

# Laotian Small and Medium Size Enterprises and the regional economic integration

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## I. The Lao P.D.R.

- Status: Last Developed Country, Landlocked Developing Country.
- Land area: 236.800 km<sup>2</sup>
- Population: 5.5 millions of which the ratio female/male is approximately 50.1/49.9, the 89% are under 50 years' old, 80% are agricultural people and most of them live in the economy of subsistence.
- opulation per square kilometer: 22

**Table1: Size of Laos in comparison with its neighbors**

	Land area km <sup>2</sup>	Population 10 <sup>6</sup>	GDP in 10 <sup>6</sup> US\$
Laos	236,800	5.5	1,759
China	1,262,000	1,263	1,237,000
Thailand	513,000	63	114,835
Vietnam	332,000	79	33,476
Myanmar	677,000	48	6,900
Cambodia	181,000	12	3,400

Sources: ASEAN Statistical Yearbook 2000 and World Development Indicator 2002

- Proclamation of the Lao PDR in 1975  
From 1975 to 1986, socialist centrally planned economy.  
Since 1985, anticipating the big change of the international situation, President Kaysone Phomvihane<sup>1)</sup> launched the new idea of constructing socialism in Lao way “Chintanakanmay” (new imagination) and recognized the necessity of the “merchandise-economy” that has to be transformed gradually to the “market—

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1) President of Lao Revolutionary People Party from 1955 to 1989

economy”<sup>2)</sup>. This idea was translated into action in 1986 with the implementation of “New Economic Mechanism”.

Starting trade liberalization 1987-88; elimination of import and export restrictions—  
Import taxes reduction—Elimination of export taxes and replaced by profit taxes  
Starting stabilization policy 1988-89; new tax system, 20% reduction of personnel  
number in public service—Control of money supply—Unification of exchange rates  
and adopt a floating exchange rate since 1995.

Deregulation 1986-90; Autonomy and rationalization of public enterprises—  
Privatization of inefficient SOEs. Abandon of agricultural cooperatives—Liberalization  
of internal trade—Financial liberalization

- The economy knew a dynamic growth from 1992 to 1997, stagnated in 1998 because of the Asian financial crisis, then, took off again with an average annual growth rate of 5.7%.

## II. Laotian SMEs

- Definition

In Lao PDR, a four—dimension—definition of SME is given in a recent Prime Minister Decree<sup>3)</sup>. It takes into account (1) the number of employees, (2) the turnover or total assets amount, (3) the business registration, and (4) the independency of the business: SMEs are business units that are independent and legally registered in accordance with the law of Lao PDR, and which sizes are determined by the following criteria.

This definition was inspired from UNIDO-Ministry of Industry & Handicrafts paper’s definition proposed in 2002<sup>4)</sup> in which a distinction between “micro” and “small” businesses was also given, for a better situation analysis.

It is recognized by all that SMEs are the engine for growth, employment and poverty alleviation; and it is also the case of ASEAN countries in general. “Small and medium enterprises (SMEs) including micro-enterprises form the backbone of the economy in

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2) Resolution of 5<sup>th</sup> Lao Revolutionary People Party Congress, 1984

3) Prime Minister Decree<sup>3</sup> No. 42/PM, concerning SMEs promotion and the development, dated on 20 April 2004.

4) MIH-UNIDO SME Development Framework, Vientiane June 2002

**Table 4: Definition of SME**

Category	Number of employees	Annual turnover <i>million Kip</i>	Total assets <i>million Kip</i>	Indepen- dent business	Business and tax registration
Small	Up to 19	<400	<250	Yes	Yes
Medium	20 to 99	<1,000	<1,200	Yes	Yes

Source: Prime Minister Decree on SME promotion and Development, 2004

**Table 5: Definition of SMEs in 2002**

Category	Number of employees	Annual turnover <i>million Kip</i>	Total assets <i>million Kip</i>	Indepen- dent business	Business and tax registration
Micro	1 to 4	<100	<70	Yes	Yes
Small	5 to 19	<400	<250	Yes	Yes
Medium	20 to 99	<2,000	<1,200	Yes	Yes

*Note: the financial criterion is Annual Turnover OR Total Assets.*

Source: MIH-UNIDO: SME Development Framework, Vientiane June 2002.

ASEAN Member Countries. They are the largest source of domestic employment across all economic sectors, in both rural and urban areas. The SME sector also provides opportunities for women and the young to participate in the economic development of the country.”<sup>5)</sup> In the case of Laos, maybe it is still early to confirm that, but it is true for the whole private sector of small, medium and large size enterprises. At the present time, State—Owned—Enterprises contribute to only 4% of GDP and 1% of employment, therefore the private producers and exporters play a very important role in the development of Lao economy and will be the main sources of economic growth in the near future.<sup>6)</sup> Like in other GMS countries, SMEs are the largest source of employment and should be an appropriate instrument of poverty alleviation because of their important and increasing number, the high diversity of their natures, etc.

There are no regularly updated statistics on the SMEs available in Laos. Lao Expenditure and Consumption Survey No.2 (LECS-2) organized in 1997-98 by National Statistical Center revealed that 164,489 households (21% of the total number of households) run business(es) of which 11,673 (7%) are with employees: 9,662 with 1-5

5) ASEAN Policy for SME Development (APBSD) 2004-2014

6) Kazy Martin, World Bank, Workshop on private sector promotion in Vientiane 2004.

employees; 968 with 6-10 employees; 1,044 with 11 or more employees. Households in urban areas are more business active as 40% of them representing 54,111 households of urban zones have their business. In rural zones there are 110,377 households equaling 17% of the total number of households, run business.

According to the survey made by the Ministry of Industry and Handicrafts in collaboration with the German GTZ, there were approximately 146,000 business engaging about 259,000 persons in 1995.

The largest sector (in terms of number of business establishments and persons engaged) was the commercial sector in which retailers constituted about 91%. The average number of persons engaged per business establishment within this sector is 1.7. The second largest sector was manufacturing: food processing, textiles, furniture making, metal working, etc. The service sector (not including commerce) was rather small representing about 12% of the total.

**Table 6: Distribution of SMEs by sectors, 1996**

Sector	Establishments		Person engaged	
	<i>Number</i>	%	<i>Number</i>	%
1 . Manufacturing	49,211	33.7	91,278	35.3
<i>Food processing</i>	17,523	12.0	38,269	14.8
<i>Textiles</i>	22,634	15.5	33,874	13.1
2 . Commerce	78,855	54.0	134,460	52.0
<i>Retail</i>	71,846	49.2	61,986	46.1
3 . Service	17,962	12.3	32,839	12.7
Total	146,028	100.0	258,577	100.0

Source: GTZ-MIH SMEs in Lao PDR: Results of a National Survey, 1996

The latest survey conducted by the Ministry of Industry and Handicrafts with the technical assistance from UNIDO in 1999 revealed that mining and quarrying, electricity, and water operations are run by a small number of large (>100 employees) and medium (10-99 employees) businesses. In contrast, the manufacturing sector was dominated by small enterprises employing less than 10 persons

- In manufacturing activities, small businesses represent 98%, medium 1.5% and large 0.4%. Small businesses create employment for about 57% of the industrial labor force. Large and medium employed 36% and 7% respectively. Grain milling represented

**Table 7: Number of establishment sizes by sector**

Sector	Number of establishments			
	Small	Medium	Large	Total
Mining & Quarrying	0	4	10	14
Manufacturing	21,760	322	88	22,170
Electricity & Water	0	0	3	3
Total	21,760	326	101	22,187
Sector	Number of persons engaged			
	Small	Medium	Large	Total
Mining & Quarrying	0	167	548	715
Manufacturing	42,723	5,359	27,318	75,400
Electricity & Water	0	0	3,683	3,683
Total	42,723	5,526	31,549	79,797

*Source:* MIH-UNIDO Survey of Industrial Establishments and Small Scale Manufacturing Establishments, 1999

75% of all manufacturing establishments and employed less than 2 persons on average. Manufacture of textiles and furniture, non-metallic products and wood products were also significant activities.

- In the industrial sector, in terms of value added, the joint—venture and foreign owned business produced 69.5%, while the SOEs 17.7%, and the domestic private businesses produced only 12.8%, despite their great number.

### **III. Laotian SMEs and regional integration**

- The effects of joining AFTA

There is no specific study concerning the effects of GMS integration on Laotian economy. But a study of AFTA effects on Laotian economy<sup>7)</sup> has been done with the following conclusions:

- 1) Joining AFTA has the effect of decreasing import price and general price.
- 2) AFTA has the effect of increasing export ..., and by the same time increasing the import ... But the import increasing effect of AFTA is larger than that of export.

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7) Analyzing the effect of AFTA on Lao economy, macroeconomic model approach, by Phouphet KYOPHILAVONG,\* Faculty of Economic and Management, National University of Laos

Laos will face a larger trade deficit by joining AFTA.

3) The effect of AFTA on GDP: a decrease of general price and an increase of all real macroeconomic variables. However the effect of AFTA on GDP is very small, and in the end, Laos will gain few benefit by joining AFTA.

The 1<sup>st</sup> conclusion seems to be obvious, and it is a positive impact on Laotian consumers. From the 2<sup>nd</sup> and the 3<sup>rd</sup> conclusions, it was recommended to the government of Laos to guide the national economy towards a more export-oriented than an import- substitution economy which is the case of today. Sound environment for private domestic and foreign initiatives, needs to be established rapidly, in order to boost the local productions and services, in particularly local productivity, source of competitiveness.

· Difficulties facing Laotian SMEs

### **(1) Red tape**

The business regulations and official formalities are getting better and better. However, problems of bureaucracy still persist. Laotian private sector is still more constrained and Laotian trade is still more restricted than their competitors in the region. For example, business registration is still a relatively complicated and long procedure compared with the neighboring countries. This situation is eroding the entrepreneurial energies.

### **(2) Low entrepreneurial spirit and lack of management skills and knowledge**

The economic and trade liberalization started only 15 years ago after 14 years (1975-89) of centrally planned economy. During these 14 years, Laos was not prepared to work in a free market economy. The economics and management education did not trained young Laotians to face the situation of free market. In consequence Laotian SMEs have difficulties to move in the new environment.

### **(3) Problem of technology transfer and productivity**

As shown in a report of UNIDO in Lao PDR<sup>8)</sup>, the technical level of the manufacturing

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8) UNIDO International Yearbook of Industrial Statistics 2001 & 2000 and Ministry of Industry & Handicrafts/UNIDO survey of industrial establishments in Lao PDR, 1999

establishments, the value—added and the ratio labor cost/gross output per employee revealed that the productivity of Laotian labor force in the manufacturing sector is still very low and so is the competitiveness of the enterprises.

**Table 8: % of types of technology utilized by manufacturing establishments**

Country	Hi-Tech (%)	Medium-Tech (%)	Low-Tech (%)
Lao PDR	<b>11</b>	<b>15</b>	<b>74</b>
Nepal	9	17	74
Indonesia	18	37	75
Thailand	38	24	38
Malaysia	50	30	20

**Table 9: Value-Added and Ratio Labor Cost/Gross Output per Employee**

Country	LC, GO, VA per Employee (X 1,000 US\$/year)			LC/GO (%)
	LC	GO	VA	
<b>Lao PDR</b>	<b>0.4</b>	<b>5.0</b>	<b>1.9</b>	<b>7.6</b>
Nepal	0.4	5.2	2.1	7.4
Indonesia	0.9	14.7	5.8	6.2
Thailand	2.4	36.1	8.2	6.7
Malaysia	4.8	72.8	19.1	6.6

#### ***(4) Issue of information and information technology***

Information is the main support of the business making decision process. In Laos the access to any kind of information is still limited. People in general don't know where and how to look for information they need. Even the circulation of official regulations is not very fluid, between different official agencies and levels, and towards the business sphere. Beside, economics or business newspapers/magazines are almost inexistent. Few documentation centers are available in the country. Moreover the low level of foreign language's knowledge in particularly of English is a real barrier to information.

#### ***(5) Difficulty in accessing to financing***

There are difficulties for SMEs to access to financing. Banks are reluctant to lend to SME borrowers because the latter ones in many cases don't have tangible assets to provide as collateral to banks. The outreach of bank is still limited, in particularly in

provinces. There are several micro finance schemes operating in the country, but usually they are not economically efficient and would not be sustainable. SME owners themselves don't know how to elaborate good business plan and hold a good accounting record in order to increase the chance of accessing to finance.

・ So what should be done?

### ***Creating a conducive and enabling environment***

The first priority is to create a good macro—environment. In Laos, the government has a very important role for that purpose. It was the case of Japan. “On contrary to the French case, in Japan the government intervened more in favor of SME in the very first stage its development—”<sup>9)</sup>

Despite all, it is much easier to say than to do. The establishment of law and regulations that regulate the macro-environment is a dynamic process as the situation changes everyday. The country like Japan, where Trust Fund was created since the 1900' s to support SME, SME Agency in 1948 to implement the SME program adopted by the government in 1947, has to wait till 1999 to set a sound policy that really take into account the specificities of today SMEs<sup>10)</sup>.

In consequence, in Laos, the government, the public and private sectors have to work in close partnership, on a regular basis, to create that sound and stable environment in which SMEs can start—up efficiently (doing things right and quick) and effectively (doing right things), grow up and can become competitive in the local and regional markets. The existing regulations should be reviewed to make them more business—friendly and attractive for local and foreign investors. Specifically in Laotian case, regulations should be simplified in terms of content, procedures and coherence. The government should direct these efforts and ensure that there is a good co—ordination between different levels (parts of the public administration, the Capital, the provincial and the districts authorities), and different stakeholders. A good dissemination of regulations is necessary as well as periodical reviews of the regulations that were

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9) from the presentation on “Japanese SMEs” at Lao-Japan Center, 2002, by Prof. Shigeru MATSUSHIMA, Department of Management of Hosei University, Japan

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implemented.

“...the role of government is deemed to be to ensure a conducive and enabling environment. That is: sound and stable laws and policies, functioning property rights, including intellectual property rights (crucial for a knowledge—based economy), and appropriate infrastructure (transport, energy, communication) at an affordable cost. In particular, there was a need for simplified regulatory frameworks that can be instrumental in stimulating the transition of micro-enterprises from the informal to the formal sector. This is a key factor in LDCs. Developing good managerial and technical support services was also considered as an area for government attention, however, only in a catalyst role. Ultimately, markets for effective support services should be developed in the private sector. When there is a good enabling environment, a healthy public—private partnership will exist for this catalyzing function to come from the private sector. On this front, business associations should be both advocacy and lobbyists for SMEs and service providers to SMEs.”<sup>11)</sup>

### ***Improving access to information***

Information is the source of power, and it is truer in the era of globalization. Effort has to be made by the public—private partnership in order to facilitate the circulation and dissemination of information. There should be fluid information’ s communication between different governmental agencies, between different levels of administration (Vientiane Capital, provinces, districts) is to be improved; a better mechanism to inform Business enterprises, etc. For business people who need business information, specialized business magazines and business information centers should be available... Beside, as part of this growing digital world, attention must be paid to promoting information and communication technologies (ICT).

### ***Improving access to financing***

The following measures would be of great benefit for SMEs and the private sector in Laos:

- Development of new instruments such as credit guarantee schemes to help solving

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11) Second OECD Ministerial Conference on Small and Medium Enterprises, held in Istanbul 3-5 June, 2004.

the issue of insufficient collaterals for SME having good business projects.

“Guarantee schemes represent a well—tested method to assist small enterprises that are unable to meet the usual collateral requirements of commercial banks. The features and principles of successful guarantee programs seem to be these: willing and well—run banks; a formula for sharing risks between a guarantee agency and lenders that encourages the latter to participate, but which is also meaningful; clear criteria for loans which qualify for a guarantee, and a straightforward claims process so that there are no undue delays in paying claims”<sup>12)</sup>.

- Reinforcement and expansion of bank services to the provinces, the districts or even the big villages.
- Improvement of micro finance system in particularly in rural areas to make it cost-efficient, in line with the development objectives, and sustainable.
- Support service to SMEs, in particularly those in remote areas, to help them approaching the financial institutions: procedures, papers, business feasibility analysis and plan, etc.

### ***Making available the business support organizations.***

All types of supports are good for the country:

- Support from donors—government—private sector

The governments and the private sector organizations those considered to have the potential to develop quality support service, should work out together, with donor support, schedules for transferring and upgrading the SMEs’ services needed to the private sector organizations, and agree on how they can be financed.

- Private consultants

Consultants are very important for SMEs even in the developed countries. In Laos there should be a promotion of private consulting firms, local and foreign. However the cost of consulting services is relatively high.

- Support from educational and research institutions

In Laos, private consulting firms are growing. But at the present time, their qualified personnel are in limited number. So, academic staff of university and research

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12) Gerry Finnegan “ MICRO AND SMALL ENTERPRISE DEVELOPMENT & POVERTY ALLEVIATION IN THAILAND” Project ILO/UNDP: THA/99/003

institutions could be complementary in offering consulting service to the community. It is true that the analysis quality of the service could be a bit lower than the professional one provided by the foreign consultants, but Lao people have a better access to information; and it is frequent to see them working with their foreign counterparts for synergy.

- Support from large enterprises

It seems that such support is largely practiced in developed countries in particularly in UK. In Laos, it is still rare because there are few big companies. Lao Brewery Company subcontracts the rice planting to farmers who learn new techniques and benefit from assurance of the market for their product.

**Improving access to technology and innovation** (*technology upgrading and transfers of innovative technologies, ICT and e—commerce included*)

Laos has to boost the technology transfer from abroad into the country. This could be done by several ways: capital goods import, licensing, foreign direct investment. Due to limited funds and especially small number of qualified human resource, FDI seems to be a good alternative. This is the trend of technology transfer within East Asian countries and Japan<sup>13)</sup>: “During the period 1990–98, FDI has increased faster than trade (trade: 1.6 times, FDI: 3.2 times), and firms prefer FDI to licensing due to the difficulty to value advanced technology and to monitor its use. The technology transfer by FDI is made through (1) intra—firm and (2) local firms to host countries; both are important”.

However, if imported technology is necessary, in long—run Laos should be capable to generate creativity and innovation within the country. For that purpose, Laos should promote R&D by FDI; improve quality labor, engineers and researchers to assimilate technology from FDI; and of course create a FDI friendly environment.

From tables 10 and 11, it is clear that FDI inflow into Laos is very little compared to other ASEAN member countries.

**Developing human resource**

· Training business people

SME managers themselves, with the assistance of the government must prepare for internalization, by developing their knowledge about legal frameworks of the country

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13) Technology & FDI – East Asia and Japan, by Tsutomu Shibata, Adviser, WBI, Seminar on Private Sector Development and SME in Vientiane–Lao PDR, 14 June 2004.

Table 10: FDI inflows into ASEAN member countries, 1995-2001 (US\$ Million)

Host country	1995	1996	1997	1998	1999	2000	2001	1 <sup>st</sup> haft 2002	1995-2001
<b>Lao PDR</b>	<b>88.4</b>	<b>128.0</b>	<b>86.3</b>	<b>45.3</b>	<b>51.6</b>	<b>34.0</b>	<b>23.9</b>	<b>21.9</b>	<b>457.5</b>
Cambodia	NA	NA	NA	NA	NA	NA	NA	NA	1,101.4
Myanmar	317.6	580.7	878.8	683.6	304.2	208.0	192.0	N.A	3,164.9
Vietnam	1,780.4	1,803.0	2,587.3	1,700.0	1,483.9	1,289.0	1,300.3	450.1	11,943.9
Thailand	2,004.0	2,270.6	3,626.8	7,433.6	6,149.8	3,280.3	3,780.5	344.5	28,545.5
Brunei Daru.	582.8	653.6	701.7	573.3	747.6	549.2	526.4	216.4	4,334.6
Indonesia	4,346.0	6,194.0	4,678.0	-356.0	-2,745.1	-4,550.0	-3,278.5	-1,172.3	4,288.4
Malaysia	3,007.0	3,698.3	2,956.0	1,766.2	1,988.5	786.1	-1,937.4	-97.6	12,264.6
Philippines	1,577.0	1,618.0	1,261.0	1,718.0	1,734.0	1,354.0	1,537.0	1,342.2	10,799.0
Singapore	9,686.2	8,608.2	12,836.4	8,214.6	12,825.2	5,389.1	8,583.1	N.A	66,142.8

Source: *ASEAN Statistical Yearbook, 2003*. Notes: 1. Negative sign means disinvestment.

Table 11: FDI inflows into ASEAN Member Countries from Japan, 1995-200(US Million)

Host Country	1995	1996	1997	1998	1999	2000	2001	1 <sup>st</sup> haft 2002	1995-2001
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Brunei Darus.	6.1	7.4	7.2	6.9	5.6	5.4	4.3	24.4	42.9
Cambodia	NA	NA	NA	NA	NA	NA	NA	NA	NA
Indonesia	1,750.9	1,828.6	1,597.2	-153.8	-1,134.8	-1,717.4	-1,101.5	-246.9	1,069.3
<b>Lao PDR</b>	<b>0.8</b>	<b>0.3</b>	<b>4.1</b>	<b>7.0</b>	<b>0.8</b>	<b>1.6</b>	<b>0.6</b>	<b>0.2</b>	<b>15.4</b>
Malaysia	450.1	390.8	490.5	308.0	241.6	41.7	-715.9	28.6	1,206.8
Myanmar	0.4	15.6	18.9	33.5	18.8	16.3	7.7	0.0	111.2
The Philippines	683.1	527.3	404.6	353.7	133.0	49.2	139.8	586.7	2,290.5
Singapore	680.8	1,503.2	2,505.6	1,633.2	1,146.5	459.2	1,104.2	0.0	9,032.7
Thailand	556.5	523.6	1,348.0	1,484.7	488.4	869.9	1,373.7	307.1	6,644.7
Vietnam	134.3	158.6	433.9	383.8	400.5	139.2	87.5	39.1	1,737.7
<b>Total</b>	<b>4,263.0</b>	<b>4,955.4</b>	<b>6,810.0</b>	<b>4,056.9</b>	<b>1,300.3</b>	<b>-135.0</b>	<b>900.5</b>	<b>739.2</b>	<b>22,151.2</b>

Source: *ASEAN Statistical Yearbook, 2003* - ASEAN Secretariat: ASEAN FDI Database.

Notes: 1. Negative sign means disinvestment.

and abroad, their management knowledge and skill, their management information system, their human resources, and upgrade their internal technological and organizational capacity to international standards, etc. in order to compete in the more and more open international markets. In many parts of the world, training and exchange of practical lessons are recognized as very helpful for business start-ups or growth, and there is an opportunity for people who wish to launch new business activities to be prepared beforehand.

- Teaching entrepreneurial spirit at schools and universities

Entrepreneurship spirit has to be promoted and nourished in schools and universities. From that perspective, Laos should intensify the triangle interaction between: (1) government (in interaction with donors and international agencies), (2) business community, and (3) educational and research institutions (NUOL, NERI, Research Institute of MOC, educational institutions, etc.), in order to build up a good R & D foundation.

### ***Building appropriate infrastructure***

Beside, there should be investments to improve the infrastructure of the country: roads, bridges, electricity, water, telecommunication, etc.. In the case of Laos, landlocked country, it is a very important factor for competitiveness in terms of cost for exporting businesses. The foreign investors pay also very much attention to it, before making any investment's decision.

Despite great efforts, the country infrastructure has to be more improved because it is still weak compared with the one of the neighboring countries.