A Model to Financially Support SMEs in Laos in View of The Life-Cycle Theory.

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Abstract

This article study Recently, small and medium-sized enterprises have played a crucial role in enhancing economic growth, creating plenty of opportunities, and improving the efficiency of industrial structure. However, due to Laos's behindhand financial system and defective financial market, it makes it impossible for Laos to financially support those SMEs. With an economic system reform and the Economic Corridor strategy, the financing needs of SMEs in Laos are increasing. The previously financial support model cannot effectively solve ongoing financial difficulties faced by many small and medium-sized enterprises. This article initially aims at the development of SMEs in Laos and analyzes the main problems and financial market thoroughly. Hinged on the Life-Cycle theory, the characteristics and needs of the development of Laos' SMEs, in different stages, are refined. The financial support model of each stage is designed in combination with the current financial market in Laos, to provide a new approach and a solution to enhance the development of small and medium-sized enterprises.

Keyword: Small and Medium-sized enterprises, Financial Constraints, Financial Support Model

Introduction

In Southeast Asia, Laos is the only landlocked country. Laos has maintained a medium-to-high-speed growth of its economy, and investment and private consumption are the main drivers of the economy. The economic growth rate of Laos in 2019 was 5.11%, higher than the average level of the global and emerging Asian economies. The domestic unemployment rate and inflationary pressure are low, and there is a certain potential for market development. However, Laos, as a traditionally agricultural country, has a very weak socio-economic basis, a single industrial structure, and low-tech products. Affected by geographical constraints and a poor transportation system, Laos exports cheap labor to neighboring countries and relies on agriculture and handicraft industries to maintain the normal operation of the economy. The motivation in economic development and innovation is seriously insufficient. More than 90% of Laos's economic contribution comes from agriculture and handicrafts. Among them, small and medium-sized enterprises play an important role in enhancing economic growth, creating plenty of opportunities, and improving the efficiency of the industrial structure.

The domestic financial development is, however, relatively creeping, and the financial market lacks innovative vitality, which cannot meet the growing needs of Laos' SMEs. This makes SMEs confront financial constraints and financial exclusion. The economic reform and the promotion of the Economic Corridor strategy have brought ample opportunities to develop SMEs in Laos. Therefore, this article analyzes financial problems and characteristics of the financial market in Laos to find a financial support model for the development of SMEs, employing the Life-Cycle as a theoretical framework.

Analysis

1. Literature Review

1.1 Finance of small and medium-sized enterprises Small and medium-sized enterprises are the most operative part of the economic system, and they play a crucial role in technological progress and economic development (Qian Long, 2015). With a continuous expansion of the SMEs scale, the funds demanded have increased sharply and financial difficulties continue to plague SMEs (Xingyu & Zhengzheng, 2005) Not only resolving the financial difficulties of SMEs is of great significance for solving employment problems and stable economic growth, but it also has a constructive effect on enhancing social stability and showing the nation's prosperity and strength (Xie Yali, 2021) The studies from the west on innovative financing for SMEs mainly focus on financial gaps, credit matching, and bank-enterprise relationships under asymmetric information (Levine, 2004) According to the Information Asymmetry theory, if the amount and content of data held by parties are not equal, the party with more information has the upper hand in the transaction while the party with less information will be in a difficult situation (Michael Spence, 1973). The financial gap mainly includes two aspects: capital gaps and credit gaps. Compared with large enterprises, SMEs generally have low information transparency, high financing transaction costs, and lacking economies of scale (Jingtai & Lijun, 2016) The credit rationing theory proposed by Stiglitz (1981) believes that corporate investors will have many problems due to information asymmetry. The most common ones are moral hazards and adverse selection. Both of these problems will be projected into the credit rationing process. Concurrently, the corporate financing structure divides the capital structure from the aspect of financing methods, including endogenous finance and exogenous finance (Yonghui & Dongxiao, 2020) exogenous financing refers to companies raising funds from other economic entities other than the company through certain methods, including bank loans, issuance of stocks, and corporate bonds, while endogenous financing refers to the funds generated as a result of the company's business activities (Zhu Lei et al., 2019) Based on the data from 2013 to 2018 of more than 30 high-tech SMEs, Wang Zhenhong (2020) found that endogenous financing can significantly promote independent innovation of enterprises. Equity financing is conducive to the improvement of independent innovation capabilities of enterprises; bond financing is beneficial to the independent innovation of enterprises. Phouphet Kyophilavong (2008) believed that Laos' SMEs were facing problems such as high taxes, high inflation, and exchange rate instability. Besides, small and medium-sized enterprises also confronted problems such as innovation and lack of competitiveness, and limited markets.

1.2 Models for financially supporting SMEs development Financial support is a series of financial institutional arrangements for government to allocate credit funds that exceed the equilibrium level of the market by adjusting the scale of bank credit and differentiated loan interest rates and providing rental subsidies (Yan Junmei et al., 2020). Frankly speaking, the model to financially support SMEs can be divided into three types: a market-oriented model, a government-led model represented by Japan and South Korea, and a social-led model based on a balance between government and market (Liu Li Chao, 2013) A bank-based financial system is a financially supporting model based on bank credit, while the market-oriented system presents more diversified financing characteristics and market-oriented operations. Rittikorn Siriprasertchok and Pinsaeng Yunsaengva (2014), conducted a survey of more than 400 SMEs in Laos, pointed out that the majority of those SMEs had problems in funding, sales, management, etc., and needed to increase government support in terms of the law, loan access, and policy support. Due to the creeping development of the financial market in Laos, corporate financing is indirect finance, and the methods of raising funds mainly include fiscal appropriations, bank loans, private loans, and venture capital. Most of the financial resources and financial support prefer large-scale enterprises and state-owned enterprises. Additionally, institutional defects make small and medium-sized enterprises at a competitive disadvantage. Chittana Dethleuxay (2016) analyzed the financing channels of SMEs in Vientiane, Laos, and found that more than half of SMEs were informal financing with higher interest rates. Only can SMEs with more assets obtain formal financing. With the breakthrough of big data technology, financial resources have become increasingly abundant, and financial support has gradually developed into a multi-subject and multi-level financing structure covering state-owned capital, private capital, and foreign capital.

1.3 Life-Cycle Theory The Life-Cycle theory originated from Larry E. Grener's Evolution and Revolution as Organizations Grow in 1972. Adizes Ichak (1989) divided the life cycle of an enterprise into six growth stages: Courtship, Infancy, Go-Go, Adolescence, Prime, and Stability; and four aging stages: Aristocracy, Recrimination, Bureaucracy, and Death period. Chinese experts and scholars use the theory as the standard and divide the company's development cycle into a start-up period, a growth period, a mature period, and a recession period (Xie Guozhen, 2006) Song Zhihui (2010) studied the financial characteristics of different stages of the enterprise life cycle, and divided the enterprise life cycle into the birth period, the growth period, the mature period, and the recession period. Corporate financing is an important part of corporate financial strategy. Companies should judge the life cycle of the company based on the characteristics of cash flow at different stages of development to propose appropriate financing strategies (Zhu Biqin, 2020) Yuan Weiqiu (2017) studied the differences between bank credit and monetary policy on corporate financing at different stages of the corporate life cycle from the life cycle aspects. During the growth period, companies had a strong ability and willingness to obtain bank credit and were not affected by monetary policy. Long-established enterprises had a strong ability to obtain bank credit, but their will is weakened. Jiang Hua (2019) found that enterprises in the start-up period had a low reputation and no financial foundation. In the early stages, the number of sales gradually increases; in the mature stages, the sales of enterprises in the mature period tend to be stable. However, during the recession stages, corporate technology was likely to be outdated and profitability declined.

1.4 The trend of and financial support for small and medium-sized enterprises in Laos The development and financial status of SMEs in Laos The total number of small and medium-sized enterprises in Laos exceeds 95% of all enterprises. They are an important part of the economic development for Laos to achieve industrialization and modernization. Also, many small and medium-sized enterprises have created a large number of jobs and made positive contributions to the increase of national income and the reduction of poverty. The SMEs in Laos can be referred to as economic units that are legally registered to engage in production and business activities within the country. According to the decree on the promotion and development of small and medium-sized enterprises in 2004 and 2012, SMEs are classified into micro-enterprises, small-sized enterprises, and medium-sized enterprises.

As reported by the Office of Promotion of Small and Medium-sized Enterprises in Laos, there are mainly three types of small and medium-sized enterprises in Laos: small and medium-sized enterprises operating in manufacturing, small and medium enterprises operating in trade, and small and medium-sized enterprises operating in the service industry. Most small and medium-sized enterprises are located in the central and southern parts of Laos. Among them, agricultural business accounts for the highest proportion. It is dominated by light industry, including rice processing, food, textiles, clothing, mining, cement, beer processing, etc. Since the emerging Lao Securities Exchange (LSX), the financial industry has led to the development of many small and medium-sized enterprises, especially the service industry, wholesale industry, transportation industry, agriculture, and manufacturing industries. Because of the low capital and technological breakthrough, it is easier for new enterprises to enter the market. However, due to the disadvantages of Lao enterprises in terms of production scale and capital accumulation, it results in low labor productivity, high production costs, and a lack of market competitiveness.

To solve the financial problems of enterprises in the early stage, the methods of most enterprises are threefold: internal equity financing, debt financing, and external equity financing. Judging from the existing financing market for SMEs in Laos, the stock and bond markets are immature. In terms of direct finance, there is only one stock exchange in Laos. Also, the high listing threshold, cumbersome application process, and time spent have not provided opportunities for the vast majority of small and medium-sized enterprises. Lao financial institutions have a high loan threshold, compared with state-owned enterprises and large enterprises, SMEs need to pay higher floating interest rates. Most small and medium-sized enterprises can only meet their financial needs through private financing, which has certain loan risks and cannot financially support long-term, safe, and reliable capital chains. Additionally, the country lacks strong policy support for SMEs, and the lagging nature of policies cannot effectively deal with the problems arising from the development of national SMEs.

1.5 Lao financial system analysis The banking industry is an important part of the Lao financial system. It currently has a comprehensive banking system including state-owned commercial banks, specialized banks, private commercial banks, and foreign commercial bank branches. Compared with neighboring Southeast Asian countries, the scale and development of the Lao banking industry are impoverished. As of 2017, the number and scale of Lao commercial banks increased to a certain extent, and their operating outlets have gradually radiated from the capital to the surrounding and rural areas. Some state-owned banks have cooperated with financial institutions in China, Thailand, France, and Vietnam to establish joint state commercial banks. At the same time, foreign banks and private banks have also begun to enter the Laos market to carry out business activities. Countries such as China, Malaysia, Thailand, and the United Kingdom have long-established branches and representative offices in Laos. As time progress and the development of science and technology, the Central Bank of Laos, a national bank, guides commercial banks to carry out modernization and diversified operations and provides convenient capital needs for the Lao economy and society. A personal loan is one of the most important channels for SMEs in Laos to obtain financing. At present, the main loan business of the Lao China bank aims at small and medium-sized enterprises, whereas the major loans of the Industrial and Commercial Bank are large-scale or state-owned enterprises. From 2013 to 2017, Lao commercial banks' loans to SMEs accounted for 37.74%, 37.73%, 41.19%, 46.21%, and 47.56% of GDP, respectively, showing a gradual upward trend, which further shows that debtors are enterprises. In 2017, the growth rate of loans on the economy was 12.04%, slightly decreased from 2016. To adapt according to the supply changes in the domestic market, the Lao Central Bank adjusted its lending rate again in 2017 to stimulate its economy and promote investment. The government financial allocations, private loans, and venture capital are means of financial support for the development of SMEs in Laos. The domestic financial market in Laos has been closed for a long time, and the capital market has developed slowly, which is extremely immature. On one hand, the financial foundation of state-owned commercial banks such as the Lao National Bank is uniformly developed by the headquarters. This credit chain cannot meet the rapid needs of SMEs; on the other hand, the unified loan conditions of banks caused SMEs to be restricted and struggling. At the same time, the simplification of financial issues, a highly concentrated economic system, and a lack of financial professionals have greatly inhibited the development of Lao's financial market and small and medium-sized enterprises. However, small and medium-sized enterprises themselves have poor ability to resist risks, low credit transparency, and financial distortions that make financial institutions unwilling to provide financial support. Therefore, most small and medium-sized enterprises are unable to raise funds from formal financial institutions and can only rely on non-financial institutions.

2. The research design of the financial support model for SMEs in Laos

Lao small and medium-sized enterprises need huge funds in all aspects, i.e., research and development, production, investment, and listing. However, the loans of Lao banks are mainly large and medium-sized enterprises and state-owned enterprises, making small and medium-sized enterprises lack effective financial support. The excessive amount of national sovereign debt has hindered external international financing. However, in recent years, the Lao government has gradually increased its policy support for SMEs. By the national socio-economic development plan, it has proposed policies to support the sustainable development of SMEs.The SMEs can barely resist risks due to their smallness, together with high business risks and credit risks. The guarantee is an effective mechanism to eliminate asymmetric information and promote fair transaction (Chen Lei, 2011) Therefore, it is necessary to improve the financing guarantee system for SMEs. Since social organizations have diversified roles such as intermediaries, counselors, and guides, they can make up for the government failure and market failure problems. Therefore, relying on social organizations to establish a multi-party government, society, and market participating in the financial support service system for SMEs is particularly necessary.

According to the life cycle theory, this article divides the development of Lao small and medium-sized enterprises into three stages: the initial stage, the growing stage, and the mature stage. Companies in different development cycles have different needs for capital and financial services, and they need to design their financial support models in a targeted manner according to their stage characteristics and capital needs.

2.1 The initial stage -- Private capital + Financial policy + Angel funder The initial stage is the formation stage for SMEs to start innovation and entrepreneurship, with their innovative characteristics. At this stage, companies have a great need for funds. If it involves high-tech industries, additional R&D costs need to be invested. The main purpose of the funds is to expand the market and product development costs. As product sales and market conditions are uncertain, there are significant operating risks and instability. The company's capital is mainly invested in the early stage, and external financing often depends on short-term loans. In addition, since the main factor in financing difficulties for SMEs comes from the lack of financing guarantees, national financial policy is particularly important at this stage. The government adopts financial investment and policy support to bring the capital flows of commercial banks, venture capital, and other financial institutions to high-quality SMEs, especially those technological innovation enterprises. By doing so, it can alleviate the financial equality and financial development of disadvantaged groups to a certain extent. At the same time, some potential SMEs will also attract the early intervention of angel investment through financial roadshows and evaluations. At this initial stage, the early capital requirements of SMEs are not that large, and the sources of funds mainly rely on their funds, financial policy, and angel funds.

2.2 The growing stage -- Bank capital + Venture capital As enterprises continue to grow, their products are increasingly accepted by the market and begin to enter the growth stage. At this stage, a company's operating risks have been reduced. Sales revenue and cash flow have gradually stabilized. The increase in assets and business reputation has improved enterprises' capability to raise funds from banks and other financial institutions. Meanwhile, venture capital is also eager to try some small and medium-sized enterprises that have been well-managed and have potential markets in the early stage, and are willing to invest appropriate capital.

Because of financial innovation, many financial institutions, i.e., microfinance and rural commercial banks, have been given the mandate to eliminate financial repression, ease financing difficulties for SMEs and micro-enterprises, and build universal access. In recent years, Laos has developed very rapidly in microfinance. Since 2006, there have been more than 190 organizations engaged in providing microfinance. The main targets of these financial institutions are disadvantaged groups such as rural areas and domestic SMEs. Those mentioned SMEs have been provided diversified financial services by strengthening and improving the governance of formal financial institutions, filling the gaps in non-governmental microfinance. Therefore, SMEs at this stage can obtain the necessary funds through bank loans and venture capital.

2.3 The mature stage -- Bank capital + Capital market + Venture capital As SMEs have entered a mature stage, their products have been widely recognized and have a certain share in the market, which has established a certain social reputation and credibility. The potential for enterprise development has been fully manifested, and the business performance has been growing rapidly. The technical risk, financial risk, and market risk have been greatly reduced. The production scale of the company has expanded which sales and profits have increased substantially, cash flow has been stable, and profitability has increased as well. Therefore, financing channels at this stage should be further broadened. The first is to obtain loans from banks and other financial institutions. The second is to use multi-level capital market financing. Under the condition that the capital market is complete, companies choose financing methods to become more diversified, including equity financing, debt financing, property rights transactions, currency markets, and over-the-counter transactions. The third is to venture capital channels for mergers and acquisitions. In the mature stage, venture capital is mainly based on mergers, acquisitions, and investments. The amount is large and the investment period is relatively short. Assets are reorganized through mergers or acquisitions so that the assets of the merged company can be fully utilized to reduce other financings.

Conclusions

The improvement of the financing issues for SMEs in Laos requires government cooperation, social organizations, and the capital market. It is not solely to rely on unilateral support from the state. There are certain differences in the financing capabilities of SMEs at different developmental stages and their demands for financing. Therefore, it is necessary to design financial support models which suit each development stage.

At the governmental level, legal support and development environment are important guarantees for the sustainable development of SMEs. On the one hand, we must improve the existing legislative system, and clarify the responsibilities of government officials, regulating government and market behavior, clarify the legal status of SMEs, and create a competitive market for them. On the other hand, the implementation of targeted policies for all aspects of the development of SMEs is needed. For example, in the existing banking system, the government stipulates the proportion of loans issued to SMEs, thereby promoting the quality and strength of financial institutions' services for the majority of SMEs. Due to the high requirements for a financial guarantee for SMEs in the early stage, a supporting credit guarantee and risk compensation mechanisms for them are needed. Therefore, the development of intermediary organizations and a loan guarantee system play an important role in increasing support for SMEs. The government should build multi-level and multiple forms of credit guarantee organizations, guiding them to operate per the laws of the economy. This can promote the effective integration of bank credit and foreign-invested enterprises, and strengthen financial institutions' confidence in financing SMEs. Concurrently, it is possible to appropriately pave the way for private funds, form a joint-stock company with multi-fund participation, explore private financing methods based on legal foundations, and enable residents' savings deposits to voluntarily invest in supporting local small and medium-sized enterprises and potential projects.

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