were established to collect and facilitate information sharing for SME.

3. Key Insights: Supply Side Issues Regarding SME Access to Finance

Thailand has a comprehensive range of private and Government financing channels and programmes that specifically cater to SME. While the government has explored and implemented alternative financing sources such as venture capital, SME bank and equity market, these initiatives are still new and have limited outreach at present. The banking

sector remains the main source of external financing for most SME. Banks in general are not adverse to financing SME. Nevertheless, there are still barriers to SME financing including:

(i) The high level of NPL in the banking system, limited level of capitalisation and the rapid growth in the number of SME in Thailand has put a strain on banks' ability to effectively fund SME.
(ii) Onerous and lengthy loan documentation process required by banks.
(iii) Bank officers lack the necessary knowledge and skills to properly evaluate SME risk
(iv) Most banks in Thailand undertake risk grading of their SME loans using technologies that lean to subjective assessment. Credit scoring has limited application for the present.

C. SINGAPORE

1. General Economic Overview

Traditionally, Singapore has relied on foreign MNCs for much of her economic growth given the small population and domestic sector. Hence, SME in Singapore are not as dynamic as that of comparable developed economies such as Taiwan or Hong Kong. However, in the last few years following the emergence of China as a powerhouse, Singapore's competitive position in the world economy is increasingly being challenged. Thus, SME sector development has become an important priority in an effort to establish a strong domestic base for the economy.

In the last 20 years, the number of SME in Singapore has grown significantly thanks largely to the effort of the government which has been very active in promoting SME, via a multi-agency network and the 31 financial institutions in Singapore. Starting with the SME Master Plan in 1986, many initiatives and programmes have since been implemented to assist and strengthen the SME sector in the hope of increasing the resilience the economy.

2. Positive Policy Developments

(i) To improve the access to information on SME, the government is launching a SME credit bureau targeted to be operational by June 2005.
(ii) The government plans to launch a pilot Loan Securitisation Scheme for SME to tap the capital markets in January 2005.

3. Key Insights: Supply Side Issues Regarding SME Access to Finance

Bank financing remains the main external source of SME funding. There are no significant issues or barriers with respect to the legal and regulatory aspects of SME financing in Singapore. Much of the difficulties faced by SME in accessing funds from the banking sector are operational in nature.

(i) Assistance to SME could be better facilitated by merging the numerous government schemes available.
(ii) Banks are selective over who they lend to given the high recovery cost of a bad loan and small margins to be earned due to high competition in the banking sector
(iii) Usual complaints from the SME regarding bank documentation, high interest rates, long processing time and that they do not know why loans are being rejected.

D. INDONESIA

1. General Economic Overview

Though hardest hit by the Asian financial crisis, the Indonesia economy has successfully weathered the aftermath of the crisis as evidenced by its exit from the International Monetary Fund Programme in 2003.

(i) Currently, the economy is growing at a steady pace and the Jakarta Stock Exchange was 2004's best performing bourse amongst the ASEAN countries.
(ii) The economy has also successfully transitioned from an autocratic political regime to a democratic regime.
(iii) It concluded the first direct Presidential Elections in October 2004 with a smooth transition of power.
(iv) Nevertheless, there are key concerns, which need to be addressed and these include the high budget deficit and fuel subsidy.

2. Positive Policy Developments

Indonesia has regained the confidence and interest of the international investment community given the sustained economic growth, the smooth transition of power and the new President's policies against corruption.

(i) The recovery in the banking sector is well underway.
(ii) The improved economic climate, the banking sector's refocus onto the retail market coupled with the prevailing low interest rate has fuelled consumer demand leading to significant multiplier effects throughout the economy.
(iii) Banks are looking for further loan and profit growth via lending to the SME sector.

3. Key Insights: Supply Side Issues Regarding SME Access to Finance

SME financing in Indonesia is gaining momentum as banks realised the profitability and lower credit risk of this segment compared to large corporate lending. In some ways, Indonesia has an adequate institutional framework (in the vast and comprehensive set of institutions) to cater to the different needs of the country's vast populace of micro and small enterprises. The country's success in micro financing is well recognised as an international best practice model. However, the same success has not been replicated for financing of small and medium scale enterprises.

(i) Although the central bank maintains the DIS, the database is limited in its coverage of SME.
(ii) Banks personnel lack understanding of SME business and do not have the relevant skills to evaluate SME risks.
(iii) Many banks still insist on collateral to be provided by SME. This is due to the lack of information and banks' own inability to evaluate the risk of SME.
(iv) Many small banks lack funds and networking to have wide outreach.
(v) The lack of legal proof of land ownership, the lack of Registry of Charges for banks to legally perfect floating charges and the undue length of time to complete default enforcement proceedings are some of the legal constraints.
(vi) Regulatory constraints such as the regulation requiring a bank to obtain from a borrower, a business license and tax registration number (NPWP) for lending over Rp50 million.

E. THE PHILIPPINES

1. General Economic Overview

The Philippines economy continues to be challenged by several problems.

(i) High budget deficit. At 110% of GDP, the national debt imposes a significant burden on the nation. Up to 40% of government revenue is being utilised towards servicing interest payment. Nevertheless, the Government is committed to reducing its budget deficit and is making significant progress in the areas of revenue collection and privatisation of state owned enterprises.
(ii) Increasing competition from China.
(iii) The nation needs significant investment to uplift its basic infrastructure (roads, electricity and water).
(iv) Corrupt practices continue to be an issue.

2. Positive Policy Developments

The banking sector's non-performing loan level is on the decline. This should enable banks to pursue higher loan growth. There are currently efforts to create a more enabling environment for SME development and financing. Some of the government initiatives include establishing a centralized database on SME, setting a mandatory target for SME lending on banking institutions and introducing a common credit rating/scoring framework.

3. Key Insights: Supply Side Issues Regarding SME Access to Finance

In partnership with the Government controlled development banks, the private sector banks are very supportive in lending to SME. However, there are institutional and banking sector constraints that hamper effective access to financing by SME.

(i) The investment climate is not conducive to attract significant FDI.
(ii) The Government's SME development initiatives do not appear to have sufficient outreach to generate the desired results.
(iii) The slow progress in land reforms which makes it difficult for borrowers to prove land ownership.
(iv) The difficulty in enforcing loan default proceedings in the courts; particularly where it involves the sale of real property. It is an expensive, lengthy and time consuming due to the multiple avenues for the defendant to appeal to a higher court at each stage of the proceedings.
(v) The lack of information sharing and central database on SME.
(vi) Banking regulations that may inhibit lending despite their prudential aspirations (such as requiring SME borrowers to furnish audited accounts).
(vii) Registration processes and administrative protocol can be complex, onerous and costly for small businesses.

F. BRUNEI DARUSSALAM

1. General Economic Overview

In the wake of increasing global competition and trade liberation, Brunei finds itself at a cross-road, having realized that for the last several decades, the economy has been characterized by:

(i) Sole dependence on depleting oil and gas reserves as the main source of revenue.
(ii) The economy is driven mainly by government spending/investments.
(iii) Domestic private sector businesses are under-developed.
(iv) The government and Brunei Shell are the major employers.
(v) General lack of entrepreneurial spirit amongst the population.

2. Positive Policy Developments

As such, the Government is committed to diversify the economy with the introduction and implementation of a two-prong strategy to reduce dependency on oil and gas. The success of its economic diversification strategy hinges on the ability to attract FDI particularly in manufacturing. In that respect, the government recognises the importance of the SME sector and is willing to promote SME development.

3. Key Insights: Supply Side Issues Regarding SME Access to Finance

(i) High dependency syndrome and non-repayment culture exist among SME.
(ii) Generally banks are keen in providing funding to government-initiated project only.
(iii) General lack of technical expertise and entrepreneurship amongst SME.
(iv) Absence of a centralised body to coordinate and monitor SME development.
(v) Absence of centralised database on borrowers and defaulters and lack of information sharing due to certain banking regulations.
(vi) Lack of alternative funding sources such as capital markets, venture capital companies.

G. VIET NAM

1. General Economic Overview

While Viet Nam has made significant progress since the mid-1980s, completing the transition to a market based economy is an on-going long-term process. Even accounting for the progress made to date, there are still many shortcomings and constraints including the following.

(i) An ineffective and uncompetitive economy, low domestic savings and low purchasing power.
(ii) Economic structural change is believed to be slow and unemployment remains a concern.
(iii) Many problems persist with the investment infrastructure and the tendency towards Government subsidization and protection of selected economic sectors.
(iv) Reforms of the state sector especially with respect to the state-owned enterprises have not been sufficient. Hence crowding out of the private sector remains a concern.
(v) Many issues persist regarding private sector development and in particular lending to SME.
(vi) In spite of the ongoing efforts at structural reform, domestic and foreign investment confidence remains weak.
(vii) Compounding the issues is the need to strengthen institutional capabilities and to further develop the legal and regulatory framework to promote private SME development and broaden the financing programmes.

2. Positive Economic Policy Developments

Recognising the importance of continuing the reform effort, the Government approved the Socio-Economic Development Strategy, 2001-2010 and the Socio-Economic Development Plan, 2001-2005. The plans outline the Government's strategy to further develop the Vietnamese economy, in particular the private sector, for the next decade. Meanwhile the international community continues to provide financial and technical support to assist Viet Nam's on-going structural reforms.

Recent efforts to step private sector development include the following

(i) Creating an enabling business environment for private enterprise and SME development since 2001.
(ii) Several decrees that officially recognize the significance of the private sector and pro-private sector policies have been adopted.
(iii) At the same time, newly issued legal documents to improve the policy environment for lending and facilitating commercial banks to adopt commercial principles in lending activities have been issued.

3. Key Insights: Supply Side Issues Regarding SME Access to Finance

Most SME rely on informal sector financing to meet their needs. The main source of formal financing is bank lending. While the state-owned Commercial Banks (SOCBs) are beginning to extend more credit to the SME, most SME still do not have access to bank financing for several reasons.

(i) Commercial banking in Viet Nam is still in the basic stages of development. Banks are unable to effectively mobilize domestic savings for lending purposes; in addition loan officers have weak credit assessment skills, are not commercially oriented and lack incentives to increase lending to the private sector.
(ii) Existing credit programmes are not designed for SME.
(iii) The SOCBs tend to favour state-owned enterprises over private sector firms in terms of credit allocation. The SOCBs also lack autonomy to make commercially viable decisions.
(iv) In practice, the only form of collateral banks will accept from SME is property. However, land titling is a complex issue and without land use rights most firms have difficulties obtaining credit from banks.
(v) The regulatory guidelines governing the banking sector are quite weak. Many institutional support infrastructure that enable credit guarantee, facilitate asset registration and the realization of collateral, promote corporate governance and financial transparency have either only been recently introduced or still do not exist.
(vi) The quality of information and information facilities are highly lacking.

H. CAMBODIA

1. General Economic Overview

The country has achieved a reasonably stable growth rate of about 5 percent from 2000 to 2003. Tourism has being the fastest growing industry, while the garment industry has been a key contributor to growth. Notwithstanding the economic progress made to date, Cambodia continues to be heavily reliant on international assistance for many facets of its economy.

The major economic challenge for Cambodia over the next decade will be the ability of the private sector to create enough jobs to the increasing workforce. Corruption continues to be of key concern.

2. Positive Policy Developments

(i) Private banks have been able to maintain a very low non-performing loan rate.
(ii) The government and private sector have organized a working group to develop the SME sector. This working group is seen as a key facilitator to promote dialogue between the public and private sector for the advancement of SME.
(iii) The government is working on addressing the legal and regulatory constraints.
(iv) National banks are working on setting up a centralised credit information centre, which will enable lenders to access information on borrowers.

3. Key Insights: Supply Side Issues Regarding SME Access to Finance

Formal sector financing is not the main source for SME in Cambodia. The main reliance is on the informal sector. The challenges for SME to access financing are numerous.

(i) Cambodia has one of the lowest rates of banking intermediation in the world. There are limited sources of financing available in the country.
(ii) Almost all credit facilities are backed by collateral.
(iii) Lack of medium and long term financing facilities provided by the banking sector.

(iv) Lack of credit database and information sharing.
(v) Weak legal system and enforcement of laws.
(vi) Weak protection of creditors rights.
(vii) No proper or official definition of SME.
(viii) High cost of conducting business including taxes and official charges.

I. LAO PDR

1. General Economic Overview

Following the transition from a central planning economy to a market economy in 1986, the country's economy performed remarkably well in the nineties, yielding an annual average growth rate of 6.3%.

(i) The economy is expected to register an economic growth of 5.8% in 2004.
(ii) However, due to the high dollarisation of the Lao economy, it is highly sensitive to fluctuations of foreign currencies (notably Thai baht). The major challenge facing the government is the fiscal weakness which constraints resources available for both economic and social development.
(iii) Although the private sector is an increasingly important source of economic activity, most private enterprises are still small and have little effect on employment outside the family. Currently, 98% of Lao PDR's SME sector consists of small scale enterprises predominantly entrenched in the handicraft industry.

2. Positive Policy Developments

(i) The Promotion and Development of Small and Medium-Sized Enterprises as envisaged under the Prime Minister's Decree Number 42 in April 20, 2004 defines the key polices and an action plan for SME promotion and development, including the establishment of SME Development Funds and the supporting organizations.

(ii) At the national level, a government decree is in place to realize the establishment of a semi-autonomous SME support coordination unit (an SME Development Agency).

(iii) Reforms initiated in 2001 focus on restructuring state-owned banks (with high NPL), improving regulation and supervision, supporting micro and rural financing and opening up the banking system.

3. Key Insights: Supply Side Issues Regarding SME Access to Finance

Due to the low level of banking intermediation in the economy, only a few SME have access to credit facilities with the commercial banks. Informal networks of private investors (like money lenders) remain a primary source of needed capital. There are numerous barriers to SME financing including:

(i) Much of the lending activities are directed towards the state-owned enterprises. Few advances were made in reforming the debt-burdened state-owned enterprises, which in turn limit the banks' ability to fund private enterprises.

(ii) Financing of SME by banks is on an ad-hoc basis and interest rates charged to the private sector are high.

(iii) There is also a dearth of bank branches in the smaller towns and in the provinces.

(iv) Lack of information sharing to facilitate financing.

(v) Weak or insufficient legal framework for collateral enforcement.

(vi) The legal environment lacks transparency and is saddled with informal red tape, inefficiencies and ambiguous practices that allow abuse.

(vii) Lack of predictable regime for resolution of default situations that hampers both investment and lending.

(viii) Lack of accounting standards.

This page has intentionally been left blank.

APPENDIX 3: SUMMARY OF RECOMMENDATIONS BY COUNTRY

A. BRUNEI DARUSSALAM

Strategies for expansion or diversification of appropriate financing for SME

Establish Private Equity/Venture Capital Fund. The government could provide the seed capital to initiate a private equity fund (with the private sector) or a venture capital fund for the purpose of financing SME start ups. Various forms of incentives such as tax rebates or loan grants can be provided to sustain the fund and generate sufficient returns for the promoters.

Strategies for institutional strengthening of financial institutions

Dedicated SME Unit in Banks. A majority of Brunei's financial institutions do not emphasise on SME lending. Given the underdeveloped nature of the SME sector, limited resources (manpower as well as time) are devoted to improving and increasing the banks' SME lending. The government may wish to consider encouraging banks to establish a specialised SME unit. In addition, incentives extended to local banks could be extended foreign ones too to encourage more lending to the sector.

Provision of Training and Technical Assistance to Banks. Efforts to provide training and technical assistance to banks in the areas of credit policies, risk management and SME-specific evaluation know-how should be pursued in order to increase the level of skill and knowledge of the banking industry. In this regard, the commercial banks could contribute a small percentage of their profits annually to a common training fund to cater to this purpose. Specific technical training with respect to financing of small businesses could be targeted through this central fund.

Strategies for changes to the legal and regulatory environment to improve SME financing

Single One-Stop SME Agency. To ensure urgency in promotion of SME development and effective implementation, the regulating functions for SME and their development need to be streamlined and centralised with a statutory body taking the lead role. Centralising the SME development efforts would allow concerted and coordinated approach to tackling related problems or issues as well as the drafting and implementing of new policies required with the constantly changing environment. This single SME agency should be able to coordinate all matters relating to SME development between the public and private sector. Moreover, this SME Agency could organise training workshops or resource centres to assist SME to develop the requisite skills. Introduction to banking facilities could also be facilitated through this one-stop Agency.

Provide incentives for SME. Currently, the incentives provided through the Investment Incentives Order 2001 cater more for large enterprises. Given that the majority of Brunei's SME are micro and small enterprises with little export or investment capacities, it would be beneficial to provide incentives that are more appropriate and can be availed by these small business. An example of such incentives is a lower tax scheme for businesses qualifying as SME.

Establish Central Credit Information Bureau. Given the difficulty of obtaining information for the lending and evaluation process, it is necessary and timely for the government to establish a central credit bureau. This central bureau could collate both negative and positive information for dissemination to the banking institutions. With the creation of a rich database, it may be possible for this central bureau to offer credit scoring services on SME to parties that require it.

B. CAMBODIA

Strategies for expansion or diversification of appropriate financing for SME

Set up Credit Guarantee Fund. Given the low risk appetite and high collateral requirements of the banks, a credit guarantee fund or scheme would be a powerful tool to improve banks' lending to SME and reduce the high dependence on collateral. The funding of the scheme could be sourced from international donors and to ensure its on-going viability, measures such as autonomy in pricing of services and an appropriate risk-sharing component between banking institutions and the scheme should be implemented.

Promote Medium- and Long-Term Deposits/Longer-Term Credit Facilities. The international community has been actively promoting infrastructure development and more efficient mobilisation and allocation of resources to commercially viable activities in Cambodia. However, in view of the significant infrastructural constraints, the banking sector is still not yet sufficiently developed to function effectively as a financial intermediary. Greater confidence in the banking sector and in the national currency still needs to be built.

Further study of the existing interest rate structure is fundamental as are strategies to assist banks in adequately pricing short- and long-term loans in order to remain commercially viable. The international community and the central bank should look into assisting commercial banks in developing and offering products that can effectively attract medium- and long-term savings. Encouraging greater transparency and corporate governance of the banks are necessary steps towards raising public confidence. At the same time, appropriate longer-term credit facilities for SME should be developed.

In the meantime, the international agencies can further assist SME financing by providing more long-term funds with low interest rates for lending purposes.

Develop Alternative Financing Facilities. Efforts to develop and promote other supplementary loan facilities such as trade financing, factoring, and leasing should be actively pursued. A review of the necessary regulations to develop the supporting infrastructure (e.g., insurance) to promote such financing facilities should be conducted. In addition, banking institutions should be provided with training and technical assistance to develop such alternative facilities. Currently, the National Bank of Cambodia with the assistance of the Asian Development Bank is developing a legal framework for leasing so that banks and leasing companies can provide medium-term leasing.

Strategies for institutional strengthening of financial institutions

Expand Financing Facilities and Other Financial Services. Banks should explore the possibility of introducing new financing facilities to cater for SME. As discussed earlier, facilities such as trade financing and leasing can help both banks and companies overcome the barriers posed by poor credit risk. Banks can learn from their ASEAN counterparts in developing or customising such facilities for their business customers.

Banks are already providing other financial services to SME. Based on our discussion with survey respondents, SME often find it difficult to prepare the necessary documents (especially financial statements and business plans) required by banks for financing. Banks could assist borrowers by providing standard but simple templates for drawing up their business plans or financial projections. As discussed later, the capability of bank officers to provide this service can be developed through training.

Provision of Training and Technical Assistance to Banks. Efforts to provide training and technical assistance to banks in the areas of credit policies, risk management and SME-specific evaluation know-how should be pursued in order to increase the level of skill and knowledge of the banking industry. In this regard, the commercial banks could contribute a small percentage of their profits annually to a common training fund to cater to this purpose. The government or international community could support this effort by contributing to this central fund. Specific technical training with respect to financing of small businesses could be targeted through this central fund.

Develop standard credit rating templates. Since most banks are of the view that SME are of higher risk and consume more manpower in terms of processing time, banks could develop standard credit evaluation techniques and simplified credit rating methodologies for SME. The credit rating methodologies need not be credit scoring but could be based on certain risk factors that are a combination of qualitative and quantitative elements. For banks without the capacity to do so, technical assistance from domestic rating agencies in ASEAN could be obtained. Such services could be funded from the central training fund or a grant from donor agencies. Given that most lending is collateralised, the ability to conduct proper risk analysis in a systematic and timely manner may perhaps encourage bank officers to look beyond collateral over time. Moreover, the standard templates are useful in collating information that can be used as benchmarks to grade future borrowers, hence facilitating the credit evaluation process.

Set up dedicated SME lending units. Micro financing and corporate loans are relatively widely available among financial institutions in Cambodia since their risks are perceived as being lower. Due to this and the limited capacity of banks, they lack the initiative to actively pursue SME loans. To encourage lending to this sector, banks could set up dedicated lending divisions for SME. The bank officers assigned to this unit could be trained with specific knowledge of SME and to facilitate processing, a standardised credit rating template may be used.

Strategies for changes to the legal and regulatory environment to improve SME financing

Definition of SME. A consistent, clear, and official definition for SME needs to be formulated and adopted by the government. This will enable cohesive policy formulation and implementation of programmes by the different government agencies and stakeholders.

Central SME Agency and SME Association. A central agency responsible for formulating SME policies and implementation should be established to oversee and coordinate SME development activities between all government agencies and associations involved in this sector in Cambodia.

Further, a SME association could be set up to facilitate assistance and dissemination of information to SME in the country. This association could also facilitate financing between its members and financial institutions by providing a reference and assisting SME to develop the necessary documentations required by lending institutions.

Review of legal framework and enforcement. The business and lending environment is hampered by the insufficient and/or lack of laws to protect investors' and creditors' interests. Laws that should be implemented include bankruptcy law, competition law, law of transaction, arbitration law and a company act. Inadequate laws such as the Land Law should be reviewed to provide for greater protection of creditor's collateral enforcement. In addition, reform is needed to improve the enforcement of laws and regulations, its transparency and the speed of implementation.

Credit Information Bureau. The lack of information or ability to verify borrowers information can deter banks from lending or to adopt a more risk adverse stance than necessary. Currently, progress is being made by the central bank of Cambodia to set up a central credit information centre. This will provide the impetus to improve lending by banking institutions. However, for the

credit bureau to be effective in promoting more lending to small firms, the information collected must be available for sharing between financial institutions and the information must be updated as regularly as possible. In addition, the credit bureau should also collect other types of data to facilitate further analysis and future studies of the SME sector for financing and development purposes. In other words, both negative and positive information should be collated.

Lower Import Tax for SME. Currently, SME do not enjoy tax exemption on import of machineries as they are excluded from the Law of Investment. To encourage SME competitiveness, the law should be reviewed to include SME.

C. INDONESIA

Strategies for expansion or diversification of appropriate financing for SME

Establish Credit Guarantee Scheme for SME. A number of studies have made recommendations to supplement the current financing structure with a credit guarantee mechanism for SME. Professor Urata recommended a core credit guarantee using either new or existing institutional form such as PT ASKRINDO and funded by government. Another study by Bank Indonesia recommended a similar guarantee institution to be funded by the market. In the blueprint of the Indonesian Banking Architecture (API), the government is facilitating the establishment of a credit guarantee scheme targeted for 2004-2006. In setting up the credit guarantee scheme, it is important to have a risk sharing element in order to instil discipline among the stakeholders in the scheme. Funding by the government or at least a guarantee of the scheme's liabilities is also crucial for its success.

Promote greater engagement of NBFI in SME lending. Given the large number of NBFI such as finance companies, venture capital funds, mutual funds etc in Indonesia which are already active in financing small businesses, they should be further encouraged to promote SME financing. Many of the finance companies provide facilities such as factoring and leasing that are especially appropriate to SME. In this regard, the government could consider providing the NBFI with more incentives for increasing their lending to SME.

Alternative channels of funding. Although the bond and stock markets have not really served the needs of SME in the region, one initiative that could be considered is the issuance of bonds against SME loans (securitisation of SME loans). This is because the legal framework for securitisation in Indonesia encourages investment opportunities and cross-border transactions. The securitisation could be undertaken by a government bank which is actively involved in SME lending. The funds raised could be used to generate more loans. Private commercial banks with sizable and reasonably good SME portfolio could also consider issuing bonds against their loans. The recent revision of certain rules by the Capital Market Supervisory Agency (BAPEPAM) eliminates some ambiguities in tax provisions that were limiting the growth of asset backed securities issuance.

Strategies for institutional strengthening of Financial institutions

Training for Financial Institutions. Given that bank officers are not knowledgeable or have the necessary skills to evaluate SME, it is necessary for banks and the central bank to facilitate more training programmes for their lending officers. The Centre for Development of Small Enterprises (PPUK) is one such institution that provides training and consultation services for credit officers of banks to improve their management of small scale credit. Donor agencies such as the World Bank and ADB have the capability to provide training grants or technical assistance to develop useful programmes in relation to SME financing.

Greater Linkages Between Commercial and Rural Banks. Create greater linkages between commercial and rural banks to promote greater outreach to SME in rural and other areas not served by commercial banks. The rural banks can become agents or conduits for commercial banks' products and services for SME.

More Approving Authority to Delegate. Banks can delegate more approving authority to branches and SME centres and provide incentives for bank officers to promote SME lending. Bank officers may not actively pursue SME loans due to the perception of higher risk and general lack of information on the sector. Delegating more authority to branches or SME centres and providing some form of incentives could empower them to increase lending to the sector.

Introduce Credit Scoring for Large Commercial Banks. From the study's survey, large banks have expressed interest and capability to implement credit scoring to reduce the turnaround time and cost of evaluating SME loans. With the setting up of a central credit bureau, banks could enhance their internal database with richer information. In addition, the credit bureau data could provide an important platform for banks to calibrate their credit scorecard.

Strategies for Changes to the Legal and Regulatory Environment to Improve SME Financing

Establish a Central Coordinating Agency. Currently there are at least 10 ministries and agencies involved in the promotion of SME. In line with the recommendations of Professor Urata (2000), the government could set up a central SME agency with regulatory authority to coordinate and implement policy measures among all the different government agencies. The State Ministry of Cooperatives, Small and Medium Business Enterprise (SMCSME) could oversee the development of SME policies and relegate its authority of co-ordinating and implementing policies to the central SME agency. In addition, the SME agency could also function as a monitoring agency to ensure that SME policies are carried out effectively and meet their objectives.

Standardise SME Definition. There are too many different and sometimes conflicting definitions for policy and lending purposes. Government agencies use different definitions to provide assistance while banks use different definitions to provide loans. As such, the issue of what really constitutes an SME and what firms qualify as SME is a confusing with many answers. Without a standardised and consistent definition for SME in Indonesia, efforts to direct assistance and resources to this sector would not meet the desired objectives. It is also important that the standardised definition legalised under an SME law to provide greater effectiveness.

Streamline Government Administrative Procedures. There are too many onerous administrative procedures for conducting business in Indonesia. The registration of businesses and possession of permits and licenses are necessary conditions to qualify for bank loans under the regulatory framework. Yet the process of obtaining registration and permits is a daunting and costly one for small and medium scale businesses. As Timberg commented, the SME pay a high price for their necessarily formality – in taxes, regulatory constraints, etc – without the corresponding benefits – bank credit, political influence (Timberg, 2000). As already recommended by many studies, including Professor Urata, we repeat this recommendation that government must simplify these administrative procedures and introduce one-stop service centres at the local government level. This would go a long way to aid SME in obtaining loans from formal financial institutions. The Asia Foundation is one such organisation that is assisting in a project to streamline the licensing procedures in Indonesia.

Establish National Registration System. Likewise, the lack of a comprehensive national registration system means that many enterprises are unregistered and cannot qualify for loans

with banks based on current banking regulation. While the banking regulation on this need to be reviewed, a national registration system to be maintained under one central authority should be established.

Create Central Credit Bureau. The government is establishing one under the API and it is targeted for 2004-2005. In order that the credit bureau plays an effective role in disseminating and improving the information environment, a balance needs to be achieved between protecting the identity of borrowers and making available the requisite information to financial institutions and other fund providers.

D. Lao PDR

Strategies for expansion or diversification of appropriate financing for SME

Credit Guarantee Scheme. Due to the problem with providing collateral on the part of the SME, the government could study and implement a credit guarantee scheme, which is particularly suitable at this stage of the country's development. Under such a scheme, the risk associated with a particular loan is shared between three parties, that is, the borrower, the bank and the government. An additional small fee above the interest charged on the loan should be able to cover most default. However, the infrastructure needs to be in place, that is, a guarantee fund would have to be provided as a buffer.

SME Bank. A specialized and dedicated SME Bank can be established and staffed with experts in SME, with initial assistance from foreign experts. Over a period of time, a pool of local expertise could be established and both knowledge and skill-diffusion takes place, contributing to the national stock of human capital. When some of these employees leave the bank to join other banks in the industry, they could improve the efficiency and profitability of their new employers, thus shortening the "learning curve".

Provide incentives to Banks. Foreign banks have the necessary capital, staff and technology but they are not allowed to operate outside Vientiane. State banks are too small to set up relationships with foreign banks and build up an inter-bank market. To encourage increased penetration by banks and greater lending to the SME sector, incentives could be provided to banks, which are active in SME lending – one such incentive could be the privilege to open up more branches. This incentive could be extended to foreign banks too.

Strategies for institutional strengthening of Financial institutions

Improve Credit Skills. The banks in Lao PDR have not yet reached the level of sophistication required in the use of credit scoring to assist in their lending decisions. Some banks have in place, a rudimentary system of credit rating. On an industry level, most banks do not have the information technology resources and database to embark on the more sophisticated credit scoring system. As such, the more appropriate solution is to improve the credit skills of banks to evaluate SME. The approach adopted could be relationship banking but the focus could be made more appropriate to SME. Banks could establish more training programmes to train their credit officers in SME evaluation. At the same time, the government could also promote SME credit skills through training programmes conducted by the central bank (perhaps in association with international donor agencies).

Establish SME Lending Units. Banks could set up a dedicated unit within the organisation to serve the SME sector. This SME unit can be provided with specialised training to focus on promoting the banks' products and services to the SME sector.

Provide more incentives for banks to lend to SME. The government could consider providing incentives such as tax rebates, lower liquidity requirements and branching privileges to banks that are active in SME lending. In addition, the government SME centres could also refer SME, which have been nurtured to a bankable status to banks.

Strategies for changes to the legal and regulatory environment to improve SME financing

Create National Debt Restructuring Agency. Given the high legacy of NPL from the SOEs in the banking sector, the government could consider setting up a debt-restructuring agency to buy the NPLs from the banks. Such an agency would have to be funded by the government or international community. This move would improve the banks' capital position and free up funds for lending to deserving sectors such as the SME sector.

Establish and streamline National Business Registry. The move to establish a National Business Registry is an important one to improve the quality of information on SME. The Registry can facilitate a central information database that can be used to facilitate communication between all stakeholders in SME development and financing. In addition, the registration processes of enterprises, which are currently disbursed across a few agencies, can be harmonised to facilitate better cross-referencing and improve the speed of registration.

Establish Central Credit Information Bureau. By collating negative and positive information, a national credit bureau would facilitate increased information disclosure on SME and encourage lending by banks. Eventually, the bureau may also be able to provide some form of rating or credit evaluation of SME to banks.

Enhance legal framework. On-going reforms of the legal framework are in place. Measures to improve the registration of land titles, enhance commercial laws, improve enforceability of contracts and default foreclosure process (by increasing the capacity of the courts and informal channels of dispute resolution) would provide greater confidence in ability to enforce creditor rights and hence encourage banks to increase lending to SME.

Land Titles and Registration. The World Bank is currently undertaking a project to develop an efficient land market by providing land titles to landowners. With proper land titles, borrowers would be able use these as collateral for bank loans. In addition, the creation of a national registry for secured transactions would provide banks with greater confidence and incentive to lend as they would be able to register their charges on the loans.

Streamline Registration and Administrative Requirements. A number of regulations require streamlining and simplification. Registration of businesses and obtaining the necessary permits and approvals are unduly complex and onerous. By standardizing requirements, integrating common administrative functions between government agencies and reducing duplication of efforts of the different government SME agencies would facilitate the operations of SME.

E. MALAYSIA

Strategies for expansion or diversification of appropriate financing for SME

Introduce Microcredit and Promissory Notes. At present, few details are available on the SME Bank that is to be established in Malaysia by the third quarter of 2005. However, as the sole financial institution dedicated to promoting SME financing the SME Bank could consider extending microcredit in addition to regular financing facilities. In this respect, the SME Bank could look into the viability of issuing promissory notes.

Risk Based Pricing. The Malaysian Government could also look into the possibility of allowing and tying risk pricing among commercial banks to a risk sharing scheme.

Review Listing Requirements of Equity Markets. The stock exchange regulators should review the listing requirements with an aim to enable all SME with lower paid-up capital requirements but viable business prospects to raise capital through sales of equity to the public.

Improving Banks' Market Outreach. The continuous marketing and promotion of SME programmes is vital to increase public awareness of bank products and Government funded programmes. Banks could undertake various initiatives including increasing road shows, conducting seminars, briefings, networking and promoting literature through the various Government agencies and trade and commerce associations.

Greater Publicity for Public Sector Funded Programmes. In order to create greater awareness the Government should increase the publicity of public sector funded programmes for SME.

Public Education Programmes on Good Practices. Public education programmes should be launched and provided on a regular and continued basis to assist SME to help themselves in addressing certain financing issues.

Finance Fairs for SME. Finance fairs organised for SME by trade or commerce associations can be beneficial in enhancing the knowledge of the opportunities available to these firms.

Strategies for institutional strengthening of Financial institutions

Improving the Skills of Lending Officers and SME Departments. Improving the knowledge and competency of lending officers in advising SME is complementary to improving bank lending technology.

Simplifying and Expediting the Application Process. Banks should be encouraged to be more flexible, innovative and to develop alternative approaches to address some of these constraints faced by the SME.

Strategies for changes to the legal and regulatory environment to improve SME financing

SME Accounting Standards. Reducing information asymmetry between SME and all financial stakeholders is vital in enabling increased assessment of the viability of these firms. The Malaysian Government in conjunction with the national accounting bodies could look into adopting separate accounting standards or amending the existing standards to suit local SME.

F. THE PHILIPPINES

Strategies for expansion or diversification of appropriate financing for SME

Enhance credit guarantee mechanisms. The current credit guarantee mechanisms offered through the SBGFC and SBC need to be improved. As the SBGFC suffers from limited funds and outreach, the government could support by providing funds or a guarantee for the SBGFC to secure loans. To gain the confidence of the banking institutions and encourage them to seek insurance cover for SME loans, the government could also provide a liquidity line or guarantee/underwrite the liabilities of the SBGFC. The administrative protocol of the SBGFC could also be simplified to facilitate faster turnaround of applications.

Another possible improvement is the implementation of a credit scoring system or standardised rating template, which would allow the SBGFC to improve and speed up its loan evaluation process. Yet another measure, which could improve the outreach of SBGFC to support guarantee of more SME loans, is for the organisation to concentrate solely on providing guarantees and not direct loans. Banks would have greater outreach to borrowers and capacity to lend to SME compared to the SBGFC.

As for the issues relating to the SBC, there is poor recognition by SME (and banks) of the guarantee system. There is a move by the DTI to increase the number of SBC personnel to increase its outreach.

Set up a Government Venture Capital Fund. This initiative is considered under the SME Development Plan. The government can (on its own or preferably with the private sector as the fund manager) pilot a venture capital fund by providing the initial seed capital. A venture capital fund would be an invaluable source of financing for start-up companies. In terms of viable exit routes for the equity investors, the SME Board (with the needed restructuring) could be a possible avenue. Return to the government could also be in the form of interest plus a small share of the fund's profit (as per the U.S. SBIC model).

Increase Promotion of Supplementary Facilities. Supplementary financing facilities such as discounting of receivables (factoring) and leasing are valuable tools that can help SME and banks overcome the issue of weak credit worthiness and collateral requirements. The government is already initiating some programmes for supplementary facilities. Nevertheless, these initiatives may only be applicable to larger SME who have contracts with large companies/exporters.

Relax listing requirements of SME Board. The current listing requirements are too stringent for the majority of SME. To encourage more SME to attempt listing on the stock exchange, the listing requirements should be relaxed. This would also enhance the viability of the venture capital industry in The Philippines.

Strategies for institutional strengthening of Financial institutions

Abolish penalty for missing or unsubmitted documents and need for audited financial statements by SME. The central bank's latest requirement that borrowers must furnish audited accounts to obtain financing will be another constraint as most of the SME lack proper financial records and documentation. Though these requirements are instituted to encourage better record keeping by SME, they would only add on to the cost of financing for SME and increase the reluctance of banks to lend to those without proper documentation.

Provide more incentives for banks to lend to SME. The government could consider providing incentives such as tax rebates, lower liquidity requirements, and branching privileges to banks that are active in SME lending. In addition, the government SME centres could also refer SME, which have been nurtured to a bankable status to banks.

Improve skills of bank personnel. The SME Loan Programme under SME Guidance proposed in the SME Development Plan involves a buddy programme to be conducted through banks and SME Centres for SME. It is a good initiative to forge a closer relationship and improve the knowledge and understanding of banks in lending to SME.

Strategies for changes to the legal and regulatory environment to improve SME financing

Establish National Business Registry. The move to establish a National Business Registry is an important one to improve the quality of information on SME. The NBR is to house a central

information database that shall be used to facilitate communication between all stakeholders in SME development and financing. Phase 1 of this initiative has already been implemented under DTI supervision. It is hoped that funding for Phase 2, the more critical stage, could be raised to realize this initiative.

Establish Central Credit Information Bureau. In the same light, the BSP has already established the central credit information bureau to improve the information environment on SME. By collating negative and positive information, the bureau would facilitate increased information disclosure and lending by banks. Eventually, the bureau may also be able to provide credit scoring of SME to banks.

Enhance legal framework. On-going reforms of the legal framework are in place. Measures to improve the registration of land titles, enforceability of contracts and default foreclosure process (by increasing the capacity of the courts) would encourage banks to increase lending to SME.

Streamline Registration and Administrative Requirements. A number of regulations require streamlining and simplification. Registration of businesses and obtaining the necessary permits and approvals are unduly complex and onerous. By standardizing requirements, integrating common administrative functions between government agencies and reducing duplication of efforts of the different government SME agencies would facilitate the operations of SME.

G. SINGAPORE

Strategies for expansion or diversification of appropriate financing for SME

Extension of the role of SME credit bureau. Although the bureau is to facilitate an information database on SME, a natural extension of the bureau's role is to become a domestic rating agency for SME. This would promote greater transparency, awareness and credibility for SME seeking to obtain financing from the various sources of fund.

Creation of an Information centre for SME exporters. Many programmes and initiatives are available to encourage SME in Singapore to expand beyond the domestic market. Given that 36% of Singapore's SME are looking to explore overseas markets (DP survey), there need to be more coordinated effort to assist SME to establish marketing networks overseas. One initiative could be to set up an information centre to coordinate and promote the available facilities for SME exporters. Such an information centre could also coordinate the financing needs of these exporters and provide a link to connect banks with the SME.

Strategies for institutional strengthening of financial institutions

Expand Financing Facilities. Many SME are still not able to access lower cost longer-term facilities to finance their investment needs. Without an appropriate range of financing tools to match the needs of the business life cycle, SME's development growth will be hindered. The banking sector should promote the use of trade-based facilities such as trade financing, factoring, and even cash management services among SME especially for those without sufficient collateral. The ability to properly match funding needs to the appropriate financing tools for SME is also dependent on education and training for bank officers. A somewhat different type of skill sets from that required for large loan is necessary to service SME appropriately.

Greater Focus on SME Lending. Over the last decade, increasing global competition, liberalisation of the financial system and a shrinking domestic market have resulted in consolidation and merger of smaller banks into much larger entities. With the expansion in size and much higher loan volumes, larger banks often tend to lose the relationship aspect of the

lending process, a critical element for SME lending given the less homogenous nature and greater opacity of smaller enterprises vis-à-vis large corporations. In reaching out to the SME sector, banks could set up dedicated lending units or divisions to provide the necessary focus on SME lending.

H. THAILAND

Strategies for expansion or diversification of appropriate financing for SME

Securitisation of SME loans. Thailand's corporate bond market is small relative to its equity market. But its growth has been steadily increasing since 1995. With several on-going initiatives to promulgate the bond market as a stable alternative to bank loans and equity throughout Asia and the reasonably well-developed financial and legal system in Thailand, the Government could initiate a loan securitisation scheme for SME loans.

Expand Outreach of Credit Guarantee Scheme. Currently the SICGC provides coverage for only 2% of SME in the country. Given that credit guarantee schemes are effective channels to increase access to financing for SME, the outreach of the SICGC could be improved by increasing its capitalisation further and expanding its operations.

Strategies for institutional strengthening of financial institutions

Setting Up SME Departments. To further assist the national agenda of developing the SME, perhaps banks could set up dedicated SME department staffed with specialists. This may encourage more focus in marketing, lending and support to the sector.

Setting Up VC Departments. The bigger commercial banks might consider establishing a venture capital department to cater for the SME that do not meet the normal criteria for loans.

Provide More Training for Dedicated SME Loan Officers. Educating loan officers to better understand the industry and the business aspects of their SME clients should be an ongoing affair.

Strategies for changes to the legal and regulatory environment to improve SME financing

Improving Bank Capitalisation. The central bank has taken several steps to expedite the non-performing loan resolution by Thai banks, including tightening provisioning requirements on long-standing NPLs and amending laws to allow the government asset management company (AMC) to acquire them from both private banks and private AMCs. The improvement of banks' capital base would encourage more lending activities including to SME sector.

I. VIET NAM

Strategies for expansion or diversification of appropriate financing for SME

Reducing the Lending Bias against SME. The business associations continue to stress the need for the banks to be less biased in lending to the SME. All stakeholders will need to conduct more frequent and more effective workshops and dialogue sessions to assist the banks in better understanding the business nature and commercial viability of SME.

Greater Information Dissemination and Marketing of Loan Facilities. Greater and more frequent dissemination of information is necessary to increase SME awareness of the loan facilities available at commercial banks. Banks could also increase road shows on their lending programmes and market their programmes through the various business associations. Financial details and availability of loan programmes could also be made accessible through a centralized and computerized system.

Develop More Appropriate SME Credit Programmes. Financial packages need to suit the needs of SME. Further research and design of appropriate credit programmes can help to improve access to credit. The current definition of SME for policy and lending purposes should be reviewed with an aim to distinguishing the small from the medium enterprises. Banks should also be encouraged to reconsider the documentation and collateral requirements in view of differences between small and medium sized firms.

Implement the SME Credit Guarantee Fund. The legal framework for the SME Guarantee Fund is presently incomplete, unsuitable, and infeasible. The Government needs to urgently rethink the design of the CGFs to enable their expeditious implementation.

Promote Medium and Long-Term Deposits/Longer-Term Credit Facilities. The medium- to long-term goals of the international community includes the promotion of more efficient mobilization of domestic resources and to improve the allocation of those resources to commercially viable activities. However, in view of the fragmentation of the formal credit market, these efforts should perhaps be expedited to enable banks to efficiently mobilize funds.

Develop Alternative Financing Facilities. Efforts to develop and promote other loan facilities besides fixed loans such as revolving loans, trade financing, factoring, and leasing among others are necessary to provide SME with various funding options that best suit their needs.

Promoting Relationship Lending. Relationship lending can also assist banks in better understanding the business nature, financing requirements, and performance of SME. This lending approach can be particularly useful given the current state of the environment where there is a lack of information on SME, their lack of transparency and inability to produce key documents and collateral.

Use of Credit Scoring technologies. Over time, with the building up of experience, statistics, and data on SME both internally and externally by other information providers such as the CIC, credit institutions would benefit from applying credit scoring technologies to SME lending in terms of processing-cost efficiency, improved risk management, and the ability to employ risk-based pricing.

Third-Party Evaluation of SME. The feasibility of establishing an information centre to evaluate and rank SME should be studied to assist banks in lending to SME. Alternatively, by working together with the various banks and government agencies the CIC could consider extending such services to meet the specific needs of its users.

Strategies for institutional strengthening of financial institutions

Increasing Incentives to SOCB Bank Officers to Encourage Lending. More incentives should be given to SOCB bank staff to encourage lending to SME. In this respect, the World Bank notes that the SOE Act should be revised so that SOCB staff and management are not held liable for losses created in the normal course of the bank's operation.

Provision of Training and Technical Assistance to the Commercial Banking Sector. Meanwhile the international community together with various Government ministries and agencies has been working relentlessly to advance the reforms aimed at developing the banking

sector and NBFIs. In the short-term, the primary objective of the reforms are aimed at stabilising and strengthening the banking system; these efforts emphasize training and technical assistance to be provided to banks in the areas of credit policies, procedures and risk management techniques, and management of the international SME development funds.

Developing Small Capital Markets. At present, the Government is considering developing the stock and capital markets as alternative channels of SME funding. A strategy approved by the Prime Minister on 5 August 2003 includes the building of another smaller stock exchange in Hanoi for SME. This will need to proceed hand in hand with the implementation of internationally accepted standards of financial accounting.

Facilitating Measures for Bank Listing to Increase Liquidity. As mobilizing capital from depositors is not easy, listing on the bourse is a way for local banks to raise funds for their development. Considerations should be given for the banks, and in particular the JSBs, to be more easily listed on the Stock Exchange as a means to accessing capital and improving corporate governance. This may create greater liquidity for lending activities to the private sector and SME in particular and improve JSBs' competitiveness.

Strategies for changes to the legal and regulatory environment to improve SME financing

Focusing the Role and Responsibilities of the SBV. Accountability for the management and supervision of the banking sector is presently confusing due to the lack of operational independence of the SBV vis-à-vis other State bodies. The relationship of SBV with the Government and other agencies should be reconsidered and the Law on Credit Institutions should be amended to strengthen the supervisory role of SBV.

Strengthening Banking Guidelines/Laws on Supervision and Monitoring. The Government can further assist bank lending by eliminating conflicting laws and strengthen the regulatory framework. The SBV does not have clear standards/guidelines for monitoring many aspects of credit operations. This includes banks' credit risk management system, underwriting standards, adequacy of provisions, and assessment of counterpart risks.

Privatising SOCBs. The SBV's direct ownership and management of the SOCBs means that the commercial banks lack the independence to operate on a fully commercial basis as they are subject to government intervention. Consideration should be given to the privatisation of SOCBs so that they are more efficient and competitive in their lending approach.

Improving Corporate Governance and Transparency of Banks. One of the means to improve confidence in the banking sector is to promote corporate governance and greater transparency of bank performance.

Levelling the Playing Field. The existing formal savings and credit markets are fragmented with various institutions competing directly for public funds and channelling these funds for various uses. Meanwhile the policy lending institutions, the Development Assistance Fund (DAF), and the VBSP further exacerbate existing market distortions. The regulatory framework governing the banking and financial sector should perhaps be altered to fully level the playing field for all forms of banks and financial institutions.

Greater Coordination of SME Activities. Greater coordination of SME activities between all government agencies and associations involved in SME development and financing will eliminate unnecessary duplication of functions and reduce resource wastage.

Expedite Land Titling and Establish a Central Registry System. The Government can assist firms in resolving collateral issues with the banks by expediting the issuance of CLURs and simplifying the process of obtaining land use titles. The establishment of a centralised land and

building registry system will facilitate greater information dissemination and assist banks in conducting their due diligence.

Promote Secured Assets Regulations. Measures that would improve bank lending to SME include providing regulations for secured assets. Towards this end, the ADB is supporting capacity building for the National Agency for Registration of Security and providing support to the Ministry of Justice to develop the legal framework for secured transactions.

Promote Accounting Standards and Enforce Audit Requirements. The MOF eventually plans to have national accounting standards that are in line with the International Accounting Standards (IAS). Towards this end, the MOF has adopted a programme to create a system of accounting and auditing standards for Viet Nam based on but not identical to the IAS and the International System on Auditing (ISA).

APPENDIX 4: BEST PRACTICE MODELS OUTSIDE OF ASEAN

A. THE JAPANESE MODEL ON THE DEVELOPMENT OF SMALL AND MEDIUM ENTERPRISES

1. Definition of SME in Japan

Standard definition of SME that is adopted by all Government agencies and private institutions.

Definition of SME

Industry	Number of Employees	Capital Size (million yen)
Manufacturing and others	300 or less	300 or less
Wholesale	100 or less	100 or less
Retail	50 or less	50 or less
Services	100 or less	50 or less

Definition of Small Scale Enterprises

Industry	Number of Employees	Capital Size (million yen)
Manufacturing and others	300 or less	100 or less
Wholesale	100 or less	30 or less
Retail and Services	50 or less	10 or less

2. Summary of the Implementation of SME Policies

Role/ Function	Organisations	Remarks
Policy Formulation	National level: SME Agency Prefecture level: Local governments	Enacted the SME Basic Law and SME related policies Each local government has its own SME policies that cater for the needs of its prefecture. They also establish their own SME support centre.
Policy Implementation	Japan Small and Medium Enterprise Corporation (JASME)	Provides information, support, and training to SME. Provides managerial and technical training to SME through the Institute for Small Business Management and Technology. Provides insurance on credit guarantees.

Continued on next page

Continued

Role/ Function	Organisations	Remarks
Training	Institute for Small Business Management and Technology (under JASMEC)	There are 9 training centres for SME.
Financing	Japan Finance Corporation for Small Business (under METI) National Life Finance Corporation (under MoF) Shoko Chukin Bank (under METI) Agriculture, Forestry and Fisheries Finance Corporation (under Ministry of Agriculture)	Provides financing to medium size companies, 59 branches Provides micro financing to individual business, 153 branches Cooperative bank. Caters for its members Provides financing to the agriculture, forestry, and fisheries sector.
Credit Guarantee	National level: National Federation of Credit Guarantee Corporation (NFCGC) Prefecture level: Credit Guarantee Corporation	The coordinating body for all CGCs. Each prefecture has one CGC. There are 52 CGCs in Japan.
Credit Insurance	JASMEC	Provides insurance over the guarantees provided by the CGCs.
Equity Investment/ Venture Capital	Small and Medium Business Investment and Consultation Co. Ltd	A private entity that invests in potential companies.
Support Organisations	Chamber of Commerce and Industry, Small Business Associations, Societies of Commerce and Industry, Shopping Centre Promotion Associations	Provide support and disseminate information on government policies to members.

3. Financing to SME

All government financial institutions provide financing to SME according to the basic principles of the New SME Basic Law. Each government financial institution has its own financing target groups. Due to their specialisation, the financial institutions are able to develop the necessary skills to assess the credit standing of the borrowers.

The approval process for loan applications in the government institutions is relatively fast, generally within one to two weeks. The lending institutions are able to develop close business relationship with borrowers because many of them have regional offices to assist the borrowers. The availability of collateral or credit guarantee is the most important criteria in approving the loan applications, even amongst government financial institutions. Only the National Life Finance Corporation that provides micro finance to small-scale businesses does not require collateral.

4. Key Success Factors of the Japanese System

Structured Approach to Develop SME. There is proper coordination between all agencies and the focus is broad-based i.e., to SME in al economic sectors.

One Ministry and Agency Overseeing the Development of SME. The Ministry of Economy, Trade and Industry monitors and implements policies on SME. The SME Agency is mandated by the Law to co-ordinate all efforts pertaining to SME development in Japan.

SME Close Relationship with the Local Chambers of Commerce. The local chambers of commerce visit SME operating in the prefectures to check on the progress of the SME and assist in solving the problems faced by SME.

Strong Commitment in Training. The Japanese Government is very committed in upgrading the skills of SME operators and personnel of support organisations for SME. The Institute for Small Business Management and Technology, a training organisation for SME, was established to provide centralised training to SME and the regulators of SME.

Greater Acceptance of Technology. Although Japan encountered problems in encouraging small operators to modernise their business operations, continuous education and training has yielded positive results.

Experience Counts. On average, SME have 15.1 years of experience before venturing on their own.

Work Culture. The Japanese work culture is one of the key factors that has contributed to their success.

(Source: Bank Negara Malaysia. June 2003. *A Comprehensive Framework for the Development of Small and Medium Enterprises in Malaysia*. Kuala Lumpur: Bank Negara Malaysia).

B. THE CHINESE TAIPEI MODEL ON THE DEVELOPMENT OF SMALL AND MEDIUM ENTERPRISES

1. Definition of SME in Chinese Taipei

The official definition of SME was revised in 1995 and contained in the "Standard for Identifying Small or Medium Enterprises" as follow:

Sector	Definition
Manufacturing, Construction, Mining, and Quarrying	200 employees or less
	Paid-up capital of NT$60 million or less
Forestry, Agriculture, Fishing, Animal Raising, Plumbing, Electrical, Gas and Fuel, Commerce, Transportation, Warehousing, Communications, Finance, Insurance, Real Estate, Industrial and Commercial Services, Personal Service Enterprises	50 employees or less
	Annual Sales Value of NT$80 million or less

2. SME Policies in Chinese Taipei

Objectives	Policies
Creating an Optimal Business Environment	(i) Maintain fair and reasonable competition (ii) Assist firms in obtaining the factors of production (iii) Improve access to financing (iv) Assist participation in Government procurement activities (v) Help improve working conditions & environment
Foresting Mutual Cooperation Between Firms	(i) Promote inter and intra industry exchange (ii) Implement cooperative projects (iii) Assist the development of cooperative organisations (iv) Support the establishment of common facilities (v) Facilitate cooperation among regional industries
Foresting Firms' Independent Growth	(i) Assist management rationalisation (ii) Assist the development of human resources (iii) Assist firms to operate more effectively overseas (iv) Assist the creation of new firms (v) Help firms adapt to changes in the industrial structure (vi) Provide a complete guidance services system

In addition to the policies formulated by the SMEA, The Small and Medium Enterprise Policy Deliberation Committee of the Executive Yuan also formulates development strategies of SME and to integrate various guidance systems and service networks for SME. The Committee is also responsible for the resolution of problems that may arise on the implementation of SME policies.

3. Development Policy Measures

Advisory

The 10 Guidance System. Many of the efforts on SME development stress on the dissemination of relevant and useful information to SME on the availability of Government assistance.

Guidance services provided at service centres around the country are well designed and structured. There are three bodies under the MOEA that administer the guidance system, namely the SMEA (the coordinator), the Bureau of Foreign Trade and Commerce Department and the Industrial Development Bureau. The 10 Guidance System also provides short-term diagnostic guidance, general individual guidance and model company guidance and model company guidance to encourage SME to further develop themselves.

SME Service Centres. The SMEA established an SME Activity Centre in Taipei with the aim of providing guidance and training (through seminars and discussions) to SME. SME Service Centres have also been establishes at every country and city in Taiwan (22 in all).

These centres aim to provide prompt and efficient solutions to all relevant applications forwarded to the MOEA. A SME Service Handbook and the SME Service Database were also published by the MOEA.

Instant Solution Centre. The SMEA also established the SME Instant Solution Centre to handle inquires and requests for assistance from SME. In the year 2000, 80% of the cases received by the Centre related to financing issues, and the assistance provided by the centre prevented around 200 companies from going into bankruptcy. The remaining 20% of cases received by the Centre were related to information on market and technology, taxation (including import and export tariffs) and other issues. Out of the 7,000 cases attended to by the Centre in year 2000, around 70% had been satisfactorily resolved.

Training

The Government established 3 regional SME training centres to capitalise on the resources of universities to intensify the SME development efforts. Currently, the SMEA has formulated a plan to set up a learning institute for the SME to enhance their capabilities and skills. The salient points of the plan include:

(i) Planning the establishment of a joint SME University;
(ii) Encouraging SME employees to undergo further education;
(iii) Establishing learning centres for Taiwanese SME operating overseas; and
(iv) Encouraging life-long learning via the issuance of ‘learning coupons’.

SME Incubation Centres

In 1996, the first SME incubation centre was established by the SMEA using allocations under the SME Development Fund. By the end of February 2001, 52 such centres had been established. Currently, more than 670 companies are being nurtured at these incubation centres, and 77 had completed their incubation process. These incubation centres provide SME the necessary support for start-up companies i.e., space and equipment, technology and professional manpower, business services and information. There are also incubation centres that are operated by the private sector.

Financing Measures

The SME Development Fund (Government Funds). The Statue provides for the establishment of an SME Development Fund to finance the operating expenses of assistance programmes, provide financing assistance through the credit guarantee institutions, invest in SME companies or companies set up by the authorities to undertake SME development programmes and other purpose deemed appropriate. The SME Development Fund Management and Utilisation of the fund. Currently, the funds are mainly utilised for the following purposes:

(i) Provide special case loans;
(ii) Establish the guidance service network for SME;
(iii) Invest in SME development corporations which provides middle- and long-term funding for the development of promising SME; and
(iv) Establish SME incubation centres.

The Executive Yuan Development Fund (Guarantee Funds). (i) The Small and Medium Business Credit Guarantee Fund. The Government's financing assistance for SME is channelled mostly through the Small and Medium Business Credit Guarantee Fund (Credit Guarantee Fund). The capital requirements of the Fund are obtained from allocations under the SME Development Fund, donations from the central and local Governments, and from the contracted financial institutions. There are currently 15 guarantee schemes administered by the Credit Guarantee Funds, with guarantees being provided up to 100% of total loans approved. Funds under the Credit Guarantee Fund are channelled through commercial banks and the specialist SME banks. In addition to obtaining financing through the guarantee scheme, SME can also obtain financing direct from these institutions.

(ii) The Mutual Guarantee Fund. The Mutual Guarantee Fund was established to facilitate mutual assistance, trust and sharing among the SME. Through this scheme, SME would be able to obtain bank financing based on mutual guarantees. Under this scheme the distribution of risks would be apportioned between the fund itself (10%), the financial institutions (20%), members of the mutual assistance circles which comprise groups of SME (15%), convenors (50%), and the insurance companies (5%).

Financial Institutions

As at year-end 2000, the total amount of outstanding loans granted to SME by banks in Taiwan amounted to NT$3.48 trillion, or 26.2% of total outstanding loans (compared with NT$3.44 trillion, or 27.3% of total outstanding loans FY1999). Specialist SME banks provide a higher proportion of loans to SME compared to private banks.

4. Key Success Factors

The key factors for the successful development and implementation of SME policies and programmes in Taiwan can be summarised as follows:

One Ministry and Agency Coordinating the Implementation of SME Policies. The Ministry of Economic Affairs is the authority responsible for the development of SME. A high-level forum in the form of the SME Policy Deliberation Committee of the Executive Yuan, charts the direction of strategies on SME. The SMEA is the coordinating agency in charge of overseeing the implementation of SME policies under the "Statute for the Development of Medium and Small Business".

Existence of Structured Guidance and Assistance Avenues. There are properly coordinated avenues for SME with respect to issues such as training and services through the setting up of guidance systems, service centres and instance solution centres. Relevant information is also efficiently disseminated through these mechanisms. Apart from conventional market-driven financing through the financial system, special conduits for SME financing requirements are provided through the credit guarantee fund.

Commitment to Training. The government established regional SME training centres with the aim of tapping into the resources and expertise of universities. A learning institute for SME, which integrates technological enhancements, is also being planned. In addition, the government has established incubation centres with links to universities and colleges, research institutions and government agencies that provide SME with the necessary technical support and professional assistance.

An Active SME Association. The National Association of SME coordinated programmes and activities to promote efficiency and competitiveness amongst members. These include seminars and recognition programmes to enhance business competency. The association also works closely with the SMEA in conducting research and development into specific areas, which aims to improve the overall state of SME.

Work Culture of Taiwanese SME. Most Taiwanese enterprises were established in the tradition of starting small and own businesses. This approach led to the growth of many small firms in the country. The employees are hard-working by nature and would not hesitate to put in long working hours for the success of the business.

(Source: Bank Negara Malaysia. June 2003. *A Comprehensive Framework for the Development of Small and Medium Enterprises in Malaysia*. Kuala Lumpur: Bank Negara Malaysia).

C. TRAINING AND DEVELOPMENT FRAMEWORK OF SME IN GERMANY

1. Definition of SME in Germany

Germany does not have a standard definition of SME. The definition of the SME may vary, on a case-to-case basis, according to the development programmes implemented and the identified target group. The Federal Ministry of Economy and Technology (MET) however, has adopted the following definition of SME:

Definition of SME by MET

Size	Number of Employees	Turnover (million Euros)
Small Enterprise	9 or less	Up to 0.5
Medium Enterprise	10 to 499	0.5 < 50

2. Summary of Roles of Authorities Involved in SME Development

Role/ Function	Organisations	Remarks
Policy Formulation	Federal level: Ministry of Economics & Technology (MET)	Formulates policies affecting the development and regulation of SME at national level. Responsible for the formulation of specific policies with regard to SME development within the state.
Policy Implementation	State MEAs Chamber of Industry & Commerce (CIC) – 82 regional branches	Focuses on the promotion of economic development and implementation of federal macro-policies at state level. Functions as public corporations (but not public authorities) to assist in the implementation of MEA's policies, particularly in the area of training and development
Training & Advisory Services	Federal MET, State MEAs, Ministry of Education	Drafts and issues guidelines on training programmes e.g., Vocational Training Policy, in collaboration with the Federal Ministry of Education and State MEAs.

Continued on next page

Continued

Role/ Function	Organisations	Remarks
	CIC	Ensures proper implementation of dual vocational training system. Coordinates and promotes training and apprenticeship programmes. Identifies gaps in training requirements of existing SME. Overseas accreditation and examination issues
Financing/ Equity Investment/ Venture Capital	Federal level: Kreditanstalt fur Wiederaufbau (KfW), Deutsche Ausgleichsbank (DAG) State-funded Banks	Government-funded banks are responsible for the implementation of funding programmes for SME across the country. Oversees implementation of funding programmes set by the state governments.
Export Promotion	German Foreign Trade Information Office (Federal subordinate agency) CIC	Provides up-to-date and practice related information on foreign markets for interested companies. Facilities matchmaking, and CICs aboard provide international network and information for SME in Germany.
Information/ Technology Transfer	Federal MET, State MEAs, CIC	Facilities research and development cooperation between SME with the scientific and academic communities.
Support Organisations	Federal subordinate agencies, applied research institutes, trade associations, state subordinate agencies, etc.	Cooperates with government and CICs in all areas towards the development and promotion of SME.

3. Financing for SME

Government financial assistance under the various support programmes are in the form of low interest loans, granted on the basis of uniform transparent rules and normal banking criteria, where loans are issued only to credit worthy applicants. The state banks administer the funds. State banks, such as Kreditanstalt fur Wiederaufbau (KfW), play an important role in promoting SME through various financing schemes, special advisory services and information services provided to the SME. KfW, which is jointly owned by the federal and state governments, acts as a state refinancing institution. Apart from government funds, KfW raises capital through the capital markets and has AAA rating. KfW channels funds to commercial banks on a refinancing arrangement, for on-lending to the SME. Loan decisions are made by the commercial banks and are market-driven, independent of KfW. For most programmes, commercial bank will assume at least 50% of the credit risk. The rest of the risk is borne by KfW.

4. Key Success Factors of German SME

Well Defined Roles of Ministries and Private Sector. Although there is no specific SME Agency in Germany, the roles and function of the authorities responsible for SME development are clearly defined to ensure no duplication of duties.

SME-Friendly Legislation. One of the roles of the MET is to ensure that the interests of the SME are protected under the law. SME-friendly provisions are incorporated into existing laws (e.g., the Taxation and Employment Acts) to address the disadvantages faced by SME due to the size and nature of their operations.

Active Role and Participation of Chambers. Apart from representing their members, the CIC play a significant role in the development of the SME, particularly in the implementation of the vocational training programmes. Through the accreditation programme, the CIC also regulate the standards and numbers of skilled workers available in the labour market.

Structured Training and Accreditation System. One of the contributory factors for the success of the German SME in the availability of a pool of highly trained and skilled workforce. Its unique education system grants school-leavers the flexibility of pursing a conventional undergraduate programme, or to engage in practical training through the dual system.

Education System that Inculcates the Spirit of Entrepreneurship. Germany's forward-looking educational policies led to the creation of the dual system of vocational training for school-leavers, and various other initiatives at school and university levels.

Well-Developed Research & Development Infrastructure. SME are given the opportunity to further explore their ideas, with the support of specialists, without having to shoulder the high costs of setting up a research and development department within their own company.

Free Flow of Information. The MET, MEA, and CIC are committed to the task of dissemination of relevant information to the SME through the provision of personal advisory services, publications and extensive use of the electronic media and information technology.

Market-Driven Funding Assistance. In providing financial assistance to SME, the MET adopts the principle of helping the SME to help themselves rather than relying on subsidies from the state.

(Source: Bank Negara Malaysia. June 2003. *A Comprehensive Framework for the Development of Small and Medium Enterprises in Malaysia*. Kuala Lumpur: Bank Negara Malaysia).

D. THE SOUTH KOREAN MODEL ON THE DEVELOPMENT OF SMALL AND MEDIUM ENTERPRISES

1. SME Profile

Manufacturing Invested	< 300 employees Won 20 billion – 80 million of capital (assets)
Mining, Transportation	< 300 employees Construction
	< 200 employees Commerce & other service business
	< 20 employees

2. SME Policies

The government's New Economy Plan, which started in 1993 when President Kim Young Sam took office, places emphasis on fostering many self-reliant SME. Various programmes have been implemented by the government. The basic direction of the programmes is to encourage competition in domestic and international markets through deregulation and removal of SME protection measures. SME are no longer considered minor economic players needing government protection

3. Best Practice Programmes in South Korea

The Small and Medium Industry Promotion Corporation (SMIPC)

The SMIPC is a non-profit autonomous organization established in 1979 in accordance with the Small and Medium Industry Promotion Act for the purpose of implementing various programmes to promote the Small and Medium Industry (SMI) sector.

The programmes include, among others, the provision of:

(v) Financial assistance and field services to the SMI on a selective basis;
(vi) Industrial extension services concerning management and technology;
(vii) Industrial training services for managerial and technical manpower of the SMI from top Management to the level workers; collection, analysis, processing and dissemination of Industrial information for SMI; and
(viii) Internationalisation support for their industrial partnership with foreign counterpart industries.

Business Start-up & Incubation Programme

Under this programme, business aspirants who despite the technical capabilities and ideas confront difficulties due to their fragile condition in the start-up of a new business are eligible to participate in the SMIPC Business Start-Up and Incubation Center for a set period of time to receive comprehensive guidance on the creation of their business and the establishment of environment for the success of the new business.

Training Programme

This programme is to help small and medium industries cope with rapid technology changes and to turn out specialized manpower who will be able to constantly improve their job-site working conditions and update their technology.

Structural Readjustment Programme

This programme aims to help small and medium industries become more competitive through automation, informationalisation and the commercialising of new technologies.

(Source: ACTETSME website)

E. THE UNITED STATES MODEL FOR THE DEVELOPMENT OF SMALL AND MEDIUM ENTERPRISES.

1. SME Profile

Categories	Description
Manufacturing	500 employees
Non-Manufacturing	US$ 5 million of sales

2. SME Policies

The U.S. Small Business Administration (SBA) was created in 1953 as an independent agency of the federal government to aid, counsel, assist and protect the interests of small business concerns to preserve free competitive enterprise and to maintain and strengthen the overall economy of our Nation. The vision for the SBA revolves around two principles: customer-driven outreach and quality focused management.

3. Best Practice Programmes

The Small Business Institute

The Small Business Institute (SBI), by contracting with the Small Business Administration, utilizes the resources of progressive schools of business to furnish business counselling assistance to members of the small business community.
The SBI programme today consists of a network of over 500 colleges/universities throughout the country with the avowed purpose of providing counselling assistance to the small business community.

The Small Business Institute Directors' Association (SBIDA) serves as the liaison between the 500 Directors and the SBA and Congress, providing guidance in operations of and policy development for the SBI programme

Small Business Innovation Research (SBIR)

SBIR programmes fund research and development efforts of a high risk nature that may have excellent commercial potential. The Small Business Innovation Development Act of 1982 and 1992 presents and exceptional opportunity for any innovator who is capable of conducting high-quality research and development (R&D).

Small Business Development Centre (SBDC) Programme

The objective of the programmes is to enhance economic development by providing management and technical assistance to small businesses.

The U.S. Small Business Administration (SBA) administers the SBDC programme. There are now 57 SBDCs In each state there is a lead organization, which sponsors the SBDC and manages the programme. The lead organization coordinates programme services offered to small businesses through a network of sub-centres and satellite locations in each state. Sub-centres are located at colleges, universities, community colleges, vocational schools, chambers of commerce and economic development corporations. A current list of all SBDC's can be found at the National SBDC Research Network.

Small Business Investment Companies (SBIC)

The objective is to provide venture capital to small independent business, both new and already established. The Corporation of limited partnership may apply to the Small Business Administration for a license to operate as a Federal Licensee under the small Business Investment Act of 1958.Small business qualifying for assistance from the SBIC programme are able to receive equity capital, long-term loans, and expert management assistance.

(Source: ACTETSME website)

APPENDIX 5: AGGREGATE FINDINGS OF SURVEY FOR ASEAN

Analysis of Results for all Countries - Aggregate

PART 1 - General Policy/ Practices/ Processes on SME Financing

	ASEAN 6		ASEAN 4		Total	
	# Resp	%	# Resp	%	# Resp	%
Definition of SME						
- By no of employee	14	24%	7	37%	21	27%
- By firm revenue/ sales	11	19%	3	16%	14	18%
- By loan amount	15	25%	6	32%	21	27%
- By asset value	19	32%	3	16%	22	28%
	59	**100%**	**19**	**100%**	**78**	**100%**
Special SME lending unit						
- Yes	21	72%	4	31%	25	60%
- No	4	14%	9	69%	13	31%
- Other	4	14%	0	0%	4	10%
	29	**100%**	**13**	**100%**	**42**	**100%**
Preferred/Targeted Industries/Sectors						
- Yes	25	68%	9	64%	34	67%
- No	12	32%	5	36%	17	33%
	37	**100%**	**14**	**100%**	**51**	**100%**
Avoided/ Not Preferred Industries/Sectors						
- Yes	24	67%	5	38%	29	59%
- No	12	33%	8	62%	20	41%
	36	**100%**	**13**	**100%**	**49**	**100%**
Opnion SME v Corporate Loan						
- Higher risk on SME loan	23	66%	5	50%	28	62%
- Lower risk on SME loan	8	23%	5	50%	13	29%
- Indifferent	4	11%	-	-	4	9%
	35	**100%**	**10**	**100%**	**45**	**100%**
- Higher margin on SME loan	21	60%	7	70%	28	62%
- Lower margin on SME loan	12	34%	3	30%	15	33%
- Indifferent	2	6%	-	-	2	4%
	35	**100%**	**10**	**100%**	**45**	**100%**
Participation in Govt sponsored financing schemes						
- Yes	32	89%	3	23%	35	71%
- No	4	11%	10	77%	14	29%
	36	**100%**	**13**	**100%**	**49**	**100%**
Success Rate of Scheme						
- High	24	70%	2	33%	26	65%
- Moderate	7	21%	4	67%	11	28%
- Low	3	9%	0	0%	3	8%
	34	**100%**	**6**	**100%**	**40**	**100%**

Continue from previous section

Most Common SME Financing Approach						
- Asset-based/ collateral lending						
- 1st	5	4%	6	15%	11	7%
- 2nd	11	9%	2	5%	13	8%
- 3rd	6	5%	3	8%	9	6%
- 4th	4	3%	2	5%	6	4%
- 5th	1	1%	0	0%	1	1%
- 6th	0	0%	0	0%	0	0%
Total	27	22%	13	33%	40	25%
- Transaction lending						
- 1st	25	20%	4	10%	29	17%
- 2nd	6	5%	4	10%	10	6%
- 3rd	2	2%	0	0%	2	1%
- 4th	3	2%	0	0%	3	2%
- 5th	1	1%	0	0%	1	1%
- 6th	0	0%	0	0%	0	0%
Total	37	30%	8	20%	45	27%
- Relationship Lending						
- 1st	10	8%	4	10%	14	9%
- 2nd	11	9%	2	5%	13	7%
- 3rd	7	6%	1	3%	8	5%
- 4th	1	1%	1	3%	2	1%
- 5th	0	0%	1	3%	1	1%
- 6th	0	0%	0	0%	0	0%
Total	29	24%	9	23%	38	23%
- Factoring						
- 1st	1	1%	0	0%	1	1%
- 2nd	2	2%	1	3%	3	2%
- 3rd	0	0%	0	0%	0	0%
- 4th	1	1%	1	3%	2	1%
- 5th	6	5%	0	0%	6	4%
- 6th	1	1%	0	0%	1	1%
Total	11	9%	2	5%	13	8%
- Trade Credit/ Trade Financing						
- 1st	2	2%	0	0%	2	1%
- 2nd	1	1%	1	3%	2	1%
- 3rd	6	5%	1	3%	7	4%
- 4th	7	6%	1	3%	8	5%
- 5th	1	1%	1	3%	2	1%
- 6th	0	0%	0	0%	0	0%
Total	17	14%	4	10%	21	13%
- Others						
- 1st	0	0%	3	8%	3	2%
- 2nd	1	1%	0	0%	1	1%
- 3rd	0	0%	1	3%	1	1%
- 4th	0	0%	0	0%	0	0%
- 5th	0	0%	0	0%	0	0%
- 6th	0	0%	0	0%	0	0%
Total	1	1%	4	10%	5	4%
	122	**100%**	**40**	**100%**	**162**	**100%**

Continue from previous section

Documentation Required						
- Financial Statements						
- 1st	9	6%	6	10%	15	7%
- 2nd	13	9%	5	8%	18	8%
- 3rd	5	3%	1	2%	6	3%
- 4th	3	2%	2	3%	5	2%
- 5th	1	1%	0	0%	1	0%
- 6th	0	0%	0	0%	0	0%
Total	31	20%	14	23%	45	21%
- Business Plan/Proposal/Cash Flow						
- 1st	22	14%	11	18%	33	15%
- 2nd	4	3%	1	2%	5	2%
- 3rd	3	2%	1	2%	4	2%
- 4th	2	1%	1	2%	3	1%
- 5th	1	1%	0	0%	1	0%
- 6th	1	1%	0	0%	1	0%
Total	33	22%	14	23%	47	22%
- Bank Statements						
- 1st	9	6%	2	3%	11	5%
- 2nd	7	5%	2	3%	9	4%
- 3rd	8	5%	1	2%	9	4%
- 4th	3	2%	1	2%	4	2%
- 5th	2	1%	4	6%	6	3%
- 6th	0	0%	0	0%	0	0%
Total	29	19%	10	16%	39	18%
- Proof of Income						
- 1st	3	2%	1	2%	4	2%
- 2nd	5	3%	2	3%	7	3%
- 3rd	6	4%	3	5%	9	4%
- 4th	8	5%	2	3%	10	5%
- 5th	4	3%	1	2%	5	2%
- 6th	0	0%	0	0%	0	0%
Total	26	17%	9	15%	35	16%
- Proof of Asset Ownership						
- 1st	4	3%	1	2%	5	2%
- 2nd	0	0%	0	0%	0	0%
- 3rd	3	2%	3	5%	6	3%
- 4th	6	4%	3	5%	9	4%
- 5th	12	8%	2	3%	14	7%
- 6th	0	0%	0	0%	0	0%
Total	25	16%	9	15%	34	16%
- Others						
- 1st	0	0%	3	5%	3	1%
- 2nd	1	1%	0	0%	1	0%
- 3rd	2	1%	1	2%	3	1%
- 4th	1	1%	0	0%	1	0%
- 5th	2	1%	0	0%	2	1%
- 6th	2	1%	2	3%	4	2%
Total	8	5%	6	10%	14	7%
	152	**100%**	**62**	**100%**	**214**	**100%**
If cannot provide necessary document						
- Reject loan	14	33%	5	38%	19	34%
- Refer loan to credit guarantee scheme	3	7%	0	0%	3	5%
- Approve loan with conditions	16	37%	2	15%	18	32%
- Others	10	23%	6	46%	16	29%
	43	**100%**	**13**	**100%**	**56**	**100%**
Information rely on evaluation						
- Internal database	30	21%	5	16%	35	20%
- Credit bureau or similar central database	27	19%	8	25%	35	20%
- Credit rating agency	4	3%	1	3%	5	3%
- Private information providers	19	13%	2	6%	21	12%
- Associations	19	13%	4	13%	23	13%
- Formal/ informal check with other banks	30	21%	7	22%	37	21%
- Others	15	10%	5	16%	20	11%
	144	**100%**	**32**	**100%**	**176**	**100%**

Opinion on Information						
- Ease of obtaining the information						
- High	5	19%	0	0%	5	14%
- Medium	16	62%	7	70%	23	64%
- Low	5	19%	3	30%	8	22%
	26	**100%**	**10**	**100%**	**36**	**100%**
- Reliability of the information						
- High	10	32%	1	11%	11	28%
- Medium	15	48%	8	89%	23	58%
- Low	6	19%	0	0%	6	15%
	31	**100%**	**9**	**100%**	**40**	**100%**
- Accuracy of the information						
- High	9	31%	0	0%	9	24%
- Medium	15	52%	9	100%	24	63%
- Low	5	17%	0	0%	5	13%
	29	**100%**	**9**	**100%**	**38**	**100%**
- Cost of obtaining the information						
- High	4	14%	0	0%	4	11%
- Medium	14	48%	8	89%	22	58%
- Low	11	38%	1	11%	12	32%
	29	**100%**	**9**	**100%**	**38**	**100%**
Most Common Problems/Impediments						
- Lack of quality/ sufficient collateral	29	16%	12	18%	41	17%
- Lack of bankable business plan	29	16%	11	16%	40	16%
- Lack of/ no track record of firm or owner	31	17%	8	12%	39	16%
- Lack of/ poor financials of SME	32	18%	9	13%	41	17%
- Lack of accurate and comprehensive information	25	14%	10	15%	35	14%
- Lack of information/ published data	23	13%	9	13%	32	13%
- Not familiar/ lack expertise to evaluate SME	5	3%	7	10%	12	5%
- Others	4	2%	2	3%	6	2%
	178	**100%**	**68**	**100%**	**246**	**100%**

PART 2 - Credit Rating/ Scoring of SME loans

	ASEAN 6		ASEAN 4		Total	
	# Resp	%	# Resp	%	# Resp	%
Grade/ score SME loan						
- Yes	25	74%	5	38%	30	64%
- No	9	26%	8	62%	17	36%
	34	**100%**	**13**	**100%**	**47**	**100%**

Next section questions represent the respondents who do risk grade/ conduct credit rating for SME loans

	ASEAN 6		ASEAN 4		Total	
	# Resp	%	# Resp	%	# Resp	%
Specific rating system for SME loans						
- Yes	12	46%	2	40%	14	45%
- No	13	50%	3	60%	16	52%
- Other comment	1	4%	0	0%	1	3%
	26	**100%**	**5**	**100%**	**31**	**100%**
Rating System Technique						
- Credit scoring	4	14%	2	33%	6	18%
- Subjective assessment	0	0%	0	0%	0	0%
- Mix/ Hybrid	23	82%	4	67%	27	79%
- Others	1	4%	0	0%	1	3%
	28	**100%**	**6**	**100%**	**34**	**100%**
Most Important for Analysis						
- Character	6	13%	0	0%	6	10%
- Collateral	6	13%	2	17%	8	13%
- Capital	2	4%	1	8%	3	5%
- Financial data	10	21%	2	17%	12	20%
- Repayment ability	5	10%	1	8%	6	10%
- Track record	4	8%	2	17%	6	10%
- Management quality	4	8%	1	8%	5	8%
- Business fundamental	6	13%	0	0%	6	10%
- Others	5	10%	3	25%	8	13%
	48	**100%**	**12**	**100%**	**60**	**100%**
Importance of rating/scoring system						
- Main determinant to loan approval	11	41%	3	50%	14	42%
- As an aid conjunction with other considerations	16	59%	3	50%	19	58%
- Others	0	0%	0	0%	0	0%
	27	**100%**	**6**	**100%**	**33**	**100%**
If SME can't achieve passing grade/score						
- Loan is automatically rejected	10	37%	3	60%	13	41%
- Loan is referred to higher authority	4	15%	1	20%	5	16%
- Others	13	48%	1	20%	14	44%
	27	**100%**	**5**	**100%**	**32**	**100%**
Problem using Rating System						
- Data Availability	9	29%	4	100%	13	37%
- Reliability of data	7	23%	0	0%	7	20%
- Quality of data	2	6%	0	0%	2	6%
- Timeliness of data	2	6%	0	0%	2	6%
- Rating system measurement	2	6%	0	0%	2	6%
- Others	9	29%	0	0%	9	26%
	31	**100%**	**4**	**100%**	**35**	**100%**

Next questions represent the respondents who USING credit scoring for SME grading.

	ASEAN 6		ASEAN 4		Total	
	# Resp	%	# Resp	%	# Resp	%
Effectiveness of credit scorecard						
- Reducing default risk						
- Very effective	4	21%	0	0%	4	19%
- Effective	9	47%	2	100%	11	52%
- Moderate	1	5%	0	0%	1	5%
- Not effective	5	26%	0	0%	5	24%
	19	**100%**	**2**	**100%**	**21**	**100%**
- Reducing loan approval/ processing time						
- Very effective	3	17%	1	33%	4	19%
- Effective	9	50%	2	67%	11	52%
- Moderate	2	11%	0	0%	2	10%
- Not effective	4	22%	0	0%	4	19%
	18	**100%**	**3**	**100%**	**21**	**100%**
- Increasing bank profitability						
- Very effective	1	6%	0	0%	1	5%
- Effective	8	47%	2	100%	10	53%
- Moderate	4	24%	0	0%	4	21%
- Not effective	4	24%	0	0%	4	21%
	17	**100%**	**2**	**100%**	**19**	**100%**
Increment since use of credit scorecard						
- Increase	9	69%	3	100%	12	75%
- Decrease	0	0%	0	0%	0	0%
- Other Comment	4	31%	0	0%	4	25%
	13	**100%**	**3**	**100%**	**16**	**100%**

Next questions represent the respondents who are NOT USING credit scoring for SME grading

	ASEAN 6		ASEAN 4		Total	
	# Resp	%	# Resp	%	# Resp	%
Credit scoring a suitable tool to evaluate the risk						
- Yes	11	79%	3	60%	14	74%
- No	3	21%	2	40%	5	26%
	14	**100%**	**5**	**100%**	**19**	**100%**
Interested in using credit scoring						
- Yes	9	82%	5	71%	14	78%
- No	2	18%	2	29%	4	22%
	11	**100%**	**7**	**100%**	**18**	**100%**
Main impediment on implementing credit scoring						
- Availability of information	9	24%	5	29%	14	25%
- Cost concern	4	11%	0	0%	4	7%
- Insufficient infrastructure to accommodate	6	16%	4	24%	10	18%
- Lack of expertise in-house	5	13%	3	18%	8	15%
- Banking restrictions	6	16%	2	12%	8	15%
- Lack of credit bureau/ central database of SME info	7	18%	3	18%	10	18%
- Others	1	3%	0	0%	1	2%
	38	**100%**	**17**	**100%**	**55**	**100%**
Have the capacity to overcome impediments						
- Yes	10	83%	4	80%	14	82%
- No	2	17%	1	20%	3	18%
	12	**100%**	**5**	**100%**	**17**	**100%**

Next questions represent all the respondents who are USING or NOT USING credit scoring for SME grading

	ASEAN 6		ASEAN 4		Total	
	# Resp	%	# Resp	%	# Resp	%
Scoring will improve bank						
- Yes	26	90%	8	100%	34	92%
- No	2	7%	0	0%	2	5%
- Other Comments	1	3%	0	0%	1	3%
	29	**100%**	**8**	**100%**	**37**	**100%**
Use 3rd party scoring for evaluation						
- Yes	18	60%	9	100%	27	69%
- No	12	40%	0	0%	12	31%
	30	**100%**	**9**	**100%**	**39**	**100%**

This page has intentionally been left blank.

APPENDIX 6: ABOUT THE AUTHORS

RAM Consultancy Services Sdn Bhd (RCS) is a wholly-owned subsidiary of Rating Agency Malaysia Bhd (RAM), Malaysia's leading credit rating agency that pioneered the introduction of credit rating services in 1990. RCS was incorporated on 31st May 2000 as one of RAM's business diversification thrusts to provide value-added information and advisory services. The company offers four key advisory services namely: Economics Advisory and Research; Risk Management; Strategic Business; and Project Advisory & Research. Since incorporation, RCS has successfully completed many projects for both public and private sector clients in Malaysia and several regional projects in Asia.

The lead contributors of this Project are:

Dr Yeah Kim Leng (Project Advisor) – Trained in development economics and business management, he has substantial experience in conducting economics, industry and capital markets research as the research head at RAM since 1994 and earlier as a Senior Analyst at the Institute of Strategic and International Studies (ISIS) where he participated in a number of national policy studies. He is currently the Managing Director of RCS and Chief Economist of RAM.

Julie Ng (Project Manager) – She is a financial analyst who has been working in the areas of credit rating, credit risk management for financial institutions and financial advisory since 1992. She has been involved in various projects to develop credit rating and scoring systems for financial institutions in Malaysia and was lead consultant in regional studies to harmonise rating standards for rating agencies in Asia. Currently, she heads RCS's unit for risk management advisory services.

Lee Tin Hui (Associate) – She is an economist who has been working in economic policy research and industry studies for public and private sector clients since 1988. One of her key research focus is on SME development issues where she has involved with the government in several projects regarding SME in Malaysia. She was the lead researcher on SME for Malaysia's Second Industrial Master Plan and contributor to the SMI Development Plan.

Others who contributed to this Project include Leow Hock Bee, Awang Zaaba Awang Mahmud, Lim Kok Shui, Tony Chin, Wong Chuu Wey, Chung Kit Hong and Lee Swee Meng.