# BOOSTING QUALITY AND EFFECTIVITY OF SMES CLUSTER THROUGH INVESTMENT-BASED FINANCIAL ASSISTANCE APPROACH IN ASEAN

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## ABSTRACT

ASEAN which is filled by developing countries majorly, are vulnerable to crisis threats due to global economic sentiment. Therefore, the development of strong economic sectors is a necessity for countries in ASEAN. One of the most important economic sectors playing a major role in economic sustainability of developing countries is SMEs. Countries that had been hit by an economic crisis like Indonesia had proven the role of SMEs as the last weapon to end the crisis. The robust development of SMEs in ASEAN is a sign of a strong ASEAN economy realization. One of the hard challenges faced in the development of SMEs is the financial difficulties of business units. Financial aid which has only been dependent on government budget is one of the reasons for the sluggish evolvement of SMEs in the majority of developing countries in ASEAN. In this paper, we examine if financial assistance in terms of investment-based model performed by SMEs connected by clusters on B2B model could avoid financial constraint for the solution to the problem of SMEs financial difficulties. With this financial assistance model, there will be financial support between business units with a reciprocal relationship in a cluster. This method will encourage the growth of SME in productivity. The study shows the evidence of financial aid through investment-based indicates positive impact to strengthen the economy of ASEAN countries through SMEs. Therefore, our study recommends that investment-finance shaping has a good prospect for SMEs.

**Keywords:** SMEs, Investment-based model, Financial assistance, Productivity, Economic crisis

## 1. INTRODUCTION

According to the United Nations (UN), SMEs are a source of employment, competition, economic dynamism, and innovation; they stimulate the entrepreneurial spirit and the diffusion of skills. Because they enjoy a wider geographical presence than big companies, SMEs also contribute to better income distribution. Small and medium-sized enterprises have proven to be resilient amidst crisis (Bank Indonesia, 2015). Data from BPS Statistics Indonesia has shown that post-1998 economic crisis, SMEs has in fact increased in number *(Id.)*. Accordingly, in the mid-1990s Philippine SMEs appeared to have recovered after hit by deep economic crisis in 1980s, although not vigorous enough to boost Philippines economy in 1998 crisis (Berry and Rodriguez, 2001). Moreover, SME development could play an important role in fostering inclusive growth over mid-to long-term (OECD, 2018). It is due to SME constitute of 97 to 99% of total registered enterprises in most economies and the population is typically highly diversified *(Id.)*

Despite having a vital role in economies sector, SMEs still struggle in terms of financing. A study in PRC and several ASEAN countries suggest that SME status has a significant large and negative economic influence on bank borrowing and line of credit availability (Wignaraja and Jinjarak, 2015). More than 50% SMEs in ASEAN has financial shortage in investing technology, wider-market recognition, and tightening competition in markets. Thus, they have the difficulties on boosting business performance (EY, 2018). One of the hard challenges faced in the development of

SMEs is the financial difficulties of business units. Most of the financing resource they have obtained is from banks. SMEs have to gain more collateral to assure banks to give them loans so that they have the ability to maintain loans. Not all of them are accepted by banks to have loans. Some who are rejected apply for financial assistance to the government. Financial aid which has only been dependent on government budget is one of the reasons for the sluggish evolvement of SMEs in the majority of developing countries in ASEAN. Therefore, SMEs in ASEAN should have another alternative in financial support.

The paper focuses mainly on the access to finance issues happening SMEs in the Philippines and Indonesia. The two countries (representatives of ASEAN) taken due to apple to apple condition of the SMEs. This paper is divided into 3 sections. After the introduction, section two discusses the difficulties SMEs of Philippines and Indonesia have faced in raising funds and current sources of SMEs finance. The final section presents the scheme of investment-based financial assistance worked in a cluster in ASEAN

## 2. METHODOLOGY

This paper shows the innovation of the new alternative way in raising fund through investment-based financial support in B2B model. The methodology used in writing this paper is qualitative approach. In this paper the subjects are Indonesia and Philippines as the representatives of ASEAN examined its credit performances and their productivities. Source of the data in this paper come from various journals and literature.

## 3. CONTENTS

**Table 3.1 Initial and Current Funding Sources for SMEs Based on Surveys (%)**

| | Initial Funding (%) | | Current Funding (%) | | | |
|---|---|---|---|---|---|---|
| Source | SERDEF 1992 | NATCCO 1998 | SERDEF 1992 | WBES 2000 | ICPS 2004 | PEP 2006 |
| Own resources | 79 | 53 | 78 | 52 | 60 | 69 |
| Bank loans | 10 | 19 | 15 | 21 | 11 | 19 |
| Informal credit | 11 | 28 | 7 | 27 | 29 | 12 |
| Total | 100 | 100 | 100 | 100 | 100 | 100 |

Source: Nangia and Vaillancourt (2007)

Table 3.1 above shows that about 53% to 73% gained their financial resources from initial funding. 10% to 19% SMEs relied their financial aid on banks, 11% to 28% chose to have loans on informal credits. We can say that the largest proportion of financing business performance of SMEs is internal source. SME owners, family, relatives play a big part in this kind of support. Only a small proportion SMEs gain loans from banks. Since their financial resource is from the internal financing only, they cannot expand their business bigger and stronger. In the amidst of financial lacking condition, Philippines needs to promote its brand due to limited brand recognition in the intense market competition.

Most of SMEs face the difficulties in borrowing money from banks. Collateral requirements and time process on applying loans are the major problem in reaching banks as a loan provider. Banks cannot accept their loans application because it is a high-risk loan because SMEs have financial management insufficiency. SMEs are not also keen on asking for loans because banks charge high interest rates on loans and lacking information on funds.

Data from Indonesian Ministry of Co-operatives and SMEs, which is quoted by OECD, have provide a first estimate of Indonesia's SMEs productivity. At current prices, GDP per worker in micro enterprises was 3% of GDP, small and medium-sized enterprises was 16% of GDP and large enterprises was 31%. OECD suggest that economic growth in Indonesia has mostly been driven by other factors, since the productivity growth net of inflation over the period 2006-2013 was modest. Productivity levels in Indonesian SMEs are still low compared to other emerging-market economies.

SMEs in Indonesia rely on obtaining credit from banks. From 2011 to 2015, nominal account of credit to SMEs increase over time. Yet its proportion is small compared to credit to non-SMEs. In 2015, Bank of Indonesia imposes a rule for banks to allocate 20% of its credit to SMEs. However, this target is hard to achieve, since there are more lucrative credit segments for banks to pursue (Yudistira, 2018).

Credit to SMEs in Indonesia is concentrated in retail sector, which totaled for Rp482,635 billion. Processing industry come in second place which accounted for Rp95,998 billion and then agriculture for Rp 89,199 billion. These financing is obtained for working capital (BPS, 2018). If SMEs can obtain more funding, it could invest more in buying asset and increasing its productivity.

## 4. SCHEME

Investment-based financial assistance in B2B model works when there are two or more parties (SMEs) becoming debtors and the others becoming creditors. The one who being the debtor may need a help in financial aid when the banks have no ability in giving loans because the SME debtor lacks of the amount of collateral required to apply for loans. The SME debtor may end up in asking the government and internal sources to obtain the money. When government and internal sources have bad performance in financing the business, The SME debtor can take investment-based financial assistance as the alternative to gain financial assistance. SME debtor is allowed to apply for loans in the area of its clusters.

Firms who have excess cash can lend their money and act as creditor. Therefore, they can gain more income through receiving interest and maturity payment. This gain could be received in the form of commodity produced by the debtors. It could also be in cash depending on the commodity price. This model is illustrated in Figure 1.

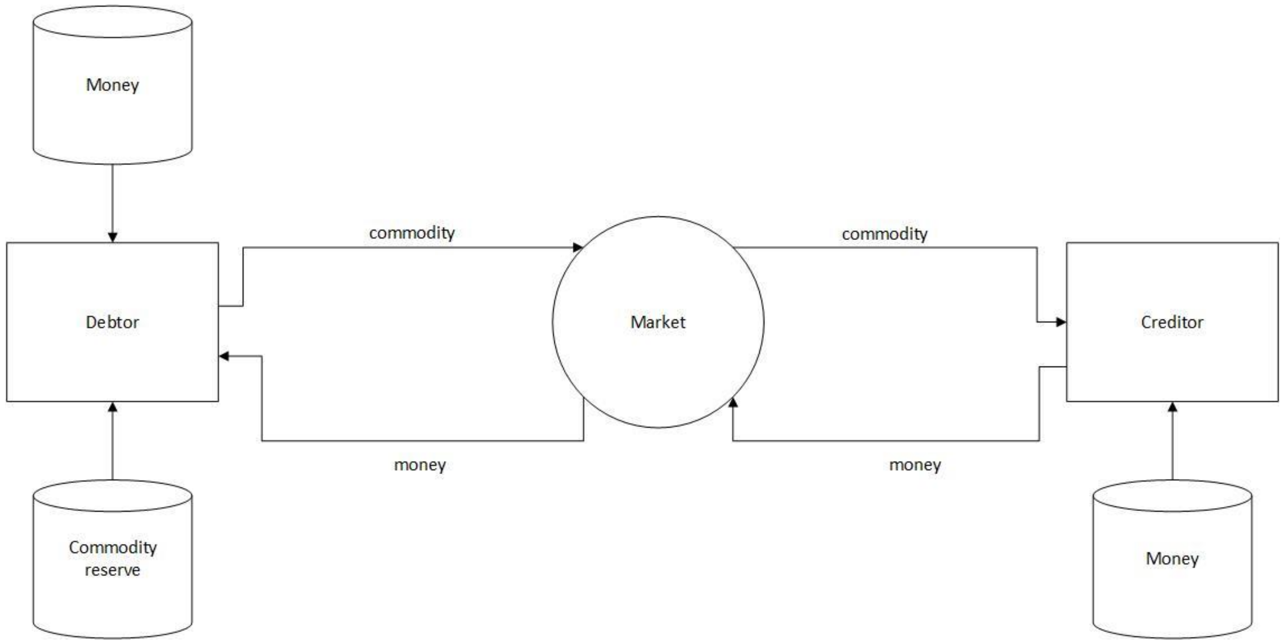


**Figure 5 Investment-based Financial Assistance Scheme**

Loan agreement should be discussed by debtor and creditor. The agreement should specify the value of the loan that could be given as well as the maturity date. It should also decide how the principal shall be paid and how much interest will be paid. If the principal and interest would be paid in cash, its value should be stated equivalent to the price of certain quantity of commodity instead of effective interest rate. Whereas for loans paid in commodity, the agreement should specify the quantity of commodity to settle the loan.

## 5. CONCLUSIONS

Investment-based financial assistance will be beneficial for SMEs who struggle to provide collateral. Instead of interest-based loans, this investment-based financial assistance would rely on the value of commodity produced by the debtors. This scheme also be beneficial for SMEs who would like to make investment.

There are limitations in this investment-based financial assistance scheme. This investment-based financial assistance works best for SMEs in production sectors. Since its interest and maturity should be paid with commodity produced by the debtor or paid in cash with the same value as the commodity produced by debtor, retail and service SMEs may not be suitable to apply this investment-based financial assistance.

The use of commodity's value as measure could also poses risk to both creditor and debtor. Price volatility of the commodity will also cause the value to fluctuate. Thus, it could be hard to predict how much revenue or expense would be recorded by both sides. However, this risk may not be big for commodities which do not fluctuate in price. Further studies should also be made to explore the most appropriate way to assess the debtor risk in this scheme.

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