

## Factors Influencing Innovation on SMEs in Lao PDR

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This research article aims to analyze the factors influencing innovation on Small and Medium-sized Enterprises (SMEs) in the Lao People's Democratic Republic (PDR) by using descriptive analysis and quantitative analysis. The objective is to investigate the comprehensive business entrepreneur operations on SMEs in the Lao PDR and explore the innovative learning of business entrepreneurs on SMEs in the Lao PDR. In order to fulfill the objective, the authors employ secondary data derived from the survey results conducted by the World Bank on Small and Medium-sized Enterprises during the period from May to November 2018, which encompassed data collection from each business entity operating in five provinces of the Lao PDR. The study's findings revealed that in the Lao PDR, small and medium-sized enterprise (SME) entrepreneurs observed that 65.38% of business managers within SMEs were male. Furthermore, it was found that approximately 33.65% of these managers possessed over 20 years of experience in business management. Additionally, the study highlighted that a majority of these enterprises were located in Vientiane capital accounting for approximately 41.83% of the sample group. In terms of sector distribution, the majority of businesses belonged to the manufacturing sector comprising 39.42% of the sample group, followed by service business at 35.10% and retailing business at 25.48%. Interestingly, the study discovered that a significant proportion of SMEs, approximately 78.47% did not possess loan collateral. Moreover, a vast majority of these establishments, accounting for 88.94%, had not undergone an external audit of their business operations. When examining the executives, it was observed that around 78.85% of them had never received any training in business operations. Furthermore, only 25.96% of enterprises utilized websites, and among them, a staggering 69.71% did not engage in export activities. Disturbingly, the study found that 77.40% of enterprises faced difficulties in access to financing capital sources. Lastly, it was concerning to note that approximately 82.21% of organizations had never implemented innovation within their operations. In the study conducted on small and medium-sized enterprises (SMEs) in Lao PDR, the Logit Model was employed by the authors to investigate the factors influencing innovation. The analysis revealed a total of seven factors that positively impact innovation. These factors include manager experience (Exper), manufacturing sector (Manuf), access to financing capital (Afc), training (train), direct export (dex), business income (Ln(Inc)), and website (Site). The study also established a significant relationship between these factors and innovation at a confidence level of 90%, 95%, and 99%. On the other hand, there were five factors that were found to have no effect on SME innovation in Lao PDR. These factors are the gender of the manager (Gen), retailing business (Ret), service business (Serv), number of labor (Ln(Labor)),

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and indirect export (Inex). Thus, the study found there was no statistical relationship and was consistent with the hypotheses.

*Keywords:* innovation, logit model, World Bank (WB) Survey 2018

## **Introduction**

According to several studies, it indicates that Small and medium-sized enterprises (SMEs) play a significant role in the manufacturing sector (approximately 60% of labor) of both developed and developing countries (Ayyagari, Beck, & Demircuc-Kunt, 2007). Small and medium-sized enterprises (SMEs) play a crucial role in fostering innovation, which in turn contributes to the overall economic growth of a nation by creating employment opportunities, attracting investments, and boosting exports (Kyophilavong, 2014). SMEs have garnered significant attention across various regions worldwide. Notably, developing countries experience slower growth rates and exhibit distinct developmental disparities when compared to their developed counterparts (Rowen, 1998).

Small and medium-sized enterprises (SMEs) are critical to economic and social development because the manufacturing, commerce, and service sectors are key drivers in creating job, generating income, and boosting living standards. Furthermore, small and medium-sized businesses can quickly and effectively adjust to changing situations, especially during an economic and financial crisis. Because it is obvious that small and medium-sized businesses are vital in most nations throughout the world, particularly in the ASEAN. In each of the ASEAN member countries, small and medium-sized enterprises (SMEs), including micro-enterprises, play a crucial role in the economy. These SMEs account for a significant percentage, ranging from 88.8% to 99.9%, of the total number of enterprises. Moreover, they have the potential to generate a substantial number of jobs, contributing between 51.7% and 97.2% of employment opportunities. Additionally, SMEs make a noteworthy contribution to exports, ranging from 10% to 29.9%. Analyzing the structure of SMEs in the Lao PDR, it is evident that 63% of these enterprises are engaged in trade, wholesale, retail, and automobile repair sectors. The processing industry sector accounts for 12.5%, while the food service as well as accommodation sector accounts for 11.7%, and the remaining sectors collectively account for 13% of SMEs in the country. Although SMEs cover a huge number, 86% of SMEs are classified as micro-enterprises with one-five employees, most of which operate outside the private sector or as a form of family business, which are not officially registered as enterprises. According to a 2010 survey by the Asian Development Bank, the cost to businesses of complying with government regulations is approximately 3% of GDP, while small and medium-sized enterprises still lack ideas, invent new innovations on their own, but mostly focusing on neighboring manufacturing before becoming self-sufficient. There is also an acute shortage capable of interpreting research institutes that can produce new innovations into products.

In addition to the aforementioned obstacles and challenges, small and medium enterprises (SMEs) encounter numerous other hindrances and difficulties. One such challenge is the limited workforce available to promote and support the growth of SMEs, as well as insufficient financial resources further compound the problem, making it difficult for SMEs to carry out administrative tasks effectively. Moreover, the lack of robust institutional infrastructure and technical resources hampers the smooth operation of SMEs. Additionally, the coordination between the government and business operators in addressing these issues remains a persistent

challenge. Furthermore, SMEs in the Lao PDR currently lack the necessary creativity and innovation to develop products and goods that can effectively cater to the demands of the modern market. Consequently, this research aims to address these problems and explore “the factors influencing innovation on SMEs in the Lao PDR”.

### **Objective**

The objective is to investigate the comprehensive business entrepreneur operations on SMEs in the Lao PDR and explore the innovative learning of business entrepreneurs on SMEs in the Lao PDR.

### **Literature Reviews**

According to Berisha and Pula (2015), an entrepreneur can be defined as an individual who engages in various roles such as selling, producing goods for sale, importing products for resale, or even purchasing items for resale. These individuals are not limited to a specific category but can also include service providers. Entrepreneurs, driven by their own initiatives, play a significant role in a capitalist economy as they constantly seek to identify and exploit new business prospects. Their ability to think innovatively and explore untapped opportunities contributes to the growth and development of the economy. According to the definition provided by Bykova and Pindyuk (2019), an entrepreneur is an individual who identifies a potential business prospect and takes the initiative to establish and oversee the operations of the business, while also being willing to assume any associated risks that may arise. According to Carter and Evans (2008), the term “entrepreneur” retains its historical significance, referring to an individual responsible for organizing, managing, and embracing business risks. In contrast, Hisrich, Peters, and Shepherd (2008) offer an alternative perspective, stating that the word “entrepreneur” originates from the French term “Entreprendre”, which denotes a person who acts as a mediator (go-between) or intermediary between those who accept and undertake business ventures (between-taker). This term was initially introduced in the business realm by the economist Richard Cantillon during the 1700s. Initially, the term “entrepreneur” referred to an individual who actively engaged in various aspects of business and took on a proactive role in its operations. According to Joseph Schumpeter (1930) and the European Commission (2005), an entrepreneur is an individual who takes the risk of investing their wealth, time, and effort into a new and innovative product or business venture with the aim of making a profit. On the other hand, Fatoki and Garwe (2010) define an entrepreneur as a business innovator who possesses the courage to take risks and is determined to succeed by establishing a small business. Gunasekaran, Rai, and Griffin (2011) define an entrepreneur as an investor who organizes a business with the intention of making a profit while accepting the risk of potential losses. Additionally, an entrepreneur is someone who personally operates and controls the business. In the context of Critical Success Factors (CSFs), as discussed by Park and Racquel (2018), these factors are crucial elements that contribute to achieving success in line with the envisioned goals. These success factors are aligned with both differentiation and lower-cost leadership strategies. To measure these success factors, it is necessary to study various theories, including the main and secondary theories mentioned above. The authors have integrated theoretical concepts based on four management principles: general management theory, production management and business operations theory, service marketing theory by Philip Kotler (2003), and the overall business environment encompassing political, legal, economic, cultural, social, and technological aspects. These theories serve as a guide in determining the variables of the study.

## Methodology

### Data Sources

To examine the factors influencing innovation on SMEs in Lao PDR, this study utilizes cross-sectional data that were derived from the survey results conducted by the World Bank on Small and Medium-sized Enterprises during the period from May to November 2018. Out of a total of 1,892 enterprises surveyed, a subset of 208 enterprises was selected for further analysis, which encompassed data collection from each business entity operating in five provinces of the Lao PDR, such as Vientiane Capital, Champasack, Savannakhet, Luangprabang, and Luangnamtha Provinces.

### Empirical Model

The Logit Model will figure out the probability of what factors influencing innovation on SMEs in Lao PDR by calculating marginal effect in every single factor based on the explanatory variables conducted in the model. The factors influencing innovation on SMEs in Lao PDR would be demonstrated by Logit Model, which the authors: Phuphet Kyophilavong (2011), Andries, Marcu, Oprea and Tofan (2018), The Dong and Thi Hong Nham (2018), Musamali and Tarus (2013), and Luyna Ung and Sovuthea Hay (2011), refer to as follow:

$$Inn = f(Gen, Labor, Exper, TB, Train, ACF, Export, Inc, Web)$$

$$P(Novat = 1) = \mu_0 + \mu_1x_1 + \mu_2x_2 + \dots + \mu_9x_9 + e_i$$

This research encompasses a set of nine variables, consisting of one dependent variable namely innovation, and eight independent variables including the gender of the manager (Gen), the number of labor (Labor), the level of experience (Exper), the type of business (TB), the training (Training), the access to finance (ACF), the business income (Inc), and the exports (Export). Thus, these variables can be formulated as following:

Table 1

*Variables and Definition of Variables for Using on Model*

Variables	Definition of variables		Expected sign
Dependent variables			Positive
Inn	Innovation	1= yes; 0 = no	Positive
Independent variables			
Exper	Experience	year	Positive
Lab	Labor	person	Positive
TB	Type of business		Positive
Manuf	Manufacture	compare	Positive
Ret	Retail	1= yes; 0 = no	Negative
Serv	Service	1= yes; 0 = no	Negative
Train	Training	1= yes; 0 = no	Positive
ACF	Access to finance	1= yes; 0 = no	Positive
Exp <sup>a</sup>	Export	Million kip	Positive
Inc	Income	Million kip	Positive
Web	Website	1= yes; 0 = no	Positive

<sup>a</sup> Direct export (dex) and Indirect export (Inex).

## Results and Discussion

According to the findings of the survey conducted by the World Bank, it is evident that the majority of small and medium-sized enterprises (SMEs) are concentrated in Vientiane capital. Following Vientiane, there are also significant numbers of SMEs located in other provinces such as Luangprabang, Champasack, Khammouane, and Savannakhet, where appropriate infrastructure is available. The survey further reveals that a significant proportion of business managers, specifically 65.38% are men. Additionally, these managers possess considerable experience of 20 years or more in operating manufacturing businesses, accounting for 39.42% of the respondents. It is noteworthy that a large majority of these managers, approximately 78.47% do not possess loan collateral. Moreover, a staggering 88.94% of the respondents have never undergone an accounting audit conducted by an external audit company. Furthermore, a significant proportion of these managers, accounting for 78.85% have never received any training in running a business from an expert or any related sector. Interestingly, a considerable percentage of enterprises, specifically 69.71% do not engage in export. Lastly, it is worth mentioning that the availability of capital for SMEs in the Lao PDR is relatively limited, particularly for smaller enterprises. Contrary to expectations, a significant proportion of enterprises approximately 77.40% remain inaccessible. This can be attributed to the fact that most small and medium enterprises (SMEs) face challenges in accessing to financing capital specifically designed for them, despite the Lao PDR government's efforts to promote such opportunities. The limited utilization of new innovations in these enterprises can be attributed to the lending conditions imposed by various financial institutions. Conversely, a considerable number of enterprises, accounting for 82.21% have yet to embrace new innovations, due to the fact that small and medium-sized enterprises primarily cater to the domestic market, with limited production, services, and supply. Consequently, these enterprises have not fully integrated scientific advancements and advanced technologies into their operations. As a result, their production and service capabilities remain relatively modest, and their ability to compete in the international market is still underdeveloped.

The findings of applying the Logit Model to analyze the variables influencing the innovation of small and medium-sized businesses in the Lao PDR. The analysis included 12 variables, namely manager gender (Gen), manager experience (Ln(Exper)), manufacturing (Manuf), retailing (Ret), service (Serv), number of labor (Ln(Labor)), access to financing capital (Afc), training (Train), indirect exports (Inex), direct exports (dex), business income (Ln(Inc)), and website (Site). The results of the analysis are as follows.

### Consideration of Data Set Limitations (Relationship of Data Sets)

Analysis of Table 2 indicates that the correlation between the independent and dependent variables in the model is only 34.50 percent, significantly lower than the statistical threshold of 75 percent. Consequently, it can be concluded that the variables within the data set may be inadequate for accurately estimating values in research models.



Table 4

*Result of Estimation of the Factors of Product Innovation for SMEs in Lao PDR*

Variable	dy/dx	p-value
Ln(Exp)	0.0917	0.08*
Manuf	0.1331	0.09*
Afc	-0.4117	0.00***
Train	0.1356	0.08*
Dex	-0.1765	0.03**
Ln(Inc)	-0.0663	0.03**
Site	-0.1506	0.08*
Gen	0.0237	0.77 <sup>ns</sup>
Ret	-0.0077	0.93 <sup>ns</sup>
Serv	-0.0379	0.64 <sup>ns</sup>
Ln(lab)	0.0420	0.51 <sup>ns</sup>
Inex	-0.0980	0.22 <sup>ns</sup>

Note. Estimated coefficient statistically significant at a (\*) 90%, (\*\*) 95%, and (\*\*\*) 99% confidence levels. ns: non-significant.

**Factors Influencing Innovation on SMEs in the Lao PDR**

By utilizing the Logit Model and analyzing data from Table 4, a total of 12 factors were examined. The findings revealed that out of these factors, seven were found to significantly impact the business operations of SMEs in the Lao PDR. These influential factors included Manager experience (Ln(Exper)), manufacturing (Manuf), access to financing capital (Afc), training (Train), direct export (dex), business income (Ln(Inc)), website (Site). On the other hand, it was observed that five factors did not have a significant effect on the innovation of SMEs in the Lao PDR. These factors were gender of the manager (Gen), retailing (Ret), service (Serv), number of labor (Ln(Labor)), and indirect exports (Inex). The following information can be summarized as: The management experience factor (Ln(Exp)) has a positive correlation with the innovation of small and medium enterprise entrepreneurs in the Lao PDR, as indicated by the initial assumptions with a confidence level of 90%. This finding aligns with the guidelines provided. Additionally, the research conducted by Luanglath (2017) and Sihamanga (2016) supports the positive relationship between production Manufacturing factors (Manuf) and innovation, in line with the set assumptions and a confidence level of 90%. On the other hand, the research conducted by Kyophilavong (2007), Kyophilavong et al. (2014), and Chittithaworn, Islam, Keawchana, and Muhd Yusuf (2011) reveals a negative relationship between access to financial factors (AFC) and innovation, with a confidence level of 99% and consistent with the hypotheses. Furthermore, the research conducted by Kyophilavong et al. (2014) and Phimmachack (2013) supports the positive relationship between the training factor (train) and innovation, in accordance with the hypotheses and a confidence level of 90%. Conversely, the direct export factor (DEX) exhibits a negative relationship with innovation, as indicated by the hypothesis and a confidence level of 95%, which is consistent with the findings of Musamali and Tarus (2013), Ung Luyna and Hay Sovuthea (2011), and Chittithaworn et al. (2011). The business income factor (Ln(Inc)) also demonstrates a negative relationship with innovation, contrary to the hypothesis and with a confidence level of 95%, as observed in previous research. Similarly, the presence of a website in an establishment (Site) is negatively associated with innovation, as suggested by the hypotheses and a confidence level of 90%, which is consistent with the research conducted by Kyophilavong et al. (2014) and Wangbenmad and Bindulem (2013). In order to thrive in the era of Industry 4.0,

it is imperative for businesses to embrace advanced technological systems. By leveraging these modern tools, companies can effectively promote their products and services to the wider society, ensuring quick recognition, time savings, and reduced advertising expenses. Ultimately, such endeavors will have a favorable impact on the organization's production efficiency, both in terms of quantity and quality.

### **Conclusion and Recommendation**

The results of the research on the general situation of SMEs in Lao PDR observed that 65.38% of business managers within SMEs were male. Furthermore, it was found that approximately 33.65% of these managers possessed over 20 years of experience in business management. Additionally, the study highlighted that a majority of these enterprises were located in Vientiane capital accounting for approximately 41.83% of the sample group. In terms of sector distribution, the majority of businesses belonged to the manufacturing sector comprising 39.42% of the sample group, followed by service business at 35.10% and retailing business at 25.48%. Interestingly, the study discovered that a significant proportion of SMEs, approximately 78.47% did not possess loan collateral. Moreover, a vast majority of these establishments, accounting for 88.94%, had not undergone an external audit of their business operations. When examining the executives, it was observed that around 78.85% of them had never received any training in business operations. Furthermore, only 25.96% of enterprises utilized websites, and among them, a staggering 69.71% did not engage in export activities. Disturbingly, the study found that 77.40% of enterprises faced difficulties in access to financing capital sources. Lastly, it was concerning to note that approximately 82.21% of organizations had never implemented innovation within their operations.

In the study conducted on small and medium-sized enterprises (SMEs) in Lao PDR, the Logit Model was employed by the authors to investigate the factors influencing innovation. The analysis revealed a total of seven factors that positively impact innovation. These factors include manager experience (Exper), manufacturing sector (Manuf), access to financing capital (Afc), training (train), direct export (dex), business income (Ln(Inc)), and website (Site). The study also established a significant relationship between these factors and innovation at a confidence level of 90%, 95%, and 99%. On the other hand, there were five factors that were found to have no effect on SME innovation in Lao PDR. These factors are the gender of the manager (Gen), retailing business (Ret), service business (Serv), number of labor (Ln(Labor)), and indirect export (Inex). Thus, the study found there was no statistical relationship and was consistent with the hypotheses.

Entrepreneurs are advised to maintain comprehensive records of their performance in order to effectively evaluate their business operations. Additionally, conducting a thorough analysis of loan applications is crucial. To enhance the convenience and likelihood of obtaining credit, entrepreneurs should develop a well-structured business plan and adhere to appropriate guidelines when applying for loans.

In order to support small and medium-sized enterprises (SMEs), the government should implement a specialized policy aimed at improving the loan application process. This policy should focus on streamlining procedures to ensure convenience and efficiency in providing loans as a means of capital accumulation. Furthermore, the government should actively promote awareness about loan application procedures and encourage entrepreneurship. Despite the existence of the Small and Medium Enterprises Promotion and Development Office (SMEPDO), which is responsible for managing a fund, it is important to note that the fund is limited in its scope and some entrepreneurs may not be aware of its availability.



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