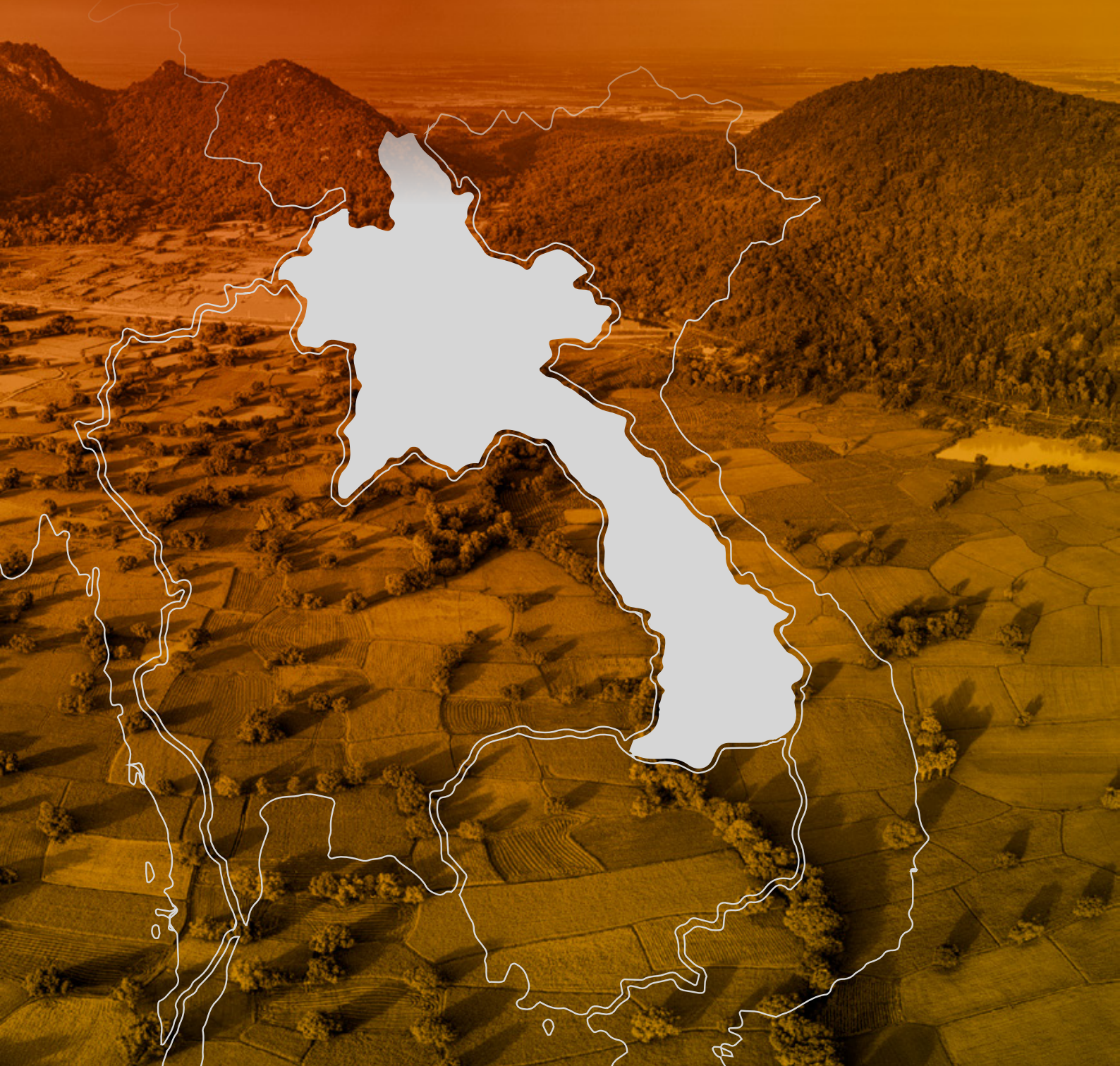


#ClosingTheGap Mekong

Executive Summary

Lao PDR

Entrepreneurial Ecosystem Assessment



Commissioned on behalf of:
Dutch Good Growth Fund (DGGF): Investment funds local SMEs
April 2019

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The Dutch Good Growth Fund, part Investment funds for local Small and Medium Enterprises (SMEs), is a “fund of funds” investment initiative from the Dutch Ministry of Foreign Affairs. The initiative aims to improve financing for the “missing middle” – i.e. entrepreneurs who have outgrown micro-finance but do not yet have access to regular financial services. The Seed Capital and Business Development (SC&BD) program was established to increase the impact of the DGGF by providing technical assistance, seed capital and business support services to intermediary investment funds and local SMEs. The program incorporates a knowledge development and sharing component that supports research, tests assumptions and shares insights into financing SMEs in developing countries and emerging markets - fostering industrywide knowledge exchange.

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Acknowledgements:

The DGGF hired Emerging Markets Consulting (EMC) to complete the #CTGMekong studies. The Evidence Network and Mekong Business Initiative provided research insights and TohLao collaborated on the #CTG Lao PDR stakeholder workshop in Vientiane.

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Disclaimer:

#ClosingTheGap Lao PDR has been commissioned on behalf of DGGF as part of the #ClosingTheGap series of entrepreneurial ecosystem assessments. The findings and recommendations are at the discretion of the consultants – Emerging Markets Consulting - and do not necessarily reflect the opinion of DGGF and/or its partners.



Ministry of Foreign Affairs



Lao PDR is the smallest country in the #CTGMekong series, with only about 7 million people (2017), and a landlocked economy reliant on extractive and hydropower industries. As a socialist republic, the government has a significant impact on the economy. The business landscape therefore consists of a few large firms in a relatively small number of industries, and numerous small and micro businesses in both urban and rural areas that remain largely informal.

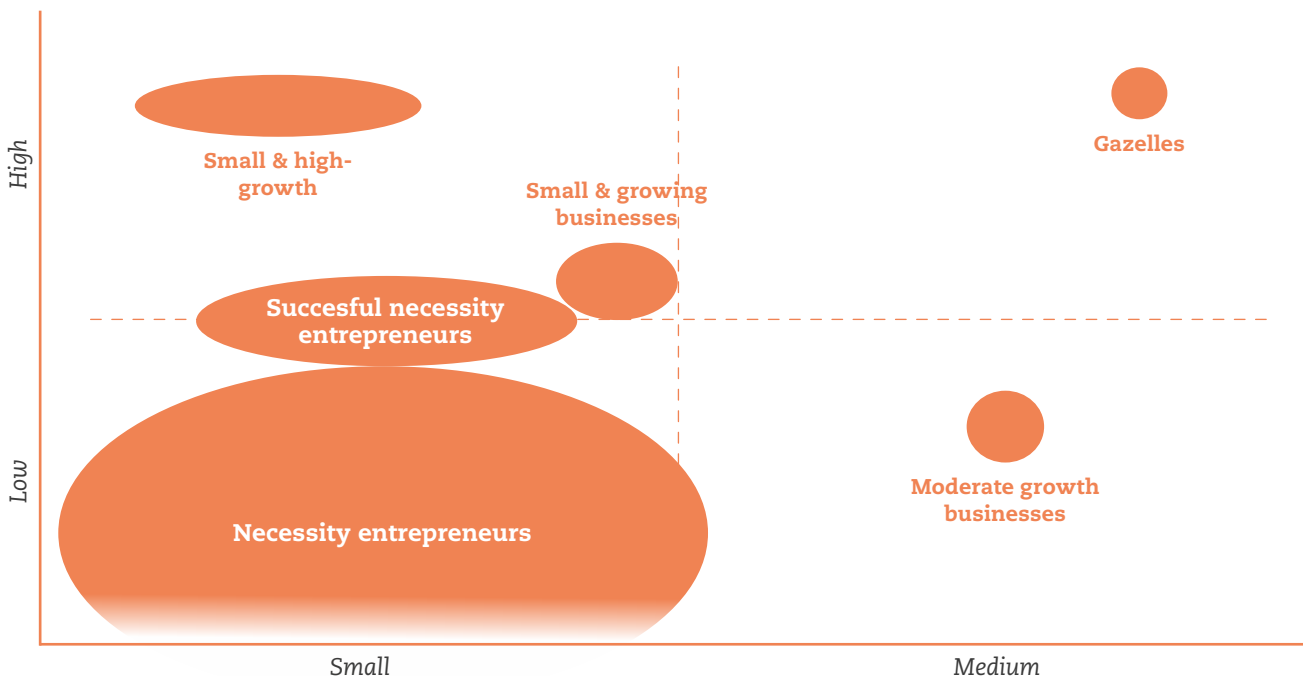
Recognizing this imbalance, the Government of Lao PDR (GoL) has begun a series of reforms to support growth and formalisation of small and medium-sized enterprises (SMEs). This includes enterprises in the “missing middle”: those that have outgrown microfinance but are not yet covered by commercial bank financing. These enterprises are important for the diversification of the Lao economy, employment generation and poverty reduction. In the last few years especially, young Laotians have increasingly discovered entrepreneurship and seized opportunities for startups in Lao PDR, following success stories observed throughout the region.

However, segmentation of the World Bank Enterprise Survey (WBES) from 2016 still shows that even the vast majority of registered firms is small and growing slowly. More than two-thirds of such establishments employ fewer than 20 people, and experience levels of revenue growth at or below 10%. In contrast, the number of SMEs that are large and growing quickly (Gazelles) represent only 1% of all enterprises. The future of Lao PDR’s entrepreneurial ecosystem rests on those smaller enterprises that have managed to achieve growth rates exceeding 10%, and they will need support services and finance to become the next Gazelles.

Most SMEs Are Small and Not Growing

As shown in the WBES, most registered enterprises are small and barely growing. Based on older surveys and anecdotal evidence, informal microbusinesses make up an even larger share of total establishments. Only few enterprises in Lao PDR are large or growing quickly.

Figure 1: Sub-segments as proportion of total



Source: EMC analysis based on the 2016 Enterprise Survey (<http://www.enterprisesurveys.org>), The World Bank

¹ World Economic Forum Classification

There are three main reasons for this. First, the market is relatively small and entrepreneurs seeking rapid growth need to establish a market in all urban areas and even abroad. Second, an unfavorable business climate with little support for formalisation encourages firms to stay informal to avoid regulatory requirements and tax payments, which is demonstrated by firms surveyed in the WBES reporting unfair competitive practices in the informal sector as the single largest entrepreneurial constraint. Third, this informality hinders businesses from obtaining funding to invest in innovation, limiting Lao business strategies to copying the region's proven models and thus inheriting fierce competition and low margins. As a result, the majority of SMEs have similar business models and compete heavily in sub-national markets, without much differentiation due to lack of managerial experience and funding.

Access to Finance Is a Growing Concern

Lack of service providers to instill the required financial literacy and business planning skills that attract growth finance was identified as the main gap by interviewed entrepreneurs. This includes the complex procedures to register with different line ministries and obtain permits, as well as approach banks for financing. Lao entrepreneurs, especially young startups, are far behind their regional peers in obtaining bank financing.

This issue is compounded by high cost of finance, introduced by regulatory restrictions on borrowing and lending in different currencies. Most SMEs requiring investment capital would seek a longer tenor than is currently available, due to systemic country and currency risks as well as an unpredictable central bank and lack of credit bureau to cover firm debt and individual debt, which is the primary funding source for unregistered enterprises.

There is also a noticeable lack of risk capital in Lao PDR, due to a lack of corporate venturing as well as minimal attention from regional venture capital and private equity funds. Some angel investors are active in the country, but they are not organised in a formal network such as in Vietnam, and most entrepreneurs therefore rely on seed financing from family and friends.

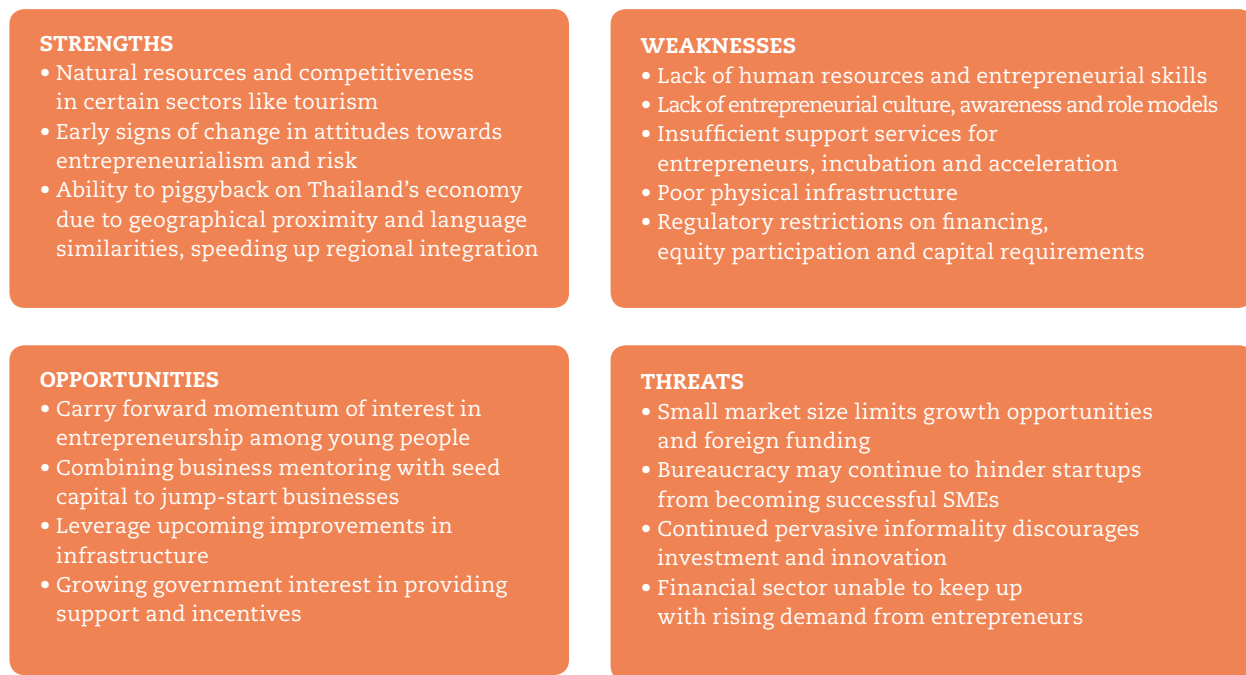
Business Support Services Are Nascent and in Need of Resources

Even more so than other countries in the #CTGMekong series, Lao PDR lacks a vibrant and dynamic ecosystem of business support service providers. While there are a few co-working spaces and business associations organising events, tailored coaching and support is lacking. The entrepreneurs that have successfully accessed these services tend to be well connected with the handful of ecosystem builders that do exist.

What became clear – both during the workshop as well as interviews with entrepreneurs reflecting on the early stages of their ventures – is that startup culture must be promoted within the Lao educational system and society.

Entrepreneurs expressed the need for role models or 'champions' to follow, as well as a space to share experiences with other entrepreneurs either in success or failure. During the #CTG workshop in Vientiane, the overwhelming response from the participants was a desire to have more of these workshops, where they can exchange ideas and boost enthusiasm for entrepreneurship. If the current ecosystem builders and co-working spaces are properly supported to host even such basic events, they could develop a pool of mentors that would allow the next generation of entrepreneurs to engage in more personalised and detailed coaching.

Figure 2: SWOT analysis of the Lao PDR ecosystem



Recommendations

In addition to implementing a pro-business, regulatory reform agenda that makes it easier to formalise businesses and integrate regionally, we recommend two opportunities to further SME growth: increase awareness and access to basic services for aspiring entrepreneurs and provide tailored financial offerings to complement these services. It is imperative to recognise the need for skill development amongst these aspiring entrepreneurs, as well as the nascent business support services and financial offers.

Crucially, the most successful entrepreneurs will need to work with financiers and support providers to export their products and services, overcome the inherent limits of Lao PDR’s small market, or focus on profitable niche areas with high value-added such as tourism or organic agricultural products.

The first step in developing the entrepreneurial ecosystem is to raise awareness among aspiring entrepreneurs, and establish learning platforms through workshops and events, preferably introducing experience from the wealth of entrepreneurial experience in the region. Lao entrepreneurs lack visible role models, which inhibits support from their immediate environment including family. More attention to entrepreneurship in education as well as the media will help overcome this information gap, and even simple events such as information-sharing of failures and successes can have a major impact in inspiring the next generation of entrepreneurs.

A first step would be to empower existing ecosystem players, such as co-working spaces, to organise trainings and workshops and facilitate experience exchanges. This could then develop into a network of coaches and even angel investors, following examples shown in Vietnam.

Once entrepreneurs have the capacity to develop solid business plans, banks and other financial institutions need to work together with donors and the financial regulator to increase access to investment and working capital financing. The regulator and government in particular play a critical role in incentivising entrepreneurs to invest in research and development as well as business models that can take advantage of regional opportunities, without the burden of onerous documentary requirements.