

# AEC BLUEPRINT 2025 ANALYSIS

## AN ANALYSIS OF THE ASEAN COOPERATION IN STRENGTHENING THE ROLE OF MICRO, SMALL AND MEDIUM ENTERPRISES (MSMEs)

### Foreword

The following report is part of a series which attempts to provide a detailed analysis on the ASEAN Economic Community (AEC) Blueprint 2025. Each report will cover a single element of the blueprint, providing a comprehensive look at past achievements, present problems, and the future

plans of the AEC. Special attention will be placed upon the strategic measures outlined in the AEC Blueprint 2025. This report aims to provide insight into the viability surrounding regional economic integration under the AEC.

### ASEAN Cooperation in Strengthening the Role of MSMEs

ASEAN MSMEs have been an important backbone of the ASEAN economies. Close to 96 percent of the total businesses in the ASEAN region is made up of MSMEs, emphasising the importance of this business segment in contributing to the ASEAN GDP and in providing employment to a large percent of the domestic workforce in the region (77-97 percent in Indonesia, Thailand and Vietnam, and 58-62 percent in the rest of ASEAN)<sup>1</sup>. In addition, MSMEs have also been instrumental in providing employment to women and opportunities for women entrepreneurs to access the potential markets.

Because of their increasing importance in the economy, ASEAN has committed to developing and supporting MSMEs to enhance their business activities and role in the realisation of the AEC. The ASEAN SME Working Group (SMEWG) was established in 1995 to coordinate all the initiatives and activities to promote SME development in the region. The Strategic Action Plan for SME Development (SAP-SMED) for 2010-2015 was formulated to guide the implementation process. The SAP-SMED itself was built upon the ASEAN Policy Blueprint on SME Development (APBSD) 2004-2014.

### A. Targets under the AEC 2015 Blueprint

Under the AEC Blueprint 2015, SME development is aimed at:

- a. accelerating the pace of SME development by optimising the diversities found in member states;
- b. enhancing the competitiveness and dynamism of ASEAN SMEs by facilitating access to the most important resources, including finance;
- c. strengthening the resilience of SMEs in dealing with macroeconomic and financial turmoil, as well as challenges from a more liberal trade region; and
- d. promoting the contribution of SMEs to the overall economic growth and development.

The following actions were to be implemented in order to achieve the aforementioned goals:

- i. Timely implementation of the ASEAN Policy Blueprint for SME Development 2004-2014 (APBSD).
- ii. Stronger networking of SMEs and their participation in the building of regional production and distributions networks.
- iii. Promotion of best practices in SME development, including SME financing.

The APBSD 2004-2014 lays out more detailed measures that ASEAN should implement in a timely manner to enhance the competitiveness of ASEAN SMEs.

<sup>1</sup>Beyond AEC 2015: Policy Recommendations for ASEAN SME Competitiveness, by the US-ASEAN Business

## B. Significant Achievements to Date

- Given the importance of ASEAN SMEs, member states have never stopped making efforts to promote the sector by implementing the measures agreed upon. However, developing SMEs is challenging and more support is needed from the relevant stakeholders. The progress made under

| Area   | Progress  |
|--|---|
| <p><b>Timely implementation of the ASEAN Policy Blueprint for SME Development 2004-2014 (APBSD)t</b></p> | <ul style="list-style-type: none"> <li>The APBSD was the basis for the development of the SAP-SMED 2010-2015, which focused on supporting SMEs' access to finance, market and internationalisation, human resource development, information and advisory services, and technology and innovation.</li> <li>Some initiatives that have been completed including the development of an ASEAN Benchmark for SME Credit Rating Methodology under Myanmar's chairmanship in 2014. This initiative was aimed at addressing the asymmetric credit information to enhance SMEs' access to finance. Information on the methodology has been disseminated to the relevant stakeholders including the central banks, credit rating agencies, SME development agencies, and commercial banks in ASEAN.</li> <li>The SME Service Centre has been developed to improve access to useful information. The service centre is a web-based system that is being developed to support ASEAN SMEs in searching for business partners, consultants, e-commerce, and investment opportunities. The system is also planned to be a source for all relevant information on AEC initiatives, relevant agreements (tariffs and customs), and Free Trade Agreements. The private sector participated in this initiative through the development of the ASEAN Market Place (AMP) which was launched in May 2015. The AMP is a collaboration of seven major ASEAN telecommunications companies to create a one-stop portal to assist ASEAN SMEs to access information, markets, technology and finance.</li> <li>To improve quality of human resource, member states have jointly developed the ASEAN Common Curriculum for Entrepreneurship in 2012, covering topics on entrepreneurial leadership, business planning, business policy and strategy, operations management, human resource management, marketing management and strategies, business creativity, commercial law, communications, financing, environmental studies, business start-up and IT management. A workshop was conducted in Cambodia in 2015 to facilitate deeper understanding of the policies and programmes to promote the development of SMEs in ASEAN.</li> <li>With regards to the regulatory environment, the ASEAN SMEWG conducted a review of the existing rules and regulations through the development of an ASEAN SME Policy Index in 2014 with support and assistance from the ERIA and OECD. The index provides some feedback on the state of SME development in ASEAN and serves as an evaluation mechanism in the next stage of development.</li> </ul> |

| Area  | Progress  |
|---|---|
| <p><b>Stronger networking of SMEs and their participation in the building of regional production and distributions networks</b></p> | <ul style="list-style-type: none"> <li>Participation in the production and distribution networks can be measured by SMEs' value of total exports. A paper by Wignaraja<sup>2</sup> attempted to evaluate the export performance by SMEs in selected ASEAN countries to find the determinants of performance. The paper uses econometric methods to measure the extent to which ASEAN SMEs have participated in exports and what the factors affecting this. There was a modest increase in the late 1990s and late 2000s in SMEs' share of exports. Countries like Malaysia and Thailand have relatively more developed SMEs and therefore have higher SME export shares compared to other member states. The paper also found that the positive determinants in the export performance include size, foreign ownership, educated workers, experienced CEOs, technological capabilities, and access to commercial bank credit. On the other hand, the most significant impediments included lack of access to finance, high electricity costs, lower quality of transport systems, inadequately educated workers, high corporate tax, as well as economic uncertainty. Drawing from the examples of Malaysia and Thailand, affordability and quality of business support services also play a role. ASEAN needs to consider these factors when shaping its future SME policies.</li> </ul>  |
| <p><b>Promotion of best practices in SME development, including SME financing</b></p>   | <ul style="list-style-type: none"> <li>One indicator that may be important in this area is how many days it requires to start a business. According to the World Bank<sup>3</sup>, most ASEAN countries have made important progress in simplifying the procedures and shortening the number of days to register and start a business. Based on data for 2003 and 2016, Indonesia made a significant progress by requiring only 25 days (2016), down from 181 days (2003). Other notable improvement was made by Lao PDR which cut down number of days it takes to register by over half(131 to 67 days). Other member states that reduced time taken to register business were Vietnam (61 to 24 days), Philippines (49 to 28 days), and Malaysia (38 to 19 days). Cambodia is the only country at did not make an improvement, with the number of days it takes to register actually increasing from 95 to 99 days.</li> <li>Access to finance has been considered the most significant barrier for ASEAN SMEs to grow. Wignaraja and Jinjarak<sup>4</sup> examined the relationship between access to finance and characteristics of firms in China and selected ASEAN member states: Indonesia, Malaysia, Philippines, Thailand and Vietnam. Their key findings are as follows: <ol style="list-style-type: none"> <li>SMEs normally opt for internal sources rather than external to finance their activities;</li> <li>When they go to external finance, they typically use non-bank sources more than banks;</li> <li>SMEs that borrow from banks undergo financial audits and are usually older and more export-oriented;</li> <li>As collateral, banks normally require personal assets of SME owners.</li> </ol> </li> <li>The above characteristics have proven to be an impediment growth for to SMEs. Given that commercial banking is still the dominant sector in the region's financial system, it is then very important to find a mechanism where banks feel comfortable funding operations of SMEs. Perhaps the role of central banks is crucial in encouraging commercial banks to include lending to SMEs in their business strategies.</li> </ul> |

<sup>2</sup> Engaging Small and Medium Enterprises in Production Networks: Firm-level Analysis of Five ASEAN Economies, Ganeshan Wignaraja, ADBI Working Paper Series, 2012

<sup>3</sup> Time required to start a business (days), World Bank, Doing Business project

<sup>4</sup> Why SMEs Do Not Borrow from Banks? Evidence from People's Republic of China and Southeast Asia, Ganeshan Wignaraja and Yothin Jinjarak, ADBI Working Paper, 2015

## C. Current Issues and Challenges

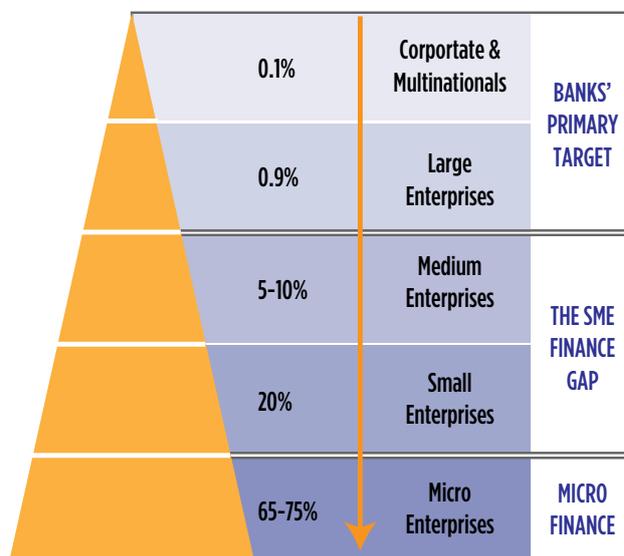
### Difficulties accessing finance

- Access to finance has been said to be the most significant challenge for ASEAN MSMEs to develop further. The common belief is that funding MSMEs poses higher risks than investing in other business entities. An OECD and ERIA report<sup>5</sup> suggests that there could be a credit rationing for ASEAN SMEs, which resulted in smaller quota of loanable funds from financial institutions for that particular business segment. This situation has prevented the existing MSMEs from expanding their business, and made it difficult for new start-ups to kick start their activities. According to a report by the International Finance Corporation (IFC)<sup>6</sup>, the SME finance gap exists because very little funding is channeled to small and medium enterprises which make up approximately 30 percent of the market in emerging economies as shown in Figure 1, and banks are more interested in funding large and multinational enterprises. On the other hand needs of micro-enterprises are being met by government led micro-credit programs.
- Absence of access to finance has also affected the MSMEs in obtaining the much needed technology, or technical know-how for doing production in the most efficient manner. More, importantly, there has not been a strategic concerted effort by the relevant authorities in providing MSMEs with technology and innovation. As a result, ASEAN MSMEs have not been able to compete fairly with their larger competitors who are in a better position to access the resources necessary to expand their businesses.

### Lack of technical know how

- Sufficient level of managerial and entrepreneurial skills are a necessary condition to improve efficiency and productivity, which would allow MSMEs to design their production methods in a way that minimises costs and optimise outputs., MSMEs need to search for new ways to meet their consumers' demand, or develop innovative products that could create their own demand. In addition, good marketing skills would enable MSMEs to better penetrate the markets and improve their competitive advantage. Lack of these skills means that a lot of business opportunities are not strategically seized.
- MSMEs lack quality human resource. Currently, the more educated someone is, the more he or she tends to work for a large established business or organisation leaving MSMEs to choose employees from a less-skilled pool of candidates. MSMEs should be able to attract the best talents which a policy on freer movement of skilled labour across the ASEAN may help to address.

**Figure 1: Business landscape in emerging economies**



Percentage represent the number of companies

Source: Current Status on Science and Technology in ASEAN Countries, CDRS, Japan Science and Technology Agency, September 2015, p.10

<sup>5</sup> ASEAN SME Policy Index 2014: Towards Competitive and Innovative ASEAN SMEs, collaboration between ASEAN SME Agencies Working Group (SMEWG), OECD and ERIA (p.60)

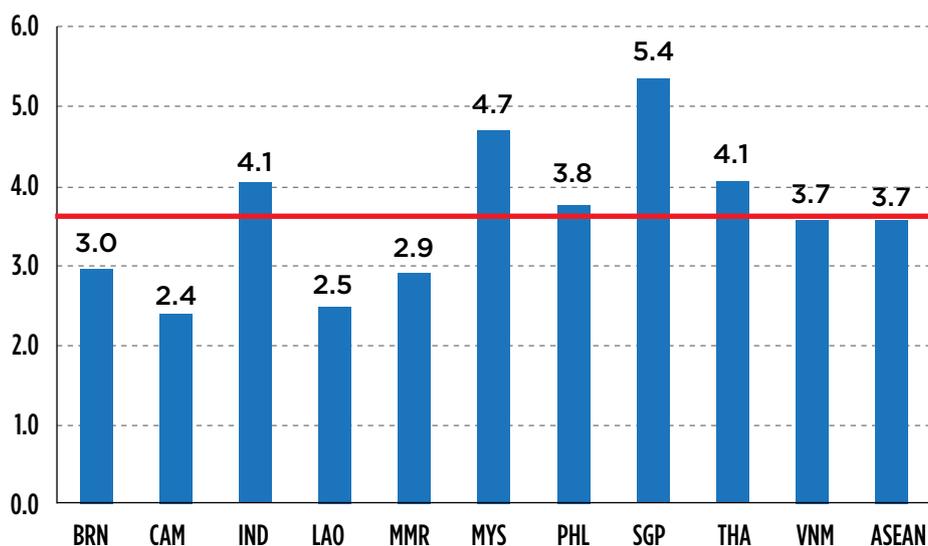
<sup>6</sup> The SME Banking Knowledge Guide, IFC Advisory Services, 2010 (p.11)

### The gap between SMEs in ASEAN countries

- As mentioned before, to measure and evaluate the progress made by ASEAN in addressing the problems above, ERIA and OECD developed the ASEAN SME Policy Index based on the successful similar exercise in Europe by the OECD and EU Commission, adjusted to fit the nature of ASEAN SMEs<sup>7</sup>. The ASEAN index is formulated based on the eight policy dimensions derived from the OECD model, APBSD and SAP-SMED: (i) institutional framework, (ii) access to support services, (iii) cheaper and faster start-up and better legislation and regulation for SMEs, (iv) access to finance, (v) technology and technology transfer, (vi) international market expansion, (vii) promotion of entrepreneurial education, and (viii) more effective representation

of SMEs' interests. Figure 2 describes the countries' performance in those areas. The ASEAN5 countries (Indonesia, Malaysia, Singapore, Philippines and Thailand) generally score higher than the younger member states, which is hardly surprising given that cooperation among them had started much earlier and that their economies are relatively more advanced. Singapore tops the list, followed by Malaysia, Indonesia and Thailand (both earn the same score), the Philippines, and Brunei Darussalam. Among the CLMV group, Vietnam's score is highest, followed by Myanmar, Lao PDR and Cambodia. Vietnam however scores higher than Brunei Darussalam.

**Figure 2: Policy Index by Country**



Source: ASEAN SME Policy Index 2014 (p.10)

- Greater competition among the growing number of MSMEs, and with other larger business entities has made it difficult for them to grow. Government intervention may be urgently needed in this case, particularly when the situation is expected to be more difficult with more competitors coming

from the more integrated market of ASEAN. The intervention can be in the form of a more conducive environment for SMEs, or initial support which may be gradually reduced to encourage their sustainability.

<sup>7</sup> ASEAN SME Policy Index 2014, ASEAN SME Agencies Working Group, ERIA and OECD

## D. Plans under the AEC 2025 Blueprint

As described by the new blueprint, the chief challenges for ASEAN MSMEs include globalisation, advances in ICT, trade liberalisation, and evolution of production processes. ASEAN efforts thus far have focused on networking, information flows and capacity building for officials on areas such as access to finance, technology, innovation, markets, human resource development, and regulatory framework.

The next period of AEC establishment focuses on a more structured and targeted MSME programme to enhance competitiveness, resilience, productivity, innovation, and capability to benefit from a more integrated ASEAN. The identified measures to achieve those objectives include to:

- **Promote productivity, technology and innovation**, build industry clusters, and promote innovation as a key competitive advantage.
- Increase **access to finance**, promote financial inclusion and literacy, and enhance tax and other incentive schemes.
- **Enhance market access and internationalisation, promote the use of e-commerce**, and enhance measures to promote exports.
- **Enhance MSME policy and regulatory environment**, provide support to micro enterprises in the informal sector and their integration, and streamline processes involved in obtaining permits and business registrations.
- **Promote entrepreneurship and human capital development** for MSMEs.

## E. AEC 2025 Blueprint Analysis

- The measures under the new AEC Blueprint have been structured based on the experience from implementing the action plans of the previous period. The table below explains the current progress

| Issues  | Current Status and Development  |
|---|---|
| <b>1 Productivity, technology and innovation</b>  |   |
| <ul style="list-style-type: none"> <li>a. Promote productivity, technology and innovation through measures to enhance MSME productivity by understanding key trends in productivity.</li> <li>b. Build industry clusters through industrial linkages, promote technology and build capabilities to foster industry clustering.</li> <li>c. Promote innovation as a key competitive advantage through technology usage and its application to business and business-academia linkages.</li> </ul>                        | <ul style="list-style-type: none"> <li>• As explained before, access to technology for ASEAN MSMEs has been quite limited. This is partly due to the limited access to finance that is suggested to be the most significant barrier for MSMEs to expand their business. Their inability to secure funding from the commercial banks has made it difficult to access other useful resources that could accelerate their growth to be more competitive.</li> <li>• As postulated by the previous paper on science and technology cooperation, ASEAN still needs to strengthen the partnership and establish a synergy between the public and private sector in developing the technology that addresses the needs of the industry and consumers.</li> <li>• Nonetheless, a simple proxy can be used to measure how much ASEAN MSMEs have utilised technology. Sato<sup>8</sup> observed that the number of ISO 9001 certifications obtained by firms in ASEAN increased more than twofold between 2003 and 2012. Indonesia, Malaysia, and Thailand are the top three countries with Vietnam not far behind. Meanwhile, shares of high technology exports decreased during the same period, and only Malaysia and Singapore showed upward trends on research and development spending as a percentage of GDP.</li> </ul> |
| <b>2 Access to finance, and financial inclusion and literacy</b>  |   |
| <ul style="list-style-type: none"> <li>a. Increase access to finance by developing and enhancing the institutional framework in respect of improving understanding and strengthening traditional financing infrastructure as well as policy.environment and measures that foster alternative and non-traditional financing</li> <li>b. Promote financial inclusion and literacy and the ability of MSMEs to be better engaged in the financial systems.</li> <li>c. Enhance tax and other incentive schemes.</li> </ul> | <ul style="list-style-type: none"> <li>• The ASEAN Working Committee on Financial Inclusion (WC-FINC) has been established to expand the inclusion of the peoples of ASEAN into the financial system. This includes providing funding support to the ASEAN SMEs. The WC-FINC is now in consultation with the ASEAN Coordinating Committee on MSME (ACCMSME, the new name of the ASEAN SMEWG) to discuss policies to facilitate funding for MSMEs.</li> <li>• The WC-FINC's streams of work cover issues such as development of national financial inclusion policy, consumer protection, financial literacy and capacity building.</li> <li>• In terms of taxation and other financial incentive schemes, member states have not really implemented anything as this requires more intensive cross-sectoral cooperation among the relevant ASEAN sectoral bodies.</li> </ul>  |

<sup>8</sup> Development of Small and Medium Enterprises in the ASEAN Economies, Yuri Sato, 2013

<sup>9</sup> Engaging Small and Medium Enterprises in Production Networks: Firm-level Analysis of Five ASEAN Economies, Ganeshan Wignaraja

**3 Market access, internationalisation, and e-commerce**

- |   |   |
|---|---|
| <p>a. Enhance market access and internationalization by extending and developing support schemes for market access and integration into the global supply chains including promoting partnership with multinational corporations (MNCs) and large enterprises to increase market access and opportunities.</p> <p>b. Promote the use of e-commerce.</p> <p>c. Enhance measures to promote exports through mechanisms such as export clinics, advisory services and ROO utilization.</p> | <ul style="list-style-type: none"> <li>• The share of MSMEs of total exports in ASEAN is still very low. Wignaraja<sup>9</sup> observed that exports by SMEs constituted only 23 percent of total exports, while large enterprises contributed 77 percent. Among member states, the largest contribution by SMEs was from Thailand at 34.7 percent, while Indonesia's SMEs could only contribute 9.3 percent.</li> <li>• In terms of e-commerce, as explained in the previous CARI analysis paper on e-commerce<sup>10</sup>, ASEAN is still working on developing its e-commerce as a new medium of integrating the ASEAN market of goods. Some of the main challenges in ASEAN e-commerce development include low penetration of information and communication technology (ICT), early stage of infrastructure development, low level of transaction security, early development of cross-border payment system, and low connectivity on logistics across ASEAN.</li> </ul> |
|---|---|

**4 Policy and regulatory environment (micro-enterprises, and permits/business registrations)**

- |   |  |
|---|--|
| <p>a. Enhance MSME policy and regulatory environment that promotes intra- and inter-governmental cooperation and coordination mechanisms, involvement of MSMEs in the decision making process to enable better representation of MSME interests.</p> <p>b. Provide support to micro enterprises in the informal sector and their integration</p> <p>c. Streamline processes involved in obtaining permits and business registrations to enable less costly and faster business formation.</p> | <ul style="list-style-type: none"> <li>• The ASEAN SME Policy Index 2014, as mentioned above, provides the best feedback on policy and regulatory framework on SME development in ASEAN<sup>11</sup>. Of the eight policy dimensions, big gaps exist between the ASEAN average, ASEAN-6 and the CLMV countries. The most significant gaps were found in five policy dimensions: technology and technology transfer, access to finance, promotion of entrepreneurial education, cheaper, faster start-up and better regulations, and access to support services.</li> <li>• The report explains that the reasons behind the gaps include lack of strategic approach to innovation policy for SMEs, poor provision of information on innovation support services, limited access to standard certification services, lack of technology support in universities, little linkages between SMEs and R&amp;D labs and incubators, poor protection and promotion of intellectual property rights (IPRs), lack of broadband infrastructure, underdeveloped science/industrial parks, lack of competitive clusters, and insufficient financial incentives in technology development and R&amp;D activities.</li> </ul> |
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<sup>10</sup> Association of Southeast Asian Nations, ASEAN women entrepreneurs to harness technology and innovation for growth

<sup>11</sup> Malaysia External Trade Development Corporation, Malaysia Champions ASEAN Young Entrepreneurship Agenda Through The 1st Asean Young Entrepreneurs

<sup>12</sup> Science and Technology Innovation in food, energy, water and related topics for ASEAN development

**5 Entrepreneurship and human capital development**

- |   |  |
|---|--|
| <p>a. Promote entrepreneurship and human capital development by creating a more conducive environment for entrepreneurship through the ASEAN On-line Academy.</p> <p>b. Enhance human capital development for MSMEs, in particular youth and women.</p> | <ul style="list-style-type: none"><li>• A two-day conference was organised by the ASEAN Women Entrepreneurs Network (AWEN) and the Women's Business Council of the Philippines (Womenbizph) in March 2017<sup>12</sup>. The event focuses on opportunities for women entrepreneurs in ASEAN to grow their business through the use of technology and innovation, under the theme of "Science, Technology, Engineering, Arts, and Mathematics" (STEAM).</li><li>• In July 2016, the Malaysia External Trade Development Cooperation (MATRADE) and the Malaysian Association of ASEAN Young Entrepreneurs (MAAYE) held the ASEAN Young Entrepreneurs Carnival 2016<sup>13</sup>. The event saw the launching of the Incubator Programme for ASEAN Export Champions which aims at is creating ASEAN export champions among young entrepreneurs from Malaysia and turning them from exporters to successful global traders. The initiative</li></ul> |
|---|--|

<sup>12</sup> Science, Technology, Engineering, Arts, and Mathematics (S.T.E.A.M.) Ahead in ASEAN Conference, organised by ASEAN Women Entrepreneurs Network (AWEN) and the Women's Business Council of the Philippines (Womenbizph), March 2017.

<sup>13</sup> Malaysia Champions ASEAN Young Entrepreneurship Agenda Through The 1st ASEAN Young Entrepreneurs Carnival 2016

## F. Conclusion: Moving Forward with the AEC 2025 Plans

Wignaraja and Dumaua-Cabauatan<sup>14</sup> suggest that ASEAN MSMEs are not prepared to reap the benefits offered by the AEC and Regional Comprehensive Economic Partnership, and compete with larger business enterprises. Therefore, they propose that ASEAN needs to revisit the following to ensure that MSMEs benefit from the AEC:

- a. The first proposal is to boost the productivity of ASEAN workers by enhancing training to bring productivity to the levels required to participate in global value chains (GVCs). The MSMEs themselves may need to invest more in the necessary specialised technical training for their workers. Support by the government may be crucial in elevating the quality and increasing the quantity of the training programs that are needed by the MSMEs.
  - b. The second proposal is concerned with streamlining the regulations. While many countries have made positive improvements in this area, MSMEs are still facing significant barriers in terms of business requirements. According to the World Bank data, Singapore is the most advanced with only three working days required to complete three procedures where online applications are made to one authority. Singapore's model should be studied and emulated by other member states to be more competitive. In addition, simplified customs procedures and tax treatments can positively contribute to the promote MSMEs performance.
- Member states need to spend more on technology development and technology transfer, which covers not only the common physical and digital infrastructure. This will not only better the production process but also marketing and business development through e-commerce. Moreover, improved connectivity across the ASEAN region through better transportation infrastructure could provide better link between suppliers and customers and support freer flow of goods, services and movement of skilled workers.
  - Improving the access to the financial system may significantly boost MSMEs capability to be more productive and competitive. In this case, the authorities in charge of MSME development need to strengthen the collaboration with the finance side and develop a scheme to facilitate more funding by ASEAN commercial banks to MSMEs and ensure that it is a good business to do so. This could be improved by better credit rating system, alternative collateral schemes, and more intensive financial education.
  - The new AEC blueprint has covered the most important measures to be taken the bring ASEAN MSME's performance to a higher level. Member states need to strengthen their commitment in implementing those agreed measures and improve cross-sectoral coordination and collaboration as many of those measures are under the purview of different economic sectoral bodies under the AEC pillar. There could be a forum where the sectoral bodies in charge of MSME development, financial cooperation, science and technology cooperation, and agriculture development, as well as other relevant stakeholders, can sit together to discuss more meaningful development of ASEAN MSMEs as an significant component of the AEC.
  - Closer collaboration with the private sector, particularly on the access to finance and technology could improve the implementation side by tapping on the resources that the industry side has. A formal forum for a partnership could be established where the authorities and industry representatives could formally discuss the ways to empower the ASEAN MSMEs better.

<sup>14</sup> Go back to basics to help ASEAN SMEs benefit from AEC

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