

Policy Brief

Empowering Micro Businesses in Southeast Asia: Addressing Challenges and Harnessing Opportunities for ASEAN Economic Integration

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Key Messages:

- Micro, small, and medium-sized enterprises (MSMEs), comprising 99% of Southeast Asia's private sector, are mainly microbusinesses, often family-run and informally operated, posing challenges for data capture.
- Despite their significance as primary or supplementary income sources, microbusinesses, especially those managed by youth and women, often lack social and legal protections due to their informal status.
- In the new Association of Southeast Asian Nations (ASEAN) Economic Community Strategic Plan Post 2045, microbusinesses should be prioritised separately from small and medium-sized enterprises, necessitating more accessible data.
- Microbusinesses are pivotal in driving and benefiting from the region's connectivity, necessitating enhancements in digitalisation, transportation, and regulatory support.
- Strengthening digitalisation and connectivity, coupled with skills training, will better equip micro businesses for success.

Micro, small, and medium-sized enterprises (MSMEs) form the backbone of Southeast Asia's private sector, with microbusinesses comprising a significant majority. However, many operate informally, posing challenges for state recognition and assistance, particularly when youth manage these enterprises. More available data are needed to prioritise microbusinesses within economic policy. Nonetheless, microenterprises stand to benefit significantly from the region's robust digital, transportation, and cultural connectivity, making enhancements in these areas crucial for their success. To address these challenges, policy recommendations focus on empowering youth in the micro-economy through digital inclusion initiatives and greater participation in decision-making processes. Additionally, enhancing cross-border payment systems is essential for promoting innovation and digitalisation in payment systems. Standard harmonisation, the adoption of shared data frameworks, and regulatory frameworks are necessary for facilitating faster cross-border transactions and minimising disruptions in payment systems.

Introduction

Since 2016, the Association of Southeast Asian Nations (ASEAN) Coordinating Committee on Micro, Small and Medium Enterprises (ACCMSME) has launched numerous significant initiatives that have provided direct and indirect advantages to MSMEs in the area by executing programmes, establishing supportive infrastructures, and facilitating exchanges of beneficial policy practices within and across regions. Currently, Southeast Asia hosts over 70 million micro, small, and medium-sized enterprises (MSMEs), employing more than 140 million individuals and representing 99% of all businesses in the region. Within each ASEAN Member State (AMS), where data is available, 40% and 99% of MSMEs are categorised as microbusinesses (Schaper, 2020). These enterprises serve as crucial drivers of job creation, social stability, and livelihood sustenance for millions across the region.

Each AMS employs varying definitions for microbusinesses. Different countries and government departments utilise diverse criteria to classify such enterprises. These criteria may encompass qualitative and quantitative aspects, including the number of employees, annual turnover, industry sector, asset base, and legal structure of the enterprise (ASEAN, 2024).

Absence of a Standard Definition

According to ACCMSME, ASEAN allows for different definitions of MSMEs (ASEAN, 2024). The latest definition of MSMEs adopted by ACCMSME was on 23 January 2024, in which each AMS differs from one another in terms of the number of employees, annual revenue, sales turnover, and total capital. This results in the absence of a standard definition, making it difficult and tenuous to quantify the number of microbusinesses in the region.

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Furthermore, most of these enterprises need to be registered formally. Issues such as the absence of a clear understanding of what constitutes an informal enterprise (totally or partially informal) – combined with the lack of statistical data, business surveys, and a good understanding of the informal and semi-formal business sector – are significant hindrances to evidence-based and promising regulation to encourage business formalisation. Acknowledging the need to understand and capture these enterprises better, the Organisation for Economic Co-operation and Development (OECD) and ASEAN conducted a study on formalising microenterprises in the region (OECD and ASEAN, 2020). The study defined micro and small businesses as enterprises owned by one person or a family or that fall under a formal definition of microenterprises applied in that AMS. Typically, they are not registered (or loosely registered) and lack a clear legal status, particularly in countries where registration coincides with corporatisation, and thus are considered informal (or quasi-formal). They often employ less than 10 employees and rely heavily on family members (ASEAN, 2020).

Microbusinesses as Drivers and Primary Beneficiaries of ASEAN Connectivity

Microbusinesses constitute the largest sector in the region and are intricately linked to the economic circumstances of the population. They play a crucial role in ASEAN connectivity, deeply interwoven with people's social and cultural engagements, serving as essential components of a more integrated regional economy. However, a significant characteristic of the region is that most microenterprises are driven by necessity rather than opportunity. Entrepreneurs or individuals typically start these businesses with limited alternatives. Consequently, many of these enterprises are not formalising their operations.

Digitalisation is having a significant effect on the way microenterprises operate. In Southeast Asia, the uptake of digital services and applications, especially e-marketplaces and e-commerce, has grown exponentially. The rapid diffusion of mobile broadband enables more people and microbusinesses to be connected. According to the 2021 World Economic Forum report on ASEAN digital generation (World Economic Forum, 2021), with more than 70% of its youth respondents expressing a high demand for digitalising finance, there is a high demand to further digitalise finance, especially amongst MSMEs. Some 66% of respondents identified payments as a critical area for further digitalisation, while 43% wanted to digitalise the loan/financing process further.

Youth comprise the largest segment of MSME employment across AMS. Many studies indicate that ASEAN youth are intensely interested in entrepreneurship and adopting digital technologies (World Economic Forum, 2021). Youth represent a crucial demographic for the success of ASEAN economic integration due to their strong identification with ASEAN identity, inclination towards digitalisation, and central role in the MSME sector – the

largest economic sector in ASEAN. In 2020, the ASEAN region boasted a youthful population of 224.2 million, with 53% classified as Generation Z (aged 15–25) and 47% as millennials (aged 26–35). This demographic trend is anticipated to peak in 2038 (ASEAN, 2022a). With ASEAN youth's strong identification with ASEAN identity (ASEAN, 2021) and their preference for digital business practices, there is an opportunity for ASEAN to enhance economic integration in the region by harnessing the potential of youth in microbusinesses.

Opportunities and Challenges

ASEAN has been working towards creating a single market and production base, which could benefit MSMEs by increasing trade, investment, and economic cooperation amongst Member States. Initial obstacles to economic integration include widespread import substitution policies; small intra-ASEAN trade; and wide differences in economic size, development level, and industrial competence (Chia, 2013). Hence, there is a need to intensify, promote, develop, and provide safety nets to strengthen the MSMEs.

The digital divide remains a significant issue in the ASEAN region. While internet penetration and coverage by 4G mobile networks have increased, progress has been more pronounced in the ASEAN 6 Member States (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, and Thailand) compared with CLMV countries (Cambodia, Lao PDR, Myanmar, and Viet Nam). As of 2020, internet penetration averaged 63% across AMS, marking an increase of about 55.7 percentage points since 2000. Furthermore, all AMS offer more than 80% coverage by at least 4G mobile networks. However, disparities persist, particularly in terms of infrastructure and digital skills. Recent data indicate a substantial gap in information and communication technology skills amongst AMS, with wealthier member states such as Brunei Darussalam, Malaysia, and Singapore enjoying a significant advantage (ADB, 2023b).

The need for integrated digital finance infrastructure is a significant challenge in the ASEAN region. Digital payment systems are crucial in facilitating smooth cross-border digital trade and as a gateway to other digital financial services. Across AMS, there are varying levels of progress in digital financial services policy and regulations, often reflecting differences in financial system development. Many AMS have implemented policies and regulations to engage with the private financial sector; enhance the retail payment infrastructure; expand identification systems to facilitate financial institutions' customer identification; and establish regulatory frameworks for services such as e-money, crowdfunding, and online lending (Alliance for Financial Inclusion and ASEAN, 2021). However, some countries need to take more structured approaches to regulating digital financial services. In these cases, strengthening traditional financial system regulations and infrastructure, such as microfinance sector regulation, credit bureau penetration, and gross and retail payment system infrastructure, could further support financial inclusion efforts (Aviles, Sitorus, and Trujillo Tejada, 2019).

Policy Recommendations

MSMEs play a crucial role in promoting economic activity in the region and are a key focus of the ASEAN Economic Blueprint 2025, which aims to bring together local economies through MSMEs (Mendoza and Tadeo, 2023). Several policies can be implemented to empower microbusinesses in Southeast Asia and should be harmonised to create a more conducive business environment for MSMEs. Important policies in empowering MSMEs include:

(1) Digital transformation and innovation

MSMEs should enhance their market reach and operational efficiency through the robust utilisation of digital technologies and e-commerce platforms. However, significant hurdles such as inadequate internet connectivity, digital skills deficits, funding constraints, and policy deficiencies persist. Amongst these challenges is the absence of innovative digital financial products tailored to the requirements of small and medium-sized enterprises (SMEs). According to a study published by the World Economic Forum, a primary factor contributing to this innovation deficit in financial services for SMEs is insufficient investment by traditional banks in digital advancements and business capabilities geared towards serving this sector, primarily due to perceived unprofitability. Consequently, Southeast Asian SMEs encounter substantial funding disparities, leading to a lack of digital innovation (World Economic Forum, 2022).

(2) Regulatory support, collaboration, and partnerships

Simplifying and streamlining business regulations is crucial to facilitating the establishment and operation of MSMEs. In ASEAN, MSMEs commonly engage in similar business activities, whether in services or manufacturing. Therefore, local companies can disseminate and adapt a shared pool of effective practices. Despite some national good practices and management tools, they often have limitations such as being available in a single local language, being distributed solely in printed form, becoming obsolete after project completion, or having a narrow scope. Awareness and visibility are lacking on a centralised platform such as the ASEAN Access, where small business owners across ASEAN can access comprehensive guides, strategies, plans, and best practices tailored to their businesses. This could also foster partnerships amongst MSMEs, government agencies, and other stakeholders to promote capacity building, knowledge sharing, and resource mobilisation (ASEAN, 2015).

The flagship initiative of ACCMSME – the establishment of ASEAN Access – resembles the *Asia Small and Medium-Sized Enterprise Monitor* of the Asian Development Bank (ADB). ASEAN Access and the *Asia Small and Medium-Sized Enterprise Monitor* function as knowledge-sharing platforms to provide essential resources for MSME development policies in Asia and the Pacific, offering valuable insights and guidance to foster the growth of small businesses across the region (ADB, 2020). While efforts have been made to simplify and streamline business regulations, significant gaps

persist in improving accessibility and dissemination. Therefore, the existing initiative of ASEAN Access will yield even greater potential if MSMEs leverage the platform. Domestic policies should encourage referring to and benefiting from ACCMSME initiatives. If effectively implemented, these policies could empower Southeast Asian microbusinesses, enabling them to overcome challenges and harness opportunities for ASEAN economic integration.

(3) Infrastructure development

Improving infrastructure, especially in rural areas where a large proportion (72%–85%) of ASEAN's MSMEs are based, is crucial for their development. Many of these enterprises encounter challenges accessing basic infrastructure (e.g. electricity), communication networks, and digital infrastructure (e.g. broadband internet). Mechanisms could be established to facilitate increased collaboration amongst private companies, academic institutions, and AMS. Such collaboration could aid in identifying bottlenecks across vital segments of the region's infrastructure connectivity. Gathering and sharing best practices for addressing these challenges throughout the region, stakeholders could work together to pinpoint critical policy areas needing attention. This collaborative approach would promote the efficient allocation of resources and foster sustainable growth for MSMEs across ASEAN (ASEAN, 2022b).

(4) Financial inclusion

The development of financial products and services tailored to the needs of MSMEs should be encouraged, particularly in the informal sector (World Economic Forum, 2022). Enhancing cross-border payment systems through cooperation and collaboration amongst stakeholders is essential for adapting to the evolving payment landscape and advancing innovation and digitalisation in payment systems. AMS should prioritise standard harmonisation to ensure system interoperability, encourage the adoption of shared data frameworks to facilitate faster cross-border transactions, and establish regulatory frameworks to streamline transactions across jurisdictions. Additionally, measures should be implemented to minimise regional disruptions in payment systems in the event of security issues in one area. Besides, as highlighted in a 2019 World Bank study, leveraging digital financial solutions can help promote formal business participation (Klapper, Miller, and Hess, 2019). Policies to support and integrate informal MSMEs into the formal economy should also be in place to ensure they have access to the same opportunities as formal MSMEs (UNDP and Generali, 2023).

(5) Promoting entrepreneurship

Youth should be empowered in the micro-economy by addressing the digital divide, improving access to safe digital learning opportunities, fostering digital literacy, and developing transferable skills amongst students. Emerging opportunities for MSMEs in the digital economy and creative industries may also be tailored to empower youth. Greater participation of youth in economic policy

decision-making and greater ownership of MSMEs are needed, especially in heavily affected sectors such as food, healthcare, tourism, and hospitality. More programmes are needed to encourage entrepreneurship and innovation amongst young people, as they are the future leaders of MSMEs (Friedrich Naumann Foundation for Freedom, 2023). AMS also should consider investing in training programmes to enhance entrepreneurial and management skills amongst MSME owners and employees (ASEAN, 2015).

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