2nd OECD CONFERENCE OF MINISTERS RESPONSIBLE FOR
SMALL AND MEDIUM-SIZED ENTERPRISES (SMEs)

PROMOTING ENTREPRENEURSHIP AND INNOVATIVE SMEs IN A GLOBAL ECONOMY:
TOWARDS A MORE RESPONSIBLE AND INCLUSIVE GLOBALISATION

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FACILITATING SMEs ACCESS TO INTERNATIONAL MARKETS

OECD

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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FOREWORD

At the first OECD Conference of Ministers responsible for SMEs, hosted by the Italian government in Bologna, Italy, in June 2000, Ministers from nearly 50 member and non-member economies adopted the "Bologna Charter for SME Policies". They envisaged the Bologna Conference as the start of a policy dialogue among OECD Member countries and non-Member economies and that it would be followed up by a continuous monitoring of progress with the implementation of the Bologna Charter. This dialogue and monitoring have become known as the "OECD Bologna Process". The second OECD Conference of Ministers Responsible for SMEs, hosted by the Turkish Ministry for Industry and Trade, envisaged by Ministers at Bologna, provides an occasion to assess the impact on SMEs of new developments relating to globalisation.

This report is one of ten background reports prepared for the Istanbul Ministerial Conference, the theme of each report being linked to a specific Workshop of the Ministerial Conference. Earlier versions of this report has been reviewed by the Working Party on SMEs and Entrepreneurship whose comments have been incorporated into the final version. Non member economies participating in the OECD Bologna Process have also had an opportunity to provide comments. This final report also sets out some policy messages and recommendations that have emerged from the preparatory work undertaken in the OECD Working Party for SMEs and Entrepreneurship. The wide variation in stages of economic development, institutional arrangements and political context across the economies participating in the Bologna Process, now more than 80, means that not all parts of specific policies and programmes are appropriate for all participants. The messages and recommendations outlined below provide material from which governments may choose to draw in promoting innovative SMEs in the global economy. In broad terms, these policy messages and recommendations elaborate on the themes developed in the Bologna Charter. Ministers will consider these and other recommendations in their deliberations at the Istanbul Conference.

This report was prepared by the SME Unit (Marie-Florence Estimé and Marian Murphy) of the OECD Secretariat in cooperation with external consultant Dr. Chris Hall, Macquarie University, Sydney Australia.

This and other background documents prepared for the 2nd OECD Conference of Ministers Responsible for SMEs may be downloaded free of charge from the following websites:

SME Unit website : http://www.oecd.org/sti/smes
Conference website: http://www.oecd-istanbul.sme2004.org

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EXECUTIVE SUMMARY

The globalisation process for SMEs can be realised through any of a range of cross border activities, including trade, international investment, and participation in strategic alliances, partnerships and networking arrangements affecting a variety of business functions ranging from research and product development to distribution. The globalisation of business, including the recent wave of global industrial restructuring has increasingly drawn SMEs, especially those in sectors subject to strong globalisation forces, into global value chains through different types of cross-border activities. There is evidence that a group of SMEs with high-growth potential require early access to international markets to ensure their development and growth. While generally SMEs report increased international business contacts in recent years, evidence suggests that relative to the contribution they make to local and national economies, SMEs, remain, overall, under represented in the international economy and change in this respect is slow to happen. For example, while SMEs typically contribute around 50% of GDP, and 60% of employment in national or local economies, most evidence suggests they contribute only about 30% of exports, and even less of international investment.

Key policy recommendations

- **Seek, through the WTO Round and other channels, to ease trade barriers.** Progress in this regard will facilitate efforts by SMEs to access international markets.
- **Promote the role that foreign direct investment can play as a vehicle for SMEs to access international markets.** In particular, the inclusion of local SMEs in the supply chains of multinational enterprises, and their resultant (indirect) involvement in exporting activity can lead to significant diffusion of technology and more efficient business models, thereby raising the international competitiveness of SMEs.
- **Encourage the smooth, cross-border growth of SMEs by reducing the need for internationally active SMEs to comply with multiple sets of rules or requirements.** Important areas in this regard include standards, intellectual property rights, financial market regulations and other regulatory domains.
- **Facilitate access to the information SMEs need to operate internationally.** Particularly important is information relating to tax, regulatory frameworks and requirements, advisory and support services for SMEs and dispute resolution procedures.
- **Enhance incentives for new public-private partnership initiatives that would help SMEs reach global markets for innovative products and access foreign sources of advanced technologies and knowledge.** This involves broadening the scope for foreign participation in national programmes and linking national networks of SMEs with similar needs and complementary capabilities.

Trends to increased levels of globalisation can impact on SMEs in two main ways:

i) On the one hand they open up opportunities. For example, SMEs which can grow quickly, which are niche exporters, or which are able to tie in with global supply chains are all able to take advantage of opportunities created by globalisation.

ii) On the other hand, globalisation poses an increased threat for SMEs which are unable or unwilling to compete. Given that labour is still less “globalised” than other factors, this poses political and social challenges for governments.

Those SMEs which *are* internationally active tend to be larger than the average SME. The average SME employs less than 10 people, whereas the bulk of SME exports and international investment comes from SMEs which employ more than 50 or 100 employees. Most net job creation and wealth creation seems to come from either fast growth firms or from net start ups and large firms are net destroyers of jobs. Therefore, only if the globalised economy is conducive to the start up and growth of entrepreneurial SMEs will the process of globalisation be seen as a positive force of net job creation (as opposed to a force for competition which just shifts existing jobs to lower cost economies).

It is suggested that in addition to a number of factors such as rapid changes in ICT and access to the worldwide web which appear to make it easier for SMEs to move across borders, other factors are at play which may be contributing to impede SME access to the global economy. A major factor said to continue to impede SMEs contribution to the global economy is the complexity and differences in the regulatory systems and business environment between countries. The success and growth of international SMEs will be enhanced by a more internationalised infrastructure geared to the smooth growth of firms across borders. This applies to the infrastructure for financial markets, advisory services, information access, telecommunications, intellectual property rights markets and regulation, dispute resolution processes, etc. all of which need to be internationalised. All of this requires active collaboration between governments, international agencies and the private sector to address these issues with the view to reaping the significant potential benefits that should accrue from the creation of a simpler, more business friendly, more integrated economy at international levels.

FACILITATING SMEs ACCESS TO INTERNATIONAL MARKETS

I. Introduction

During the past decade there have been steady technological and structural changes which have made it easier for SMEs to participate in the international economy. Advances in ICTs, and in particular, the Internet, have been a major factor in facilitating information flows and expanding the market potential of smaller firms. Governments have been making efforts to reduce barriers to international business activity, at the global and especially at the regional level (*i.e. European Union, APEC, ASEAN and ASEAN+, Mercosur, and more recently in the context of the Doha Development Agenda)*. A major policy challenge is to reap the potential benefits of the global economy for all businesses, including for the SME sector.

However, SMEs are still relatively under represented in the global economy. SMEs only contribute between one quarter and one third of manufactured exports and account for a very small share, usually less than 10%, of foreign direct investment (FDI) (Schreyer (1996), Hall (2002), Sakai (2002)). In most national economies SMEs make up more than 95% of market participants, and contribute around 50% of direct value added or production. Why do SMEs make, proportionately, a much smaller contribution to value added in global markets and why are fewer SMEs active on global markets? The reasons for this are manifold. International activities expose SMEs to a more complex and risky business environment, for which, compared to larger firms, SMEs are relatively unprepared and less well-resourced. Some of these risks and complexities can be addressed by governments as they relate to the differing regulatory, administrative and policy environments that governments create. There are significant potential benefits which might accrue from the creation of a more business friendly, more integrated economy at international levels. Were SMEs to increase their contribution to the international economy to levels approximating their contribution to national or local economies then the gains would be very substantial.

More detailed empirical evidence relating to the globalisation of SMEs is set out in the following section. This shows that while SMEs make a useful contribution to the international economy, and while SMEs use a variety of means, or vectors, to pursue international strategies (such as direct and indirect exports, alliances, networks, FDI, etc.), and while anecdotal evidence suggests some increases in the level of international SME activity, *SMEs still remain underrepresented in the international economy.* How to better capture the international potential of SMEs and entrepreneurs is an important policy issue.

For many enterprises gaining access to international markets and internationalisation is a strategic instrument for their competitiveness and their further development. Gaining access to global markets can help realise the potential for prospective high-growth firms, and is often an essential strategic move for SMEs with large investments in intellectual property. Such firms have high fixed and sunk costs which need to be recouped from as large a market as possible, as quickly as possible. Access to global markets can also offer a host of business opportunities, such as new niche markets; possibilities to exploit economies of scale, scope, volume and technological advantages; the upgrading of technological capability; ways of spreading risks; lowering and sharing costs, including R&D costs; and in many cases, affording improved access to finance. Recent research findings link high-growth firms and exports, and find that exporting is not the end of a strong growth process but rather appears instead to be its starting point and serves to accompany the growth process (OECD, 2002a).

In addition to opportunities, globalisation can also pose challenges and threats for SMEs by exposing them to heightened international competition from foreign firms and the associated adjustment and exit costs incurred; the issues of standards and international compatibility; intellectual property concerns; political risks, corruption and rule of law concerns. Globalisation can have important implications for business and organisation models, managerial and technological capability; and innovative capacity. SMEs from a resource viewpoint are less well-equipped/prepared than larger firms to face these globalisation challenges or to exploit the opportunities presented.

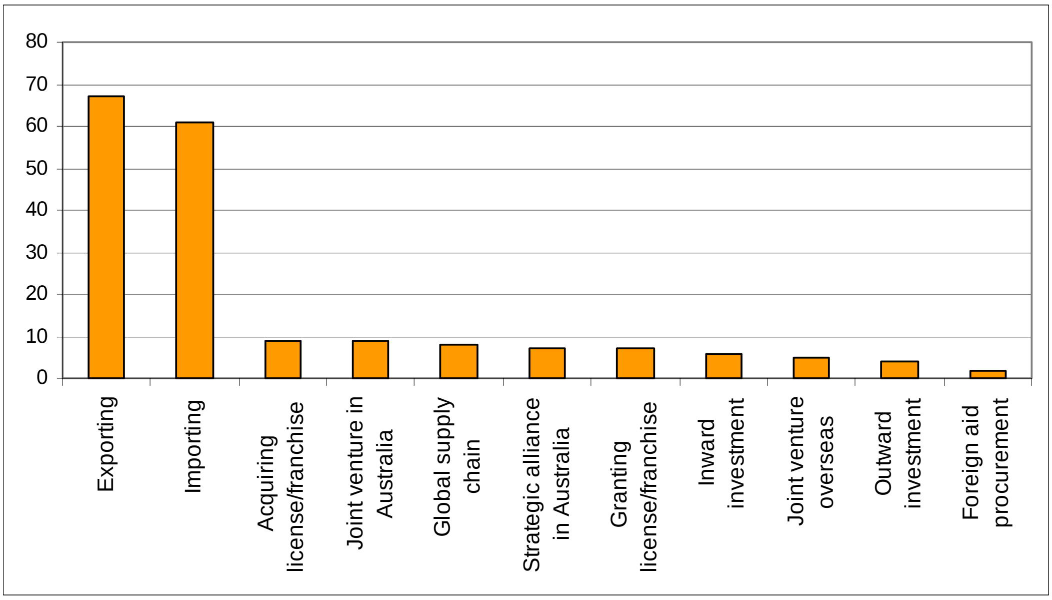
II. Evidence of the current level and trends of SME international activity

There is a shortage of accurate, timely statistics on levels and trends of international activity by firm size. Despite data shortcomings, this section seeks to sketch a broad picture of SME globalisation, showing the disproportionately low level of SME activity in international markets. The opportunities and challenges facing SMEs in global markets will be described, noting in particular the opportunities presented by global markets for a category of start-ups characterised by high-growth and export potential. Unfettered access to the global market allows such firms to develop niche markets and expand their businesses. The barriers and impediments which inhibit an entrepreneur's access to international markets will be reviewed, along with the policy implications to which they give rise.

i) SMEs' access to global markets: opportunities and challenges

The globalisation of business, including the recent wave of global industrial restructuring, has increasingly drawn SMEs, especially those in sectors subject to strong globalisation forces, into global value chains through different types of cross border activities (OECD, 1997, and in Sakai, 2002). There is evidence that a group of SMEs with high-growth potential require early access to international markets to ensure their development and growth (OECD, 2002a). The globalisation process for SMEs can be realised through any of a range of cross border activities, including trade, international investment, and participation in strategic alliances, partnerships and networking arrangements, affecting a variety of business functions ranging from research and product development to distribution. Figure 1 illustrates in a very summary fashion the extent to which internationally active SMEs in one OECD country, Australia, have recently engaged in types of globalisation activities. This has not changed substantially since the OECD research a decade ago.

Figure 1. Internationalisation of SMEs in Australia, by type of activities, 2001



Source: Yellow pages Business Index, 2001.

Many entrepreneurs are recognising the opportunities offered by internationalisation, and gaining access to international markets has become a strategic instrument for their competitiveness and their further development. Access to international markets for small businesses can offer a host of business opportunities, such as larger and new niche markets; possibilities to exploit scale and technological advantages; upgrading of technological capability; ways of spreading risks, lowering and sharing costs, including R&D costs; and in many cases, affording improved access to finance. Gaining access to international markets can help realise their potential for prospective high-growth firms, and is often an essential strategic move for SMEs with large investments in intellectual property. Substantial investments by such firms need to be recouped from as large a market as quickly as possible. Recent research links high-growth firms and exports, and finds that exporting is not the end of a strong growth process but rather appears instead to be its starting point (OECD, 2002a).

In addition to opportunities, globalisation can also pose challenges and threats for SMEs which from a resource viewpoint, are less well-equipped than larger firms to confront. These challenges can expose them to heightened international competition from foreign firms, and may result in the loss of traditional markets to lower-priced competition from overseas. Challenges and threats can concern the following: standards and international compatibility issues; intellectual property protection; political risks, corruption; and rule of law issues.

ii) Evidence on SME participation in international markets

Data are scarce and do not provide, except for a few countries, comprehensive and detailed information on the extent of the SME role in international markets and the pattern of its development. However, it is possible to sketch a broad picture for many OECD and some non-member economies, of SME globalisation which shows the disproportionately low level of activity by SMEs in international markets, when compared to that of larger firms.

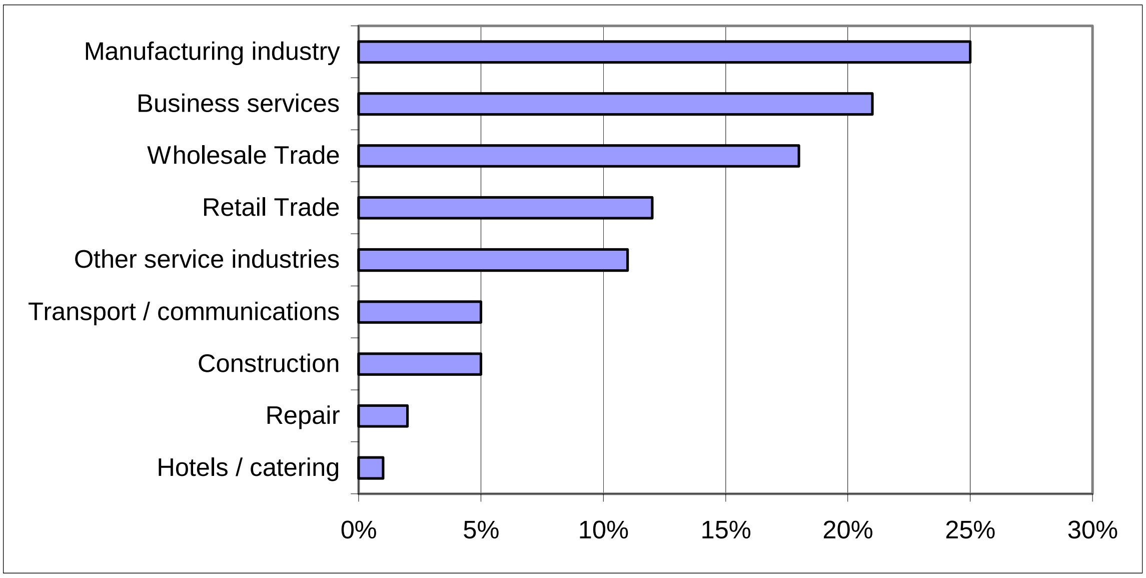
iii) SME exports and imports

The incidence and level of exporting activity are related to firm size, and as mentioned earlier, SMEs are in general, under-represented in world trade, although there is increasing evidence of SME globalisation for OECD and non-OECD economies. While they can comprise up to 99% of a country's enterprises, only about one-fifth of manufacturing SMEs in OECD countries draw between 10% and 40% of their turnover from cross-border activities. Overall, SMEs are estimated to contribute between 25% and 35% of world manufactured exports, although significant variations can exist across economies and by sector (Schreyer, 1996, Sakai, 2002).

A recent survey for the Observatory of European SMEs (2002) undertaken for 19 European countries found that approximately 20% of European SMEs (<250 employees) declared exporting activity (individual country shares ranged between 34% and 7%). While 20%, on average, of European SMEs were found to be involved in exports, the percentage varied by size class: micro enterprises (19%), small enterprises (32%), and medium-sized enterprises (46%) (Figure 2). More European SMEs in industry were exporters (22%) than in services (14%). In the United States, the exporting role of SMEs (<500 employees) has been growing and two-thirds of exporting firms were firms having fewer than 20 employees in 1998.

In contrast to European SME exporters, 70% of US exporting SMEs were outside the manufacturing sector[1].

Figure 2. Percentage Share of European SMEs that Export, Europe-19, 2002



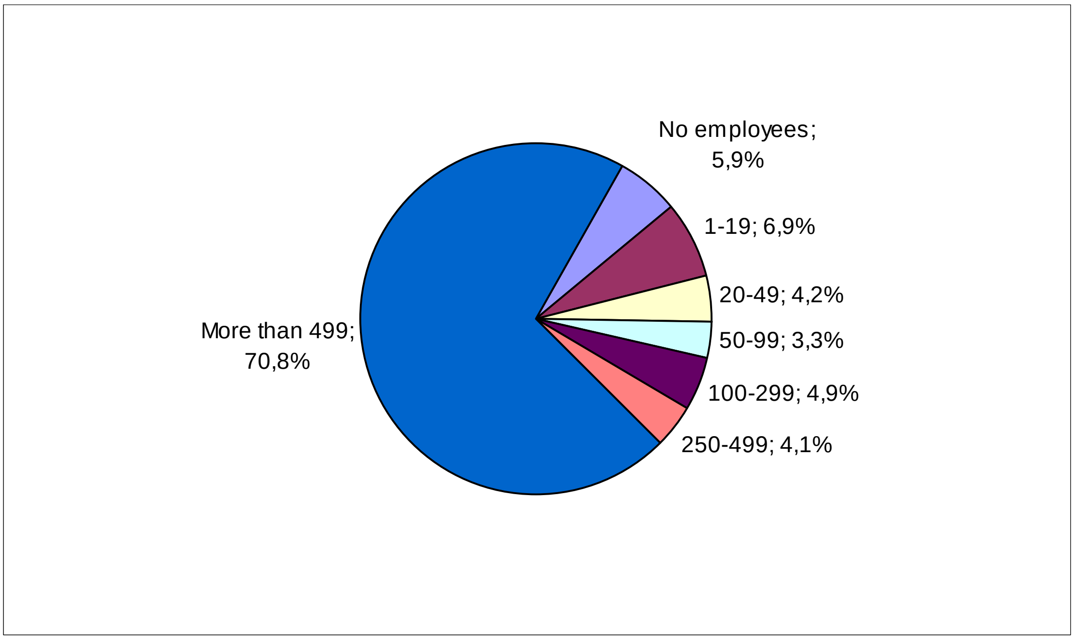
Source: ENSR Survey 2002 (for the Observatory of European SMEs) of 7669 SMEs in 19 European countries (weighted data).

In terms of their share in total exports, SMEs fare less well. In the United States, the SME share in total US exports averaged about 30% in recent years, 60% of which was accounted for by non-manufacturing companies. In Japan, the SME share (<300 employees) in total manufacturing exports was close to 50% throughout the nineties, similar to the Australian SME (<200 employees) experience, while in Korea, SME exports (<300 employees) varied between one third and two fifths of total exports during that time. The SME share in Korea's exports progressed from 36.9% in 2000 to 42% in 2002. A study conducted for APEC economies suggest that SMEs contribute less than 30% of exports, on average, in APEC economies (Hall, 2002).

Within SMEs, exporting activity increases with firm size. In terms of enterprise numbers, the share of European medium-sized enterprises engaged in exporting is more than twice that of micro-enterprises (EIM, 2002). In value terms, in the case of US exporting firms, it was firms that had at least 20 employees which were found to be the most successful exporters (US Department of Commerce, 2001) (see Figure 3). Data for Australia show that 36% of exports are attributable to firms having between 20 and 199 employees whereas 14% of exports originate at the level of small or micro firms.

1 . « Innovations in U.S. Trade Statistics: An Overview » -- Presentation to the OECD, September 26, 2000 by Jonathan Menes, Office of Trade and Economic Analysis, Department of Commerce, Washington D.C., United States.

Figure 3. Share of US Export Value, by size of Companies



Source: 1998 Exporter Database, US Department of Commerce and Small Business Administration.

Exporting SMEs do not tend to venture beyond one export market. Almost two-thirds of U.S. SME exporters in 1998 sold to just one foreign market, and another quarter of them had sales in between 2 and 4 foreign markets.

There is evidence that suggests that SMEs in some non-OECD economies have similar levels of exports to OECD SMEs. According to a recent UNCTAD report, certain Asian countries account for significant shares in total exports, as in Chinese Taipei (where SMEs were thought to make up 56% of total exports), China (40-60%), and Singapore (16%). However, it may be claimed that the figures for Chinese Taipei are misleading and even incorrect as they are based on estimates of residuals. More recent and reliable official estimates (Hall, 2002) based on Value Added Tax show that SMEs in Chinese Taipei contributed only 21.6% of exports in 2000. In certain Latin American economies SMEs make up a disproportionately small share in total industrial exports, *e.g.* in Brazil (22%), Costa Rica (29%), and Peru (25%) (Table 3).

Some SMEs have significant levels of imports, sourcing inputs for their businesses, which serve to assist their globalisation process. Data for imports by enterprise size class appear to be scarcer than for exports.

Table 3. Share of SME Exports in Industrial Exports in Selected non-OECD Economies

	SMEs' Share in industrial exports
Argentina (1995)	10
Brazil (1998)	22
Chile (1993)	5
Colombia (1997)	35

Costa Rica (1997)	29
Peru (1994)	25
Uruguay (1988-95)	18
Venezuela (1996)	5

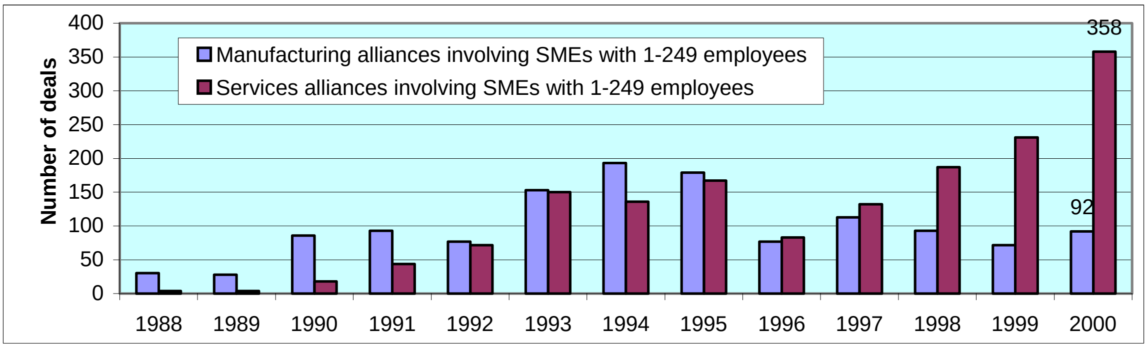
Source: UNCTAD paper "Improving the competitiveness of SMEs through enhancing productive capacity" report by the UNCTAD Secretariat, Addendum (TD/B/COM3/51/Add.1).

iv) SME participation in international alliances and networks

The recent and ongoing wave of global industrial restructuring, combined with technological advances (especially in ICTs) have been the major driving force for the rapid development of cross-border strategic alliances, mergers and acquisitions and inter-firm networking. Opportunities have emerged for SMEs to become: i) partners in international strategic alliances; ii) participants or targets in cross-border mergers and acquisitions; iii) specialised suppliers to multinational enterprises; iv) members of globalised informal networks; and/or v) participants in electronic networks (Sakai, 2002). For SMEs such arrangements can confer any of a variety of benefits including access to financial resources, pooled research efforts, product development, wider distribution channels, etc. Large firms are motivated to form alliances with SMEs, as when faced with rapid changes in technologies and customer preferences, and shorter product life cycles, such alliances can help to fulfil specific needs. Figure 4 shows the evolution of such cross-border alliances during the period 1988-2000. A survey conducted in 2001 of more than 7 600 European enterprises revealed that about one-third of all SMEs reported an increasing number of international business contacts over the previous five years, ranging from 30% for micro enterprises to 50% for medium-sized enterprises (Observatory of European SMEs, 2002).

During the past decade, small firms became more frequent participants *and t*argets of *cross border mergers and acquisitions*, often with larger firms that were seeking specialised units, new technologies or niche products and services. A principal SME motivation may be to seek to: strengthen market presence; secure new management; ensure the survival of the business following retirement; or obtain new capital to start another venture. Becoming a *specialised supplier* to large multinational enterprises is another form of globalisation, as demonstrated so successfully by some SMEs in the automobile and electronics industries. Through such arrangements, SMEs can expect to upgrade their products and processes, and enjoy a bilateral partnership involving mutual learning with its partner firm.

Figure 4. Cross-border alliances involving SMEs, 1988-2000



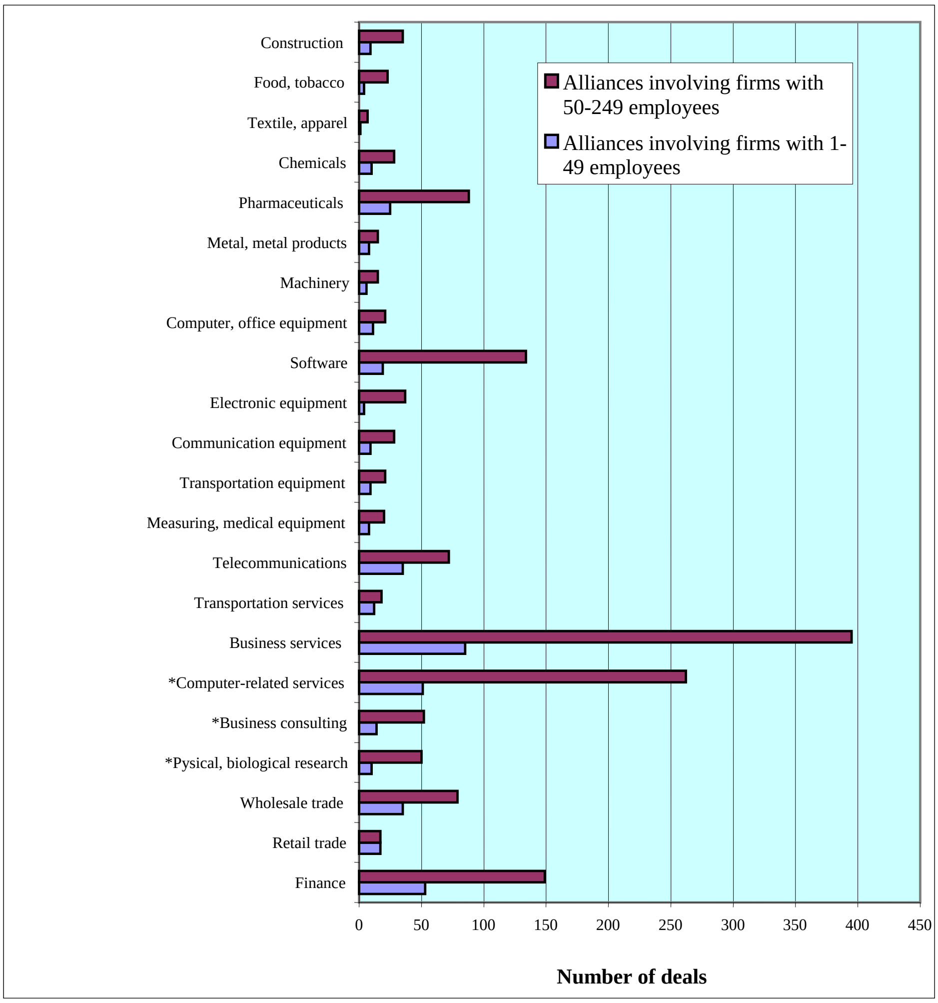
Source: OECD, and Sakai 2000.

Clustering and networking[2] also facilitate the globalisation process for SMEs, and inter-firm networks offer the prospect to small firms to compete on a par with larger companies. Both clusters and networks can lead to greater specialisation amongst small firms, opening opportunities for economies of scope and scale. Productivity, innovativeness and competitive performance, can be enhanced. Specific benefits arising from such inter-firm collaboration include a more efficient division of labour between enterprises, joint design possibilities, and marketing initiatives.

In sum, the development of inter-firm SME collaboration varies by industrial sector and by firm size. In particular, many providers of high-technology and knowledge-based goods and services are rapidly becoming internationalised, particularly through strategic alliances with larger companies. Cross-border alliances involving SMEs in the ICT industry, pharmaceuticals and business services, increased significantly in the second half of the 1990s through 2000. Figure 5 shows the number of alliances by industry made during this period. Most SMEs joining alliances in these sectors are medium-sized firms, the bulk of the deals involving collaboration with larger firms, although some are also with other SMEs.

2. An enterprise cluster is an agglomeration of co-located firms working in related lines of business and while not all networks need be geographically concentrated, networking is a critical element underlying the competitive advantages that derive from membership of a cluster. *Source*: "Partnerships, clusters and networks: opportunities and challenges for innovative SMEs in a global economy" a separate background report prepared for the Istanbul SME Ministerial Conference.

Figure 5. Cross-border alliances involving SMEs by sector, 1995-2000

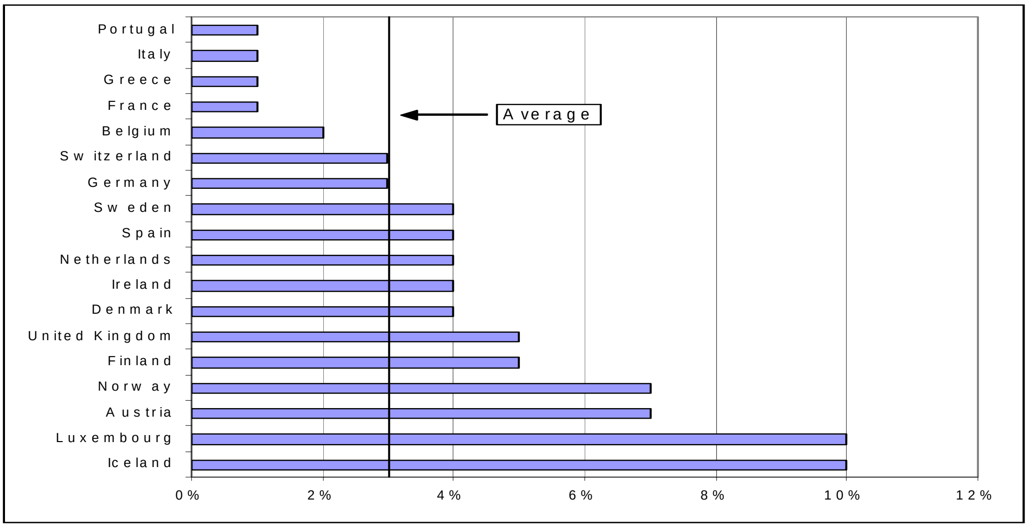


Note: * Sectors that are part of business services.
Source: OECD.

v) SMEs and Foreign Direct Investment (FDI)

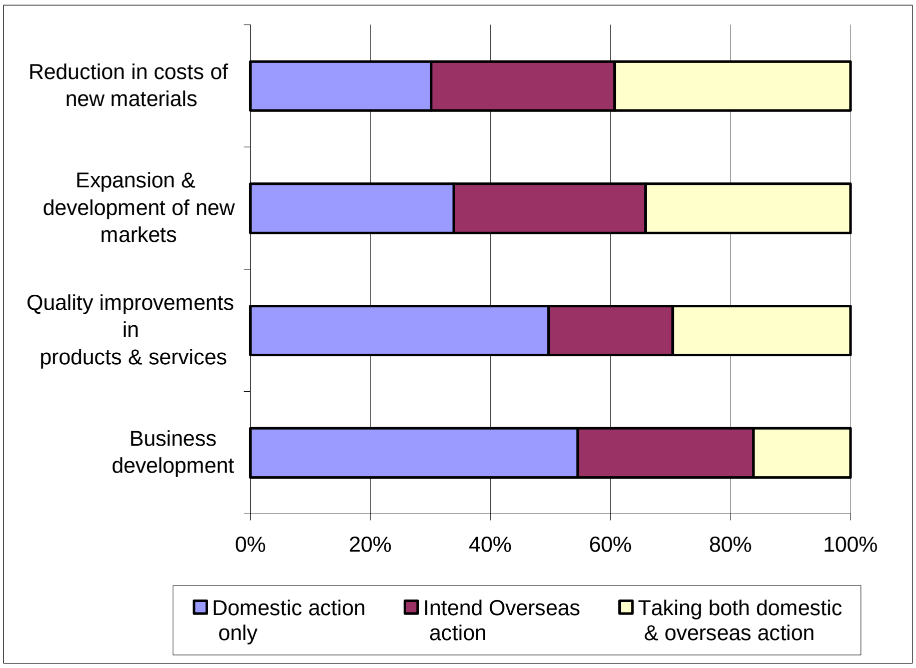
Foreign direct investment (FDI) can be another important vehicle for SME globalisation, although generally tending to occur down the line (after successful experience gained in exporting and perhaps forming alliances) although some young high-tech companies are an exception. A very small minority of SMEs invest abroad, and a recent survey showed that only 3% of SMEs in Europe have subsidiaries, branches or joint ventures in other countries (Figure 6). However, this is not true for all OECD countries. In the case of Korea, according to the Small and Medium Business Administration (2004) the share of SMEs foreign investment abroad rose from 16.0% in 2000 to 20.6% in 2001 and 37.6% in 2002. Findings of a recent survey of Japanese SMEs (Figure 7) show that when faced with business challenges, approximately two-thirds of SMEs that wished to expand or develop new markets and about two-thirds of companies that seek to reduce the costs of materials, were taking action *both* domestically *and* overseas (the latter implying FDI) *or* were intending to take action overseas. On the other hand, with regard to the business goals "business development" or "quality improvements in products and services", about half of Japanese SMEs stated that they intended to take action only on domestic markets.

Figure 6. Internationalisation: European SMEs (<250 employees) having subsidiaries/branches/joint ventures located abroad, 2001 (% of SMEs)



Source: ENSR Survey (Observatory of European SMEs) of 7669 SMEs in 19 European countries conducted in 2001.

Figure 7. Japan: Domestic & Overseas Responses by SMEs to Business Challenges

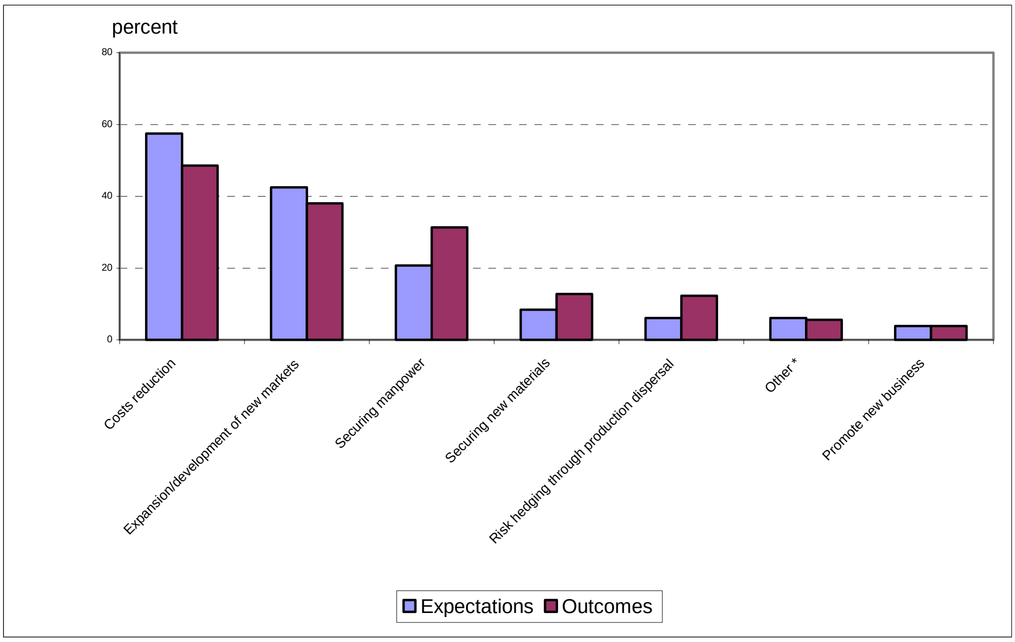


Source: JASMEC, Overseas Expansion by Small and Medium Enterprises (March 2001).

SMEs need to make adequate research and preparations before investing in overseas projects. While SMEs may have any of a variety of objectives when they decide to invest into foreign markets, few statistics are available about the extent to which these objectives are met. Evidence concerning Japanese

SMEs finds that the actual outcomes in terms of their two principal objectives for undertaking the investment (cost reductions, and expansion and development of new overseas markets) fell short of expectations, only about one-third of the firms succeeding in expanding and developing new markets. On the other hand, expectations concerning other less important goals, such as sourcing manpower and new materials, were exceeded (Figure 8). Decisions to withdraw from the overseas market by Japanese firms were taken largely because of falling sales. Other reasons leading to investment withdrawal include problems experienced with partners in the host country, or changes in the local business environment.

Figure 8. Expectations and outcomes of overseas investments, Japan, 2002



* *Other:* requested by parent company, acquisition of data, training of employees and PR centre, expansion of scale of business.
Note Totals exceed 100 due to multiple responses.

Source: JASMEC, Overseas Expansion by Small and Medium Enterprises (March 2000).

SMEs may also achieve a level of internationalisation by exploiting the opportunities that inward FDI can offer to SMEs to engage in (indirect) exporting activity. Global corporations who account for most of world FDI and world merchandise trade, according to recent research estimates by Dembinski (2003), are actually quite complex structures whose value chains may involve a large number of SMEs. The advantages conferred on local SMEs by becoming suppliers to these global firms establishing locally, can be observed on several fronts: in terms of upgrading of business and organisation models, managerial and technological upgrading; skill acquisitions, and innovative capacity.

Because the extent and type of cooperation with outside enterprises vary from one industry to another, depending on a range of factors, the project is expected to examine the patterns of cooperation/competition between SMEs (dependent and independent) and large enterprises with special reference to five different global industries: automotive industry; the hotel industry; precision instruments; the music and film industry; and the software industry. The study will also, to the extent possible, cover both OECD countries and non-member economies. It is expected that the research, by identifying the potential needs and weaknesses of SMEs hooked into global supply and distribution chains, will allow policies to create a more level playing field for SMEs.

III. Barriers and impediments to SMEs' access to markets and SME globalisation

To date, there has been little research undertaken to quantify the amplitude of impediments to SME globalisation or their economic impact, for either OECD member countries or non member economies. However, it is to be expected that trade and FDI would benefit significantly if a more business-friendly, more integrated international economy, existed.

Barriers and impediments that deter or inhibit SME access to global markets deny enterprises and ultimately domestic economies the significant potential gains to be reaped on global markets. For instance the issue of Alternative Dispute Resolution (ADR) is becoming an important issue for SMEs in their cross border business transactions. For this reason the SME Working Party in cooperation with other relevant bodies of the OECD is pursuing work in this area.

While a majority of SMEs have the vocation to serve only local markets, a significant share of enterprises need to access foreign markets to ensure their survival and expansion, among which is a group of high-growth, export-oriented enterprises (OECD, 2002). The unique business environment of each target "foreign" market, characterised by its own configuration of regulatory, administrative, policy and cultural dimensions, embodies a formidable challenge to the would-be SME exporter, investor, or future network partner, involving both complexity and risk dimensions, for which the exporting SME is largely ill-prepared. SMEs are less well-resourced than large firms for meeting globalisation challenges but experience the same needs as larger firms for prior research and preparations before embarking on global markets.

Many of the barriers that SMEs can face originate at the level of the national economy, institutions, and general infrastructure. Competition policy, legislative and regulatory frameworks, telecommunications infrastructure, research and education policy all contribute to SME preparedness or lack of preparedness for globalisation. Barriers can concern, *inter alia*, intellectual property rights; political risks; corruption and rule of law issues. They can relate to the entire range of business operations, having implications for business and organisation models, managerial and technological capability; and innovative capacity. As mentioned earlier, SMEs are less well-equipped than larger firms to address these difficulties.

That said, SMEs from more developed, knowledge-based economies are nonetheless, relatively better placed than SMEs in emerging and developing economies to meet globalisation challenges, benefiting as they do from a more business-friendly, and supportive policy environment.

The protection of intellectual property can be a serious issue for SMEs with global[3]. Within the SME population there is enormous potential for developing new and innovative products and services, as evidenced in certain high-technology sectors, such as semiconductors and biotechnology. Depending on the sector, patenting activity, trademarks and industrial designs, or the copyright system, can have central importance. An intellectual property system which is ineffective, inefficient, inaccessible, or unsuitable for SMEs, can constitute a major barrier and impediment for a would-be globalising SME. There is a need for monitoring the environment to decide which policy or other measures need to be taken.

Governments have a role to play in order to lower the barriers faced by entrepreneurs who wish to globalise their activities – thereby benefiting, in particular, a category of entrepreneurs whose businesses have high growth and export potential and who could develop and exploit niche markets and expand their businesses on international markets. Governments need to ensure that regulatory, administrative and policy

3. In May 2003, the World Intellectual Property Organization convened a Forum open to the Intellectual property offices of OECD member countries in order to share experience concerning their respective efforts to encourage SMEs to benefit from the use of the Intellectual Property system.

environments do not inhibit access to global markets. Efforts by governments seeking to ease such barriers through the WTO Round and the appropriate channels would benefit SME trade and FDI involvement.

In particular, with respect to innovation networks, disincentives and obstacles to networking by SMEs translate into three types of bottlenecks/distortions in multi-layered regional, national and global research and innovation networks:

- Lack of collaboration between SMEs which reduces the circulation and exchange of information and tacit knowledge, to the detriment of non-technological innovation, for instance in the fields of market intelligence, design and branding, and human resource development.
- Insufficient interaction between high-tech firms and others, to the detriment of technological innovation and technology diffusion, especially in science-based fields.
- Geographical imbalances in international co-operation patterns, including the under-development of "North-South" and "South-South" co-operation.

Governments have a role to play to correct such imbalances within global innovation networks by: (i) ensuring that their promotional programmes help national actors to access international networks, and (ii) developing the international dimension of public-private partnerships. They must also co-operate to avoid mismatches between the strong regional dimension of most self-organised SME networks, the national scope of many programmes to promote them, and the increasingly global nature of the knowledge infrastructure and of markets for innovative products and services. This involves interconnecting national and local hubs of technology transfer, linking national networks of SMEs with similar needs and complementary capabilities, building global networks of intermediary organisations, and coordinating national support programmes.

IV. Implications for Policy

SMEs are under represented in the global economy. The main reason for this appears to be that there are impediments to their internationalisation. In other words, the international business environment is less conducive to the start up and growth of companies than are the domestic business environments in most countries. Although the evidence on these impediments is mostly fragmentary and anecdotal, it would seem that many of the impediments are *not* at the borders, but rather are NTBs (non tariff barriers), and often relate to the need for smaller firms to deal with two or more sets of regulatory requirements once they go beyond a single market. At present, the biggest contribution from SMEs to exports and FDI comes from quite large SMEs; typically those employing less than about 50 people only make a small contribution. However this is more a reflection of the high fixed (and often sunk) costs of doing business internationally. Were these costs to be reduced, by reducing the various impediments, there is no reason why smaller firms could not make a greater contribution beyond their immediate national borders. There is increasing evidence that quite small firms *can* now successfully operate internationally, as a result of a constellation of factors that have been evolving over the last two decades, such as: improved technology for communication and management; better awareness and education of managers; greater internationalisation of large firms and service providers; the acceptance of new and innovative corporate "vehicles" (clusters, networks, etc.); reductions in language barriers through a variety of factors (English as lingua franca in much of the world, automatic translation tools, etc.); and the increasing pervasiveness of the worldwide web. In short, there are many factors facilitating the internationalisation of smaller SMEs, but government and its national administrative rules and burdens remains one of the main factors impeding the internationalisation of smaller firms.

There are some significant potential benefits which might accrue to the world economy were we to develop a more conducive International Entrepreneurial Business Environment (IEBE). On the one hand, the potential gains from reducing trade barriers are still there and should be pursued, but the fifty years of benefits which have flowed from GATT and WTO are unlikely to be repeated in the next fifty. The main areas of potential gains from trade are now in politically sensitive areas, such as agriculture, and some national services (such as communications, airlines, and banking) where progress is possible, but likely to be slower. On the other hand, increased entrepreneurship and the growth of SMEs internationally could add significantly to the global economy. Modelling and estimating the size of the potential benefits is difficult, but can be done with some simple and robust assumptions.

These potential benefits are most likely to accrue from growth oriented firms, managed by entrepreneurs with a higher than normal propensity for risk and uncertainty. These firms are a major source of job creation and wealth creation. They also often provide a means for large firm expansion, as large firms target them for takeover. Although many of these high growth SMEs will be relatively large (and of course, some dynamic SMEs in this category "disappear" by becoming large), there is no real reason (apart from government impediments) why quite small, and even micro firms, cannot be active in taking advantage of the opportunities offered by a more international business environment. The business environment which is conducive to these entrepreneurs is likely to be one which:

- Is continually changing in the sense of continually opening up new opportunities, without being chaotic or unstable at a macro economic and societal level.
- Allows and encourages entry, and exit without unnecessary impediments and restrictions, and in which mobility of resources is high (and thus so also are competition and contestability).
- Is supported by an international infrastructure. That is to say that the infrastructure for financial markets, advisory services, information access, telecommunications, intellectual property rights markets and regulation, dispute resolution processes, etc all have to be internationalised.

At the same time, globalisation also imposes costs. The main costs are likely to be felt by small lifestyle and micro businesses that are unable or unwilling to cope with increased competition and pressures of change. These small firms are usually operating only at a local level, but are nonetheless affected by the broader international environment, without them being able to leverage much advantage from internationalisation. In addition, there will always be gains accruing to some regions or countries which have a more attractive entrepreneurial business environment. This attractiveness is relative to that prevailing in other locations and countries, and relative to the different types of entrepreneur.

A main factor impeding the development of a more conducive International Entrepreneurial Business Environment could be governments themselves. These impediments are difficult to monitor at present, because they are relative, not absolute, and because most are non border impediments. There need to be better ways of identifying what government regulations and practices are impeding the start up, growth and internationalisation of fast growth firms. Because many of these firms are small, and because they are "pushing the envelope" in new industries and new technologies they do not show up as significant "blips" on trade negotiation "radar screens" Governments need to collaborate more to set up monitoring systems to identify these impediments, understand their longer term impact, and establish mechanisms for addressing them, at bilateral and multilateral levels.

The success and growth of international SMEs will be enhanced by a more internationalised infrastructure geared to the smooth growth of firms across borders. This applies to the infrastructure for financial markets, advisory services, information access, telecommunications, intellectual property rights markets and regulation, dispute resolution processes, etc. all of which need to be internationalised. All of this requires active collaboration between governments, international agencies and the private sector to address these issues with the view to reaping the significant potential benefits that should accrue from the creation of a simpler, more business friendly, more integrated economy at international levels.

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