

INTERNATIONALIZATION OF MICRO, SMALL AND MEDIUM ENTERPRISES (MSMES) IN ASEAN

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Abstract

Micro, small and medium enterprises (MSMEs) account for mass shares of employment and GDP of the ASEAN region, involving, to date, Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Viet Nam. MSMEs play an important role in the regional production networks established by the multinational enterprises (MNEs), serving as subcontractors and suppliers of various inputs to value chain. MSMEs originated in ASEAN tend to internationalize through, among others, direct/indirect exports, licensing, franchisings, and contract manufacturing with MNEs.

The main objective of the article is to indicate the role of MSMEs in the ASEAN region, that established economic community in the end of 2015 with a single market and production base, major drivers of MSMEs' internationalization, as well as challenges to MSMEs' internationalization.

Key words: micro, small and medium enterprises (MSMEs), internationalization, ASEAN

JEL Code: F23, L22, L26, R12

Introduction

Micro, small and medium enterprises (MSMEs) play significant role in the economy of ASEAN (Association of Southeast Asian Nations), involving, to date, ten regional states, namely, Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Viet Nam. MSMEs' dominance in numbers is accompanied by rising shares in the regional GDP and employment, contributing to regional integration through implementation of ASEAN Economic Community (AEC) project. AEC, established in the late 2015, assumes transformation of the region into the single market and production base, whereas MSMEs may act as building blocks in intra-regional value chains (see also: Bobowski 2017, 31-61).

MSMEs serve large multinational enterprises (MNEs) as subcontractors and providers of inputs in the regional production networks through arm's length transactions and contractual arrangements. Thus, they contribute to the development of supporting industries as critical FDI trigger, while improving the countries' investment environment.

Internationalization of MSMEs tends to be a challenge mainly due to limited access to capital, market information and aversion to risk, however, the extent of MSMEs' internationalization differs depending on the home-country's policy, presence of the home-grown brands, characteristics of industry of origin, as well as MSMEs' culture of internationalization.

Major forms of internationalization of MSMEs from the ASEAN region are as follows: exports, international licensing, franchising and contractual arrangements – both in manufacturing and services – with intra- and extra-regional MNEs.

The aim of the paper is to indicate the role of MSMEs in the ASEAN region, major drivers of MSMEs' internationalization, as well as challenges to MSMEs' internationalization.

1. Review of the literature

There is no single, widely recognized theory of internationalization in economics, however, it may be understood as the process of rising engagement of the enterprise on the international market, related to regular cross-border activities in various forms and due to multiple motives. In internationalization studies both trade theories may be considered ie. absolute cost advantage theory by Smith, comparative cost advantage theory by Ricardo, Heckscher-Ohlin model, market imperfection theory by Hymer, Kindleberger and Caves, Leontief paradox, location theory, as well as traditional approaches and future theories ie. diamond model by Porter, eclectic paradigm by Dunning, foreign direct investment theory, technology gap theory by Posner, product life cycle theory by Vernon, internalization theory by Buckley and Casson, monopolistic advantage theory by Hymer, transaction cost theory, as well as Uppsala model. The latter is a theory that provides reasoning behind gradual intensification of the enterprise's activities on the foreign markets. According to this model, prior to internationalization, enterprises collect experiences on the domestic market, initiating their foreign activities on the proximate markets both in geographical and cultural terms, addressing distant markets gradually. An expansion of the company's market portfolio may trigger the evolution of the foreign operation modes – from traditional exports, toward more

intensive and demanding contractual or non-equity modes such as franchising, licensing, subcontracting arrangements, and foreign direct investment (FDI), ie setting up a subsidiary company specializing in sales or distribution, or manufacturing plant (DaSilva and Trkman 2014, 379-389; Eriksson et al. 2000, 307-328; Vahlne and Johanson 2013, 189-210). The presented model has become the starting point for further consideration and, consequently, the creation of innovative models, according to which the decision to enter foreign markets is considered as an innovation in the functioning of the company, as well as unconventional internationalization, where the company does not go through successive stages of internationalization, as well as simultaneous internationalization, that assumes the unification of markets and the disappearance of cultural differences on a global scale (Gorynia and Jankowska 2007, 31-33). Criticism of the Uppsala model includes, among others, the so-called born globals, then, enterprises that become global at the initial stage of existence, skipping the phased model of internationalization, and rising importance of the network approach in international business. The assumption of this model is opposed to the Uppsala model, and constitutes a departure from the dominance of the individualist behavior of a company to perceive it as an element within a broader network.

Analogically, there is no single definition of MSMEs among the member states of ASEAN, mainly due to diversified level of development. Consequently, it is hard to assess the dynamics of MSMEs sector, its development and internationalization ie. in statistical terms, as well as its contribution to regional economic integration. For instance, Lao PDR, Myanmar and Thailand do not recognize micro enterprises, while Singapore – micro and small enterprises, in legal terms. Interestingly, Brunei Darussalam categorizes micro, small and medium enterprises only in terms of number of employees (less than 4, 19 and 99, respectively), while Philippines – only in terms of the size of assets (less than 3, 15 and 100 million PHP). Whereas Brunei Darussalam, Cambodia, Myanmar, Singapore, Thailand and Viet Nam skip the criterion of the size of turnover, Malaysia omits the criterion of the size of the assets. Malaysia, Myanmar, Thailand and Vietnam diversify thresholds for MSMEs depending on their type, for instance, manufacturing and service enterprises (Malaysia), manufacturing, labour-intensive manufacturing, retail, services (Myanmar), manufacturing, retails, other services (Thailand), manufacturing, services (Viet Nam). For instance, according to Malaysian law, manufacturing enterprise of the medium size employs less than 200 persons, service enterprise – less than 75 persons, while retail enterprise of the small size in

Myanmar employs less than 30 persons, labour-intensive manufacturing – less than 300 persons (ASEAN Secretariat 2015, 16-18)¹.

2. The role of MSMEs in the ASEAN region

According to ASEAN Secretariat, MSMEs account for 88-99 percent of all establishments in the ASEAN region, 51-97 percent of total employment, 23-58 percent of GDP, as well as 10-30 percent of exports. Domestic policies of the ASEAN member states aimed at promotion of MSMEs' development and internationalization are heavily supported at the regional level through, among others, „ASEAN Economic Community Blueprint 2025 on Equitable Economic Development“ and the „ASEAN Strategic Action Plan for MSME Development, 2016–2025“. The latter document lists actions and goals to be pursued till 2025 for the purposes of strengthening ASEAN MSMEs' capacities and development in the areas as follows: promoting productivity, technology and innovation; increasing access to finance; enhancing market access and internationalization; enhancing policy and regulatory environment; promoting entrepreneurship and human capital development (ASEAN Secretariat 2015, 8-11).

In the context of ASEAN MSMEs' internationalization the first and third area should be addressed particularly. Namely, rising productivity and technological capacities are recognized as key drivers of integration with the production networks established by MNEs in the region. Thus, it has been found as necessary to enhance industrial linkages among MSMEs as well as among MSMEs and MNEs, and to promote technology and industry clustering. Regarding the market access and internationalization issues, MSMEs tend to lack technical knowledge required to enter global value chains and contribute to a larger extent to exports. Therefore, it is recommended to develop information platforms addressing regional and global markets, to promote partnerships with MNEs, to enhance the use of e-commerce, last but not least, to promote adoption of international standards of quality. Moreover, capacity-building programmes are promoted for the purposes of stimulating the exports.

3. Major drivers of MSMEs' internationalization

MSMEs may decide to internationalize, following similar motives and reasons, both active and proactive, as larger enterprises. As such, internationalization might be found as natural

¹ In general, when studying MSMEs in the ASEAN region, there is a tendency to assign an upper limit of employment – namely, 250-300 persons, while addressing national definitions and thresholds only if necessary.

attribute of the company's growth and its transformation into MNE, starting with enterprises of limited size operating on the highly profitable and technologically advanced niche markets. On the other hand, majority of MSMEs will not internationalize due to lack of such a necessity (optimal size of the company's activities within domestic market), lack of appropriate capacities to expand abroad, including various tangible and intangible resources such as capital, skilled personnel and market information, aversion to risk related, for instance, to domination of MNEs on the foreign markets.

Among major drivers of MSMEs' internationalization in the ASEAN region there are push, pull and neutral factors. Push factors address specificity of the domestic market, that enhance enterprises to seek for opportunities ie. markets, resources overseas due to, for instance, stagnation or intensive competition on the home-market, while pull factors relate to various opportunities and incentives provided by the foreign markets such as access to technology, raw materials, cheap labour forces, unique institutional and strategic resources (Susman et al. 2007, 104-106). In other words, push factors account for outflows while pull factors – inflows at crossborder scale².

Furthermore, proactive, active and neutral motives of MSMEs' internationalization are distinguished. Namely, proactive enterprises may be pushed to foreign markets to maximize their advantages or upgrade the skills, while being pulled by those overseas markets that provide opportunities in these fields, whereas reactive one may be pushed by intensive competition within domestic market or pulled by foreign business partners and clients. Proactive enterprises used to be the so-called entrepreneurial MSMEs, seeking for foreign markets, resources, technologies, as well as opportunities to enter regional and global value chains that would classify them as business frontiers. On the other hand, reactive enterprises used to be those traditional MSMEs, fuelled by more defensive triggers, placing themselves somewhere on the „backseat“ of a business, however, with possibility to become entrepreneurial if reorienting on the more creative, innovatory vision, leadership, resources, and capacities³.

² For instance, many MSMEs originated in Brunei Darussalam and Singapore may be pushed by their relatively smaller domestic markets, while being pulled by larger emerging economies of Indonesia and Thailand.

³ The latter category, then, neutral factors. involve development of information and communication technology (ICT), as well as the phenomenon of born globals, then, enterprises established as global due to characteristics of the niche markets, that tend to be technologically advanced and knowledge-intensive. Consequently, scarce strategic resources possessed by born globals enable them to expand internationally in such a rapid manner, that conventional sequence of internationalization may be skipped or at least drastically accelerated. Importantly, high-speed internationalization of born globals might be enhanced by scarcities faced within home-market,

Just like in case of large enterprises, MSMEs' potential of internationalization differs depending on the specificity of the company, industry and the macro-environment of the home-country. More frequently, combination of push and pull factors encourages enterprises to internationalize, and to invest abroad, making them either market-seeking, resource-seeking, strategic-seeking or efficiency-seeking business operators. In order to minimize the risk enterprise may decide on exports to benefit from the economies of scale or decide whether to license or franchise brand, technology or expertise to the foreign entity or to enter overseas market with capital or equity investment, if such a presence is needed. In case of ASEAN MSMEs, both market-seeking internationalization⁴ and foreign direct investment tend to dominate these days.

MSMEs originated in the ASEAN region, when internationalizing through exports, frequently operate as both exporters, producers and subcontractors. Among numerous ASEAN MSME manufacture exporters there are, among others, Samatoa (producer, wholesaler), and Tatan Agrotech (agriculture) from Cambodia, CV Priskilla (producer), and Pandawa Eletrindo (LED lighting manufacturing) from Indonesia, Burapha Agro Forestry (teak and eucalyptus products) from Lao PDR, Green Solar Energy (solar panel manufacturing), and LTP Engineering Sdn Bhd (design, development and manufacturing of mechanical machines) from Malaysia, P. L. Myanmar Co. Ltd (lubricants and specialty chemicals manufacturing) from Myanmar, Quilter Philippines Inc (garment manufacturing), and Growl Corporation (OEM in-dash audio, video and navigation system) from Philippines, Benrico Systems & Electronics Pte Ltd (electronics manufacturing), and SKIMZ Singapore LLP (marine equipment manufacturing) from Singapore, Tanadol (OEM and design service),

related to specific technological resources, expertise or labour forces. Again, aforementioned ICT revolution might speed-up such a process.

⁴ Examples of market-seeking internationalization by MSMEs from the ASEAN region that entered both intra-regional as well as extra-regional markets are, among others, Java Offshore (oil and gas survey), ICT Group (steel), and Barong Batik (garments) from Indonesia, Efficient Technology (mechanical services to energy markets), and Technoprofit (engineering services) from Malaysia, Love and Madness (clothing), Human Nature (beauty and care products), and KLT Fruits (processing of tropical fruits) from Philippines, Vela Diagnostics (molecular solutions for infectious diseases), and Applied Total Control Treatment (metal finishing industry) from Singapore, ADI Group (human resource and recruitment agency), Zanroo (software), Cool Company (manufacture of commercial freezers, coolers, and cold chain products), and Quo Global (advertising and marketing agency) from Thailand, Phibious (brand marketing and communication consultancy) from Viet Nam, as well as Phoenix Voyages (tour and travel) from Myanmar and Viet Nam (ASEAN Secretariat and UNCTAD 2016, 110). Aforementioned firms used to penetrate foreign markets through establishment of marketing, trading, sales, or representative offices overseas, warehouses, service centers, distribution arrangements and partnerships with the local operators, however, in some cases, move toward contract manufacturing (eg. Cool Company) or combine market-seeking with strategic- or efficiency-seeking internationalization, acquiring such assets as niche skills and technologies overseas (eg. Barong Batik, Vela Diagnostics).

Siam Water Flame Co Ltd (hydrogen generator manufacturing), and N. I. K. Woods Limited Partnership (wood products manufacturing) from Thailand, Global Gowell Co Ltd (wood products manufacturing), and Vietnam Electronics and Telecommunications Technology (electronic and telecommunications manufacturing) from Viet Nam (ASEAN Secretariat and UNCTAD 2016, 119-121).

Noteworthy, there are many brands originated in the ASEAN region, that internationalized through franchising or joint ventures, such as Es Teler 77, and J. CO Donuts and Coffee from Indonesia, Old Town White Coffee, Secret Recipe, and Optical England from Malaysia, Jollibee from Philippines, BreadTalk, and YaKun from Singapore, MK Restaurant, and Coca Restaurant from Thailand (ASEAN Secretariat and UNCTAD 2016, 124). Beyond the ASEAN region, intra-regional brands tend to penetrate, among others, markets of China, India, Saudi Arabia, United Arab Emirates, Qatar, Australia and the United States⁵.

Internationalization through foreign direct investment used to be selected by the MSMEs originated in the more advanced ASEAN economies, ie. Indonesia, Malaysia, Philippines, Singapore, Thailand and Viet Nam. Among the target markets there are mainly intra-regional economies, as well as locations in Canada and the United States, addressing wide spectrum from low- to high-technology manufacturing industries, eg. electronics, cosmetics, metal design, pharmaceuticals, food and beverage, semiconductors, as well as services, eg. logistics, consulting, education and training, information and communication technology, research and development⁶.

⁵ Contractual service arrangements with foreign MNEs, embracing professional services, infrastructure development, engineering, application development and management, involve numerous ASEAN MSMEs, eg. Java Offshore (Indonesia), Mersing Group, NGLTech, and Technofit (Malaysia), EON (Philippines), AllAlloy, MahaChem, Vela Diagnostics, and InsightAsia (Singapore), QUO Global, and ADI Group (Thailand), as well as Synectics Consulting Corporation, and Phibious (Viet Nam). Among the clients of the aforementioned ASEAN MSMEs there are, among others, Petronas, BP, Coca Cola, Roche, Sanots Limited, Alstom, Toshiba, Danone, Nestle, Unilever, Michelin, Asahi, Fujitsu, Prudential, Volvo, Panasonic, Samsung, and Facebook.

⁶ The most innovative and internationalized MSMEs established in the ASEAN region are as follows: CMC (engineering consultants) from Malaysia, TSI (information and communication technology services) from Philippines, Freshening Industries (wet-wipe producer at the niche markets), and Numoni (social banking) from Singapore, as well as Baezeni (3D engineering services) from Thailand. Interestingly, some ASEAN MSMEs internationalize to follow the major clients, namely, MNEs – an example may be Directive Communications International from Indonesia, providing leadership development and organizational culture change solutions to, among others, Citibank, Emirates, Philips and Toyota. Interestingly, there are minor representatives of primary sector among foreign investors originated in the ASEAN region, for instance, Dao-Heuang Group (coffee production, processing and overseas sales) from Lao PDR, and Indonesian Thus Britmindo, providing mining services to intra- and extra-regional MNEs as subcontractor. The group of ASEAN MSMEs that internationalized through FDI involves also, among others, Sucofindo Appraisal (information technology and services), PT Petronesia Benimel (oil and energy), and PT Indonesia Bulk Carrier (logistics) from Indonesia, Datamicron System Sdn Bhd (business intelligence), N2N Global Solutions Sdn Bhd (R&D software), and

4. Major challenges to MSMEs' internationalization

When accessing foreign markets, MSMEs face various challenges and constraints that would potentially disadvantage even those more experienced and technologically advanced. Indeed, both nature, and the scale of the said barriers result of combination of internal enterprise's attributes as well as external factors, associated with characteristics of domestic and foreign market.

Major challenges to ASEAN MSMEs' internationalization are as follows: deficit of international managerial skills; functional constraints, with special regard to limited access to capital; information gap on foreign markets; government policies and regulations (Leonidou 2004, 279-302).

Deficit of international managerial skills used to be assigned to micro and small enterprises, with limited access to well-skilled and experienced staff that manifests itself in aversion to risk, change, as well as focus on survival, and domestic market. Functional constraints result of MSMEs' limited experiences and capacities in regards of addressing foreign markets' demand and standards, while discouraging potential creditors from lending to such enterprises due to higher risk of failure. Another issue is the information gap on foreign markets, including their characteristics, regulatory and institutional frameworks, trade and investment agreements impacting overseas business activities, as well as inability to process available data in appropriate manner, that results in inefficiency and additional pool of risks. The latter challenge relates directly to government policies and regulations, that may discourage MSMEs from internationalizing, namely, home-country restrictions imposed on exports, and outward FDI by local enterprises, as well as requirements set by host-markets in regards of the form of the foreign enterprise's market presence, for instance, establishment of subsidiary or joint venture with the local entity. There is also an issue of local competitors within foreign markets, equipped with unique local knowledge and domestic channels of distribution. The way the host government interferes in the market game, addresses the

Ecava Sdn Bhd (industrial automation) from Malaysia, IT Group Inc. (information technology and services), Techcel Inc. (outsourcing), and Chalre Associates Executive Search (staffing and recruiting agency) from Philippines, 99.co (internet real estate search operation), Achieve Group (staffing and recruiting agency), and Dalwin Marine (mechanical and industrial engineering) from Singapore, QUO Global (marketing and advertising), Travex Group (leisure, travel and tourism), and Movaci (information technology and services) from Thailand, as well as IMT Solutions (software outsourcing), Fresh Studio (food and beverages), and Synectics Consulting Corporation (construction) from Viet Nam (ASEAN Secretariat and UNCTAD 2016, 137-140).

fairness of rivalry, and treats foreign business operators will obviously affect internationalizing MSMEs, their strategies, as well as schemes of operation.

MSMEs planning to internationalize are expected to build up and upgrade their resources, skills and experiences, but also to seek for support both at home and abroad from the government, advisory agencies, banks and various consultants. Information and financial gaps tend to be more and more frequently addressed by venture capital funds and private equity investors operating in the ASEAN region, aimed at investing in the fast-growing enterprises, including MSMEs⁷.

Noteworthy, more and more born globals emerge in the ASEAN region, consuming opportunities related to digital technological, and policy developments, improved access to information and both intra- and extra-regional venture capital funds. Many of them are termed as frontier tech companies within their home-markets, eg. Orami, and HappyFresh from Indonesia, Grab, and FashionValet from Malaysia, Garena, and ZALORA from Singapore, as well as CleverAds from Viet Nam. It seems that the establishment of AEC may ease intra-regional operations of born globals, while accelerating internationalization of start-ups originated in the ASEAN region.

Conclusion

⁷ Undoubtedly, the size and relative importance of various constraints, as well as supportive government policies differ within ASEAN region, depending on, among others, the level of economic development, quality of business environment, structure of the economy. Thus, MSMEs considering internationalization, originated in Singapore and Malaysia, have an access to much more extensive set of solutions and instruments, when compared to those established in Cambodia, Lao PDR, Myanmar or Viet Nam. Among the top 10 venture capital firms operating in the ASEAN region in years 2014-15 there were as follows: Tiger Global Management (3 deals, aggregated value of transactions – 415 mln USD), Coatue Management (1 deal, 350 mln USD), Rocket Internet (3 deals, 274 mln USD), Square Peg Capital (2 deals, 260 mln USD), TPG (2 deals, 260 mln USD), Verlinvest (1 deal, 249 mln USD), Kinnevik (1 deal, 249 mln USD), Sequoia Capital (7 deals, 200 mln USD), Vertex Venture Holdings (9 deals, 120 mln USD), 500 Startups (45 deals, 108 mln USD). When combined, top 10 venture capital firms invested 2,5 billion USD in 74 start-ups in the ASEAN region, the largest number of deals was made by 500 Startups, while Tiger Global Management reached the highest aggregated value of transactions. The five largest venture capital deals in years 2014-2015 addressed four start-ups established in Singapore (GrabTaxi, taxi hailing application, value of transaction – 350 mln USD; Lazada, e-commerce, 249 mln USD; PropertyGuru, property portal, 130 mln USD, Giosis, e-commerce, 82 mln USD), as well as one from Indonesia (Tokopedia, e-commerce, 100 mln USD). Aforementioned five deals involved investors as follows: Tiger Global, Coatue Management, TPG, and Sequoia Capital from the United States, Softbank from Japan, Rocket Internet from Germany, Kinnevik from Sweden, Verlinvest from Belgium, Square Peg Capital from Australia, Temasek Holdings, and Singapore Press Holdings from Singapore, as well as China Investment Corporation from China (ASEAN Secretariat and UNCTAD 2016, 118).

The role of MSMEs in the ASEAN region proved to be significant, both in terms of GDP shares, exports and employment. Internationalization of MSMEs tend to address numerous drivers and triggers, while being challenged by various obstacles and constraints.

Next to government programs both at national, and regional level of ASEAN aimed at support of MSMEs' development and internationalization, there is an important role of MNEs operating within the ASEAN region, that enhance MSME's internationalization through inclusion of those into the regional, and global value chains.

The establishment of AEC may contribute to further expansion of MSMEs within the region, diminishing functional obstacles, ie. financial constraints, as well as information and skill gaps, while contributing to emergence of born globals and start-ups operating in the high technology industries. Consequently, more better paid jobs would be delivered, lifting up the wealth of regional nations.

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