The Communications Capabilities of SMEs in Lower-Mekong Transition Economies

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December 2012

The paper concerns with the degree and efficiency of small- and medium-sized enterprise (SME) participation in Southeast Asian transition economies, from the perspective of "right to development". Our starting point is that even though these transition economies have empowered private sectors with crucial roles in national development process, the latter, for some reasons, are hesitated to take advantage of these privileges. As the United Nations Declaration on the Right to Development in 1986 (United Nations, 1986) and the 2nd UN World Conference on Human Rights in 1993 revealed, implementation of the right to development needs to establish an equitable economic environment in international sphere. In other words, countries should negotiate international agreements relevant to trade, competition and technologies. Based on these agreements, member countries shall establish an equitable economic environment domestically to solve various relevant economic problems.

Furthermore, decentralization and de-concentration policies are crucial in many developing countries to achieve development goals. This is the main spirit of participatory or democratizing development. It was also asserted by Amartya Sen as freedom in development—freedom of participation in political decision-making, freedom of participation in market operations, and freedom of participating in various social organizations (Sen, 1999). Therefore, this paper plans to focus on such lower-Mekong countries (LMCs) as Laos, Cambodia and Vietnam, with respect to SME's participation in development which will be measured in terms of communications capabilities.

Governments of LMCs cannot control international demand and competition but facilitate imports of components and capital goods and exports of products. It is therefore important to develop local SMEs to accumulate skill and know-how. However, there are bottlenecks in low technology, unskilled management and unskilled workers. A network of support through well-connected communication with customers as well as among SMEs themselves is crucial. And while the governments were encouraging registration of SMEs, many of the latter are disadvantaged as existing policies are biased in favor of state enterprises. This paper, therefore, wants to evaluate preliminarily what the chance to survive for the SMEs in terms of their communicative capability.

We will first take a look at the private sector development in the LMCs in the first section and then some government promotion policies are reviewed in the second section. In the third section the network of support especially related to SMEs' communicative capability with customers and among themselves is evaluated. Some concluding remarks are in the last section.

1. Overview of Private Sector Development[1]

Performance of the private sector is closely tied to how well a country promotes the development of new businesses, how much and how fast existing businesses are able to grow and become more efficient, and how well enterprises that sell international market compete. Economic growth alone, of course, is not the only consideration: both equity and environmental considerations are important as well as to ensure sustainable economic development.

Development of a strong private sector is a complex process, with many factors contributing to the strength or weakness of a country's private sector. Efficient and competitive private sector firms do not develop solely because of their own internal capabilities. While innovative entrepreneurs, skilled managers, a dedicated and well-trained workforce, and efficient administrative and operational procedures are important, the number, size, and efficiency of enterprises in a country are affected by a host of external factors. Generally, a private sector needs an overall "enabling environment" that allows private firms to operate efficiently, and specific institutions and policies that promote private sector development. The following are some of the more important factors affecting the size, characteristics, and strength of the private sector:

- Political and social stability. The private sector requires a conducive political and social environment in order to operate most efficiently. Political and social institutions such as public administration systems, judicial systems, schools, hospitals and the like provide an environment for sound economic development.
- Physical infrastructure. The size, characteristics, and efficiency of the private sector depend very much on the infrastructure in place. Public investment in infrastructure "crowds in" private investment.
- Macroeconomic stability. A key to economic growth is prudent economic management that avoids volatility and uncertainty. Policies that lead to high inflation, excessive taxation, distorted factor prices, or lack of foreign exchange discourage business formation and investment.
- Financial system. An efficient financial system is an important component of economic development, in mobilizing savings and channeling them into investments. For private sector firms, it serves an additional purpose besides providing them credit—a means of enforcing discipline on firms that borrow.

[1] This section draws from Kennedy and Hobohm (1999).

- Competitive market. Competition promotes efficiency, and policies that promote intense, but fair, competition will result in a strong private sector. Competition policy, privatization, and public sector procurement policies all can help make markets competitive.
- Regulations. Regulation of the private sector is necessary to insure competition and fair trade, but unnecessary regulation burdens the private sector and leads to fewer enterprises, less efficient enterprises, and reduced competition. Appropriate regulation is essential for a robust private sector.
- Legal framework. Business, like society in general, needs to operate under the rule of law. No strong private sector can exist unless an adequate legal framework exists in which to resolve dispute and facilitate efficient transactions, as well as to protect property rights.
- Policy framework. Various policies, even those not directly related to the private sector, can affect the growth and size of the private sector. Important policy areas include tax and trade regimes, regulation and registration procedures, customs procedures, education and training programs, and policies specific to SMEs. In particular, policies that unnecessarily constrain businesses need to be eliminated.
- Access to resources and support services. Entrepreneurs need access to financing, information, and various types of support services to create and operate businesses, and enterprise managers need similar access to operate their organizations in the most efficient and competitive manner. The existence of institutions, such as universities, consulting firms, accreditation and standardization bodies, and vocational training institutes can play major roles in private sector competitiveness.

2. SMEs and SME Promotion Policies in Lower-Mekong Countries

Small and medium-sized enterprises (SMEs) comprise the bulk of private production units in the lower-Mekong countries (LMCs). Enhancing private sector competitiveness in the LMCs must thus necessarily focus on SMEs. Enabling these enterprises to realize their economic potential is expected to increase business activity, investment and trade, and general employment, which, in turn, will result in increased incomes and consumption and, ultimately, sustained growth. In addition to infrastructure and an enabling policy environment, SME development requires more direct forms of support such as: i) business development services including business planning, networking, and matching with other business opportunities; ii) Short- and long-term financing; and iii) Support in creating and strengthening of producers and trade associations.

The LMCs have chosen to focus on trade facilitation to establish an attractive environment. Clearly private sector, export oriented trade and investment is the economic model that governments in this region have adopted (Singh 2007: 4).

SMEs are flourishing in Vietnam following the implementation of preferential policies. Since 1986, a number of SME-related laws have been passed, including Enterprise Law (1999) and the Law on Encouragement of Domestic Investment (1994). As a result of the various policies, the number of SMEs has increased to 190,000 in 2005. Regulations have also helped create a legal foundation for the development of a SME support network. So far, almost two-thirds of provinces and cities across the nation have launched programs assisting SMEs with technology, personnel training and trade promotion. Along with booms in their numbers, SMEs have improved the efficiency of their operations. These achievements have allowed SMEs to contribute about 45% of the GDP and more than 27% of the nation's total investment. SMEs also provide jobs for about 25% of the nation's workforce (Singh, 2007: 4).

The Lao government began promoting graduate economic liberalization through the introduction of the New Market Mechanism in 1986. This was followed by the Law on Promotion and Management of Foreign Investment (LPMFI) and Business Law in July 1994. To promote and provide more incentives to FDI, the LPMFI was amended in October 2004. In addition, Lao government also began conducting the Business Forum in Laos to facilitate dialogues with the business sector. Government efforts toward SME promotion were expressed in Primary Office Decree No. 42/PM, the goal of which are to improve regulatory environment, enhance competitiveness of business establishment, expand domestic and international markets, improve access to finance, encourage the development of business organizations, enhance entrepreneurial attitudes and characteristics within the society. Furthermore, the National Small and Medium Sized Enterprise Office (SMEPDO) was established by virtue of the Prime Minister's Decree No. 42/PM. However, there were still no specific support programs to improve managerial, technical, and entrepreneurial skills of SMEs, along with access to finance (Kyophilavong, 2008: 195-96).

In 2004, medium enterprises numbered about 722 and small enterprises 25,271 in Laos.[2] In terms of human development, SMEs have generated more than 60,000 job opportunities, accounting for 40% of the total employment in Laos. About 10% of establishments are performing well in Vientiane Municipality (VTM) and Other Provinces (OTP). In addition, about 20% of the SMEs in VTM and 17% in OTP are optimistic about the future of their businesses (Kyophilavong *et al*., 2007; cited in Kyophila-

[2] According the prevailing laws of the Laos, small enterprises are those having an average number of employees not exceeding 19 people or total assets not exceeding 250 million kip or an annual turnover not exceeding 400 million kip, and medium sized enterprises are those having an annual average number of employees not exceeding 99 people or total assets not exceeding one billion kip. See Prime Minister's Office (2004).

vong, 2008: 197).

As of March 2009, there were 376,761 enterprises in Cambodia, in which 93% were SMEs. According to a survey conducted by the National Institute of Statistics (NIS) in 2000, almost 80% of Cambodian SMEs were engaged in the food, beverage, and tobacco sectors, 13% of the SMEs were small-scale garment and textile, machinery, and non-metallic operations, and 7% were furniture manufacturers (Baily, 2008: 6). Cambodian SMEs have low total factor and labor productivity relative to neighboring countries. A 2004 World Bank study shows Cambodian firms to have total factor productivity 18 percentage points below those of India and 24 percentage points below those of China. Labor productivity is 65 percentage points below that of India and almost two thirds below that of China (World Bank, 2004).

Over the last ten years the Royal Government of Cambodia has introduced a number of laws designed to promote commerce in general. These include financial sector laws, a land law to strengthen land rights and encourage the use of property for collateral, and amendment to the Law on Investment and Audit was introduced as a first step towards implementing improved accounting standards. The Law on Commercial Enterprises and a law on Commercial Arbitration have recently been passed in an attempt to reduce risks associated with trading. These policies address many barriers hampering commerce and therefore SME development. But it is only within the last few years that the government has focused on removing barriers specific to the development of SMEs.

3. SME Support Networks

SMEs comprise the bulk of private production units in the lower Mekong countries. Enhancing private sector competitiveness in the LMCs must thus necessarily focus on SMEs. Enabling these enterprises to realize their economic potential is expected to increase business activity, investment and trade, and general employment which, in turn, will result in increased incomes and consumption and, ultimately, sustained growth. In addition to infrastructure and an enabling environment, SME development requires more direct forms of support such as: i) business development services including business planning, networking, and matching with other business opportunities; ii) Short- and long-term financing; and iii) Support in creating and strengthening of producers and trade associations. A number of initiatives have been undertaken at the regional level to facilitate trade. For one, there is the Mekong Private Sector Development Facility (MPDF). The MPDF promotes SME development at the macro, meso and micro levels of the economy, and achieves economy of scale by implementing programs across Vietnam, Cambodia and Laos PDR. Activities are tailor made to suit local challenges and opportunities, and to respond to changing economic conditions.

Similarly, there is the GMS Strategic Framework for Action on Trade Facilitation and Investment (SFA-TFI). The priority areas of this agreement are trade logistics development, business mobility improvement among others. This agreement reinforced the revised Kyoto Convention, ASEAN Transit agreement and the WTO agreement.

The LMCs have chosen to focus on trade facilitation to establish an attractive environment (see, *e.g.*, Lin, 2012). Clearly private sector led, export oriented trade and investment is the economic model that governments in this region have adopted. Table 1 shows selected indicators for doing business in these countries and how they fare relative to Singapore which is ranked number one by World Bank in trade openness.

Table 1 Trade Across Borders in LMCs and Selected Countries, 2012

	Rank	No. of Documents for Exports	Time for Exports (days)	Cost to Export (US$ per container)	No. of Documents for Imports	Time for Imports (days)	Cost to Import (US$ per container)
Vietnam	74	6	21	610	8	21	600
Cambodia	118	9	22	755	10	26	900
Lao PDR	160	10	26	2,140	10	26	2,125
Thailand	20	5	14	585	5	13	750
China	68	8	21	580	5	24	615
Singapore	1	4	5	456	4	4	439

Note: The most recent round of data collection was completed in June 2012.

Source: World Bank, "Doing Business: Measuring Business Regulations" (http://www.doingbusiness.org/data/exploretopics/trading-across-borders).

Labor-intensive industries for exports such as apparel and footwear industries have developed in LMCs. As the Multi-Fibre Arrangement (MFA) restricted export quantity from developing countries to the U.S. and European markets, exports from factories in China had been regulated by quotas. This encouraged foreign direct investments in LMCs from Taiwan and Korea. Apparel manufacturers in LMCs could take advantage of cheap labor and utilize export quotas for LMCs under the MFA before 2005. Even after the MFA was withdrawn, they maintained exports due to the advantage of generalized system of preferences (GSP) and quantitative regulations on exports from China based on safeguards by the European Union (EU) and the United States.

In Vietnam, foreign companies as well as local public and private companies set up factories and started exports under contract with foreign buyers. The apparel industry developed rapidly beginning in the 1990s. Cambodia and Laos followed suit. Its apparel industry has promoted industrialization and contributed to employment creation. Most apparel manufacturers in LMCs depend on buyers from the U.S. and Europe for material, design and marketing. Foreign buyers procure textiles, distribute them to manufacturers, and take inventory risks under a cut-make-trim (CMT) contract. The former extends technical assistance and management guidance to the latter. Manufacturers must meet international standards on quality control. As such, they need to invest in machinery, which only medium- or large-scale enterprises are capable of doing. Footwear is another product manufactured under contract with foreign buyers. Foreign and local private enterprises are set up and begin exporting, taking advantage of low-wage labor and utilizing the GSP. As export manufacturers must invest in machinery to maintain international standards on quality control, they mostly comprise medium- or large-scale enterprises. Although apparel and footwear are main export industries in LMCs, their share in SMEs are low. In addition to apparel and footwear, some industries are increasing exports to LMCs. In Vietnam, these include the wood product industry (Uchikawa and Keola, 2007: 241-42).

Nevertheless, with the advent of trade liberalization and FDI inflow, SME competitiveness as well as the opportunity for SMEs to increase production and exports was enhanced. For example, in 2005, garment exports of Laos amount to US$ 142 million. SMEs' garment share of total exports was about 30%. Export market has expanded compared to the previous years (Kyophilavong, 2008: 199). Furthermore, networking between SMEs, contractor, and suppliers was also enhanced. In theory, firms operate by transforming raw material into finished products. Final products depend on input (raw materials and intermediate goods) from several other firms. This comprises a network between firms. Past networking between SMEs, contractors and suppliers in LMCs seemed to be poor. Many SMEs were run as family businesses. Now, even though supporting government and private institutes such as banks were not bode well for SME development in, for example, Laos, external networking of SMEs in LMCs is improving in prospect.

We will illustrate the last point with respect to garment SMEs in Laos. The garment industry plays a very important role in the manufacturing sector since it has created employment opportunities, contributes to strong export growth, and generated more income for the Lao people. The value of garment exports was increased from US$ 142 million in 2005 to US$ 145 million in 2006. The total number of export garment enterprises in Laos in 2007 is 59, of which 17 are doing FOB, 22 FOB and CMT and the rest only CMT. There are about 58 garment SMEs and the majority of them are doing as subcontractors (see Table 2). The export companies employed more than 21,000 workers in 2007.

Table 2 Exports and Subcontractors of Garment Establishments in Laos

	No. of Export Company	Sub-contractor and Others	No. of Workers	Export Quantity		Value of Exports	
				Piece (million)	% change	US$ million	% change
1998	58	10	17,200	27.06		76.15	
1999	55	18	18,000	25.93	-4.18	100.03	31.36
2000	53	26	19,000	25.56	-1.44	108.09	8.06
2001	52	26	20,000	26.96	5.46	103.49	-4.26
2002	53	27	21,462	23.11	-14.25	103.38	-0.10
2003	55	31	23,846	28.12	21.66	115.13	11.37
2004	57	43	26,000	31.91	13.47	131.73	14.41
2005	58	55	27,500	35.58	6.31	151.81	6.25
2007	60	59	22,700	N/A		N/A	

Source: Association of the Lao Garment Industry, 2007; cited in Kyophilavong (2008), p. 203.

The Study of Kyophilavong (2008) randomly surveyed 20 garment SMEs in Vientiane in December 2007. The result of the survey shows that there are 18 SMEs with subcontracting arrangements. They have very good relationships with contractors who lent the former sewing machines. The contractors sometimes even made payment in advance before the due date. The majority of these SMEs did not exchange their orders with others, because they took order as their production capacity. They paid penalty when they did not deliver on time. Only two of them exchanged orders because they are relatives to each other. They usually exchanged information on orders and prices. The contractors sometimes permitted representatives from those SMEs to negotiate prices with large companies. However, such negotiations did not always succeed, since the prices quoted by large companies were quite competitive especially in recent years (Kyophilavong, 2008).

As mentioned above, the Lao government has implemented SME promotion policies. However, of the 20 SMEs surveyed, 19 did not get any assistance from the government. Neither any of them got any assistance from the Association of Lao Garment Industry (ALGI). According to the study, the SMEs need government assistance in obtaining more orders, financial support and training as orders were fluctuating and some of them were able to maintain production for only three months within a year. They also need access to financing for expansion of production. The majority of these SMEs were not able to get a loan from banks that required collaterals and the process of borrowing is complex and tedious. Moreover, they also need government assistance in worker trainings. Institutions like Japan International cooperation Agency (JICA), German Development Corporation (GTZ) and United Nations Industrial Development Organization (UNIDO) have funded some training programs which were only short-term and were already discontinued. On the other hand, ALGI 's assistance was also quite limited so that most of them would have to deal with their problems by themselves (Kyophilavong, 2008: 206-7).

Creating and maintaining relationships with customers is of particular importance for SMEs. Responding to customers with flexibility and adaptability is one of the key opportunities for SMEs to compete with large counterparts (Tagliavini et al., 2001). However, customer relationships in SMEs are largely managed in a traditional way through costly face-to-face contact and handshakes without sophisticated software support (Ritchie and Brindley, 2005). Today's customer relationship management research is largely limited to large organizations focusing on their sophisticated software applications with little attention to SMEs' needs (see, *e.g.*, Koh *et al.*, 2007). In practice, only a small percentage of SMEs have implemented sophisticated ICT to support customer relationship management objectives (Ritchie and Brindley, 2005). However, SMEs which want to compete in globalized economies cannot ignore customer management. A study by Chheang *et al.* (2010) on Cambodian SMEs' participation in production networks showed that not many of them have applied information and communication technology (ICT). Furthermore, about half of the SMEs in garments, and automotive parts and components participate in business networks and trade fairs, compared with close to 100% in other sectors.

4. Concluding Remarks

Facing with the increasingly competitive international market, especially with remarkable market expansion created by the entry of Chinese components, lower Mekong transition economies of Laos, Cambodia and Vietnam definitely need to pursue structural change, especially for those small and medium enterprises. As Japanese multinational corporations launched a cheap model to compete with products made of imported components in the first place, local first-tier suppliers such as those from Japan and Taiwan had to reduce production costs. In January 2001, the Vietnamese government began implementing selective import tariffs for components with more restrictive local content requirement which forced Japanese and Taiwanese first-tier suppliers to replace imported components with locally produced ones. They also replaced components sourced from Japanese second-tier suppliers with components from Taiwanese or Vietnamese second-tier suppliers (see, *e.g.*, Fujita, 2008). Some domestic market-oriented SMEs are investing in equipment to introduce high technology and improve management methods. Cottage industries even have started to export. They need to improve their communicative capability to take advantage of such shift and diversifying opportunities.

In addition to apparel and footwear, other industries are increasing their exports in LMCs. This will need support in marketing and information gathering. Our discussion in the text showed that there is still a long way to go in this respect. Of course, without structural change in domestic market, SMEs would not have the incentive to change their business style dramatically.

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