Background information

This paper was prepared as a background document to the OECD Ministerial Conference on Small and Medium-sized Enterprises, taking place on 22-23 February 2018 in Mexico. It sets a basis for reflection and discussion.

About the Ministerial Conference

The 2018 OECD Ministerial Conference on Strengthening SMEs and Entrepreneurship for Productivity and Inclusive Growth is part of the OECD Bologna Process on SME and Entrepreneurship Policies. The Conference will provide a platform for a high-level Ministerial dialogue on current key issues related to SMEs and entrepreneurship. It will seek to advance the global agenda on how governments can help strengthen SME contributions to productivity and inclusive growth; how SMEs can help address major trends and challenges in the economy and society; and how the OECD the support governments in designing and implementing effective SME policies.

More information: oe.cd/SMEs

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Enabling SMEs to scale up

Discussion paper
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Summary

- Enabling SMEs to scale up can help countries address low productivity growth and widening income gaps, since SMEs that grow have a considerable impact on competition, innovation, employment and wages.
- SMEs, with different characteristics and across many sectors, can scale up at different stages of their life cycle, to seize new opportunities in markets and strengthen competitive position. High growth represents a transitory stage in the life of firms. Many factors influence high growth, and entrepreneurs’ skills and ambitions are critical.
- Start-ups that scale up represent only a tiny fraction of all start-ups, but are a key source of innovation and job creation. However, post-entry growth varies widely across countries, and surviving start-ups scale up faster in high-risk sectors, such as telecommunications, scientific research and development and IT services.
- Medium-sized enterprises that scale up are a driving force of competitiveness and often contribute to increase aggregate productivity by ensuring coordination and upgrading of smaller suppliers.
- Participation in global value chains (GVCs) allows SMEs to scale up and increase productivity, especially in sectors that are at the centre of global production networks.
- The digital transition triggers new and different forms of business growth, with some companies able to achieve a substantial scale without an important mass of employees or other tangible assets. However, digitalisation also increases the need for skills upgrading and investment in complementary assets.
- A coordinated policy approach is needed to support the scaling up of SMEs and start-ups. Institutional and regulatory settings are crucial, as well as policies to ease SMEs access to markets and strategic resources for scaling up, including growth capital, workers and management skills, as well as knowledge and technology. Strengthening partnerships between SMEs, large firms, investors, Universities and research centres, including at the local level, can spur SME growth.

Questions for discussion

1. What policy approaches have proven effective in stimulating the scaling up of start-ups and SMEs? Which barriers to SME growth call for further attention?
2. How can digital technologies be harnessed to enable SMEs to scale up? How can policy address the barriers to adoption and use by SMEs of digital technologies?
3. How can policy take into account different growth aspirations by entrepreneurs and help them manage the challenges of high growth?
The scaling up of SMEs is key to boost productivity and achieve inclusive growth

The dynamics of SMEs and entrepreneurship is a key underpinning for productivity enhancement and inclusive growth. SMEs that grow, in terms of employees, turnover profitability or market share, can have a considerable impact on employment creation, innovation, productivity growth and the competitiveness of national and sub-national economies, as well as contribute to raising wage and income levels. Scaling up may be sought following the start-up phase, but also at other moments in the life of a firm, for example to satisfy a major increase in demand, strengthen a competitive position, or seize new opportunities in markets.

In many countries, enabling SMEs to seize growth opportunities over time is a policy priority to address low productivity growth and widening wage and income gaps. Across countries, there is in general a persistent productivity gap between SMEs and large firms. To the extent that large firms can exploit increasing returns to scale, productivity typically increases with firm size, although some variability across sectors and countries is observed. In particular, in the services sector, medium-sized firms outperform large firms in some countries, exhibiting competitive advantages in niche, high-brand or high intellectual property content activities, as well as the intensive use of affordable ICT.

In some OECD countries, the gap in productivity between SMEs and large firms increased in aftermath of the crisis. While for small and medium-sized enterprises there has been a reversal in this trend during the recovery, the larger gap has become persistent for micro-firms, especially in manufacturing (Figure 1).

Figure 1. The productivity gap between large firms and smaller SMEs has widened in some OECD countries since the global crisis

Value added at factor cost per person employed, current US dollars, current PPPs
Large firms (250 persons employed or more = 100)

<table>
<thead>
<tr>
<th>Manufacturing</th>
<th>Business services</th>
</tr>
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<tbody>
<tr>
<td>Micro (1-9 persons employed)</td>
<td>Micro (1-9 persons employed)</td>
</tr>
<tr>
<td>Small (10-49 persons employed)</td>
<td>Small (10-49 persons employed)</td>
</tr>
<tr>
<td>Medium (50-249 persons employed)</td>
<td>Medium (50-249 persons employed)</td>
</tr>
</tbody>
</table>

Note: Data cover Austria, Czech Republic, Estonia, Germany, Hungary, Italy, Latvia, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, and United Kingdom. Data for manufacturing (10-33 of ISIC rev.4) and business services, excluding financial services (45-82 less K of ISIC rev.4).
In many emerging and developing economies, the productivity gap between large firms and SMEs — and the resulting income gaps — are especially large, due in particular to a disproportionate concentration of employment in micro and small firms, often informal ones, with relatively little employment in medium-sized firms.

Productivity growth is faster when businesses can grow... and shrink

Across countries, the distribution of business growth exhibits large similarities, with most firms experiencing modest or zero growth, and a relatively small share of firms that are expanding or contracting. However, evidence shows that productivity grows faster in competitive environments, where the share of firms that expand and shrink is higher.

A dynamic distribution of firm growth is linked to innovation, as it reflects a business environment where firms experiment with new projects, scale them up when successful, and are able to back track and shrink when unsuccessful (Bravo-Biosca, 2010). Furthermore, expanding SMEs contribute to innovation and higher productivity indirectly, by contesting markets and forcing other firms to invest and upgrade (OECD, 2010a).

SMEs can experience high-growth at different stages of their life cycle, generating benefits for the economy

High-growth firms (HGFs) are firms that grow rapidly over a short period of time. They typically represent a small share of total businesses, but account for a larger share of employment. For example, when considering established companies with more than 10 employees, in 2015 in Israel HGFs represented 4% of firms but accounted for 10% of employment (OECD, 2017b).

While there may be a short-term trade-off between rapid employment growth and productivity growth, evidence suggests that, in the long run, HGFs have higher productivity growth than other firms, since they are more innovative and invest heavily in human capital (Du and Temouri, 2014; OECD, forthcoming). Furthermore, HGFs provide an indirect contribution to productivity growth by sparking new demand for advanced products and services, generating knowledge spill-overs which other nascent or existing enterprises can harness, and strengthening the local entrepreneurial culture by acting as role models for future and nascent entrepreneurs (OECD, forthcoming; OECD 2010a).

... but high growth is a transitory stage in the life of firms

Evidence suggests that "high growth" represents a transitory phase in the life of firms, which may have different characteristics and operate in many sectors (OECD, 2010a). In fact, there is no consistent pattern across countries as to which sectors host the largest share of high-growth enterprises. For example, in France and Sweden the rate of high-growth enterprises is higher in the services than in the industry sector, while in Hungary

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1 The OECD-Eurostat Manual on Business Demography Statistics (2007) defines high-growth enterprises as “enterprises with an average annualised growth greater than 20% a year, over a 3-year period, and with 10 or more employees at the beginning of the observation period”. Growth is measured by turnover or employment, with the turnover definition giving higher numbers than the employment definition. Gazelles are the subset of high-growth enterprises which are up to five years old. In the European Union, the Commission implementing regulation (EU) No 439/2014 has lowered the recommended growth threshold to “greater than 10% per annum, over a three year period”.
and Latvia the opposite is true. However, countries with a comparatively large share of HGFs in one activity tend to have a large share of HGFs in other activities, too, suggesting that the drivers of high growth are strongly influenced by the underlying business environment (OECD, 2017b).

While HFGs are more common in regions with high population density and skilled human capital (i.e. large urban areas), especially in the services industry, they can also sprout in peripheral regions, where their impact on net job creation and social inclusion can be significant (OECD, forthcoming).

Evidence suggests that established firms account for the largest share of HGFs. For instance, in 2014 in Canada and in 2015 in New Zealand respectively, 82% and 87% of HGFs were more than 5 years old (OECD, 2017b). However, within a given size class, young firms (less than 5 years) appear more likely to be high-growth firms than their older counterparts (Bravo-Biosca, 2010).

HGFs tend to be innovative, but are not necessarily found in high-tech sectors; in some countries, for instance, they appear to be overrepresented in the business-to-business services segment. Very few high-growth firms are university spin-offs, while a larger share are corporate spinouts, suggesting the importance of knowledge channels and close interaction with customers and other entrepreneurs to seize growth opportunities (OECD, forthcoming).

Growing fast can also put considerable pressure on managerial, financial and technical resources, and growing firms may need to address new risks that scaling up can bring. In particular, difficulties in supporting the leadership capabilities of SMEs, such as through an expansion of the leadership team around the founder, have been identified as a key barrier to growth (OECD, 2010a; Goldman Sachs, 2015).

Furthermore, while high growth is the result of a mix of factors, growth ambitions, skills and personal experience of the entrepreneur, such as international experience and links to knowledge networks, are critical (Richbell et al., 2006; Moen et al., 2016). In fact, most entrepreneurs do not wish to grow, especially in employment, even under favourable macroeconomic conditions. A survey among UK SMEs, for example, indicates that only about 15% of firms have substantive growth ambitions (TBR, 2016). The entrepreneurial eco-system is important for nurturing the growth ambitions of SMEs, and policies can have an impact on aspirations of current and potential entrepreneurs, through entrepreneurship education and training, support to peer-to-peer networks and collaboration between entrepreneurs and knowledge centres, and promotion of role models. Still, a better understanding of what types of measures might be most effective in different contexts is needed.

**Start-ups that scale up provide a key contribution to job creation**…

Start-ups are a key source of radical and disruptive innovations and young firms contribute disproportionately to net job creation: the share of young SMEs in total job creation is about twice as large as their share in total job destruction or in total employment. The same is true for young large firms, although there are relatively few such firms. Older SMEs and older large firms continue to account for the bulk of employment across countries, but create fewer jobs than they destroy (Figure 2).
Figure 2. Young firms are a key driver of job creation

Employment, job destruction and job creation by firm age and size

Note: Data cover eighteen countries and firms in manufacturing, construction and non-financial business services, and refer to the 2001-11 period for most countries. Owing to methodological differences, figures may deviate from officially published national statistics.

Source: Criscuolo et al. (2014) based on the OECD DynEmp Express database.

Start-ups that grow represent only a tiny fraction of all start-ups. However, it is the rapid scaling up of a small number of very successful start-ups that drives the large overall job creation by young firms. For instance, only 4% of micro-start-ups grow on average, but they contribute disproportionately to new jobs in this segment: between 22% (the Netherlands) and 53% (France) (Figure 3).

In contrast, most start-ups either fail in the first years of activity or remain very small. For instance, Figure 3 shows that out of 100 micro start-ups entering the market in a given year, after five years 26 to 58 are not active, 36 to 71 have still less than 10 employees, and only 1 to 8 have 10 employees or more. The large number of failing young firms is due to the distinctive “up-or-out” dynamics of start-ups, where high average growth rates co-exist with low survival rates. This happens to a much larger extent for young firms than for older incumbents (Bartelsman et al., 2013; Criscuolo et al., 2017).
Figure 3. Few micro start-ups grow, but these contribute disproportionately to job

Panel A: Share of firms

Panel B: Share of total job creation/ job destruction

Note: Figures report the average for different time periods t = 2001, 2004 and 2007, conditional on the availability of data. Panel A represents the share (in terms of number of units) of micro (0-9 employees) entrants at time t by their size class at time t + 5. Panel B represents the net contribution to aggregate flows (defined as net job creation by the group over the sum of the net job variations by all groups in absolute values) for micro (0-9 employees) entrants at time t by size class at time t + 5. Size classes are aggregated as follows: stable (0-9 employees), growing (10 or more employees) and exiting units. Owing to methodological differences, figures may deviate from officially published national statistics. Source: Criscuolo et al. (2017) based on the OECD DynEmp v.2 database.

... but post-entry growth of start-ups varies widely across countries

There are sizeable differences across countries in the extent to which younger firms are able to scale up. Rapid expansion of successful young firms seems to be more of a feature of the United States than of other OECD economies (Calvino et al., 2016). The cross-country differences depend on the industrial structure and country size, but are likely to be also affected by institutional and policy settings. Figure 4 shows that although for all countries most of the growth of new entrants occurs in the first 2-3 years of activity, there
are significant differences across countries in the extent to which start-ups continue to grow in the following years. For instance, in countries like Belgium and Sweden, start-ups continue to grow also after five and seven years following entry, while in other countries – like Italy and Denmark – the trend is much flatter after the third year.

**Figure 4. Post-entry growth varies across countries**

Country average of final over initial employment for initial years 2001 and 2004, surviving entrants at 3, 5, and 7 years, in percent

*Note:* The graph shows the ratio between employment at time $t+j$ and employment at time $t$ of surviving entrants. Figures report the average for different time periods $t = 2001$ and 2004, conditional on their availability. Sectors covered are: manufacturing, construction, and non-financial business services. Each of the time lags $j = 3, 5, 7$ is reported separately. Owing to methodological differences, figures may deviate from officially published national statistics.

*Source:* Calvino et al. (2016) based on the OECD DynEmp v.2 database.

**Medium-sized enterprises that scale up are key drivers of competitiveness**

Established medium-sized enterprises that innovate and scale up are the driving force behind growth in many OECD economies, often ensuring the coordination, upgrading and participation in supply chains of smaller firms. For instance, in Italy, more than 60% of manufacturing medium-sized firms are located in industrial districts and play a crucial role in driving local supply chains of specialised small producers, typically focusing on market niches which are created or dominated through product differentiation and continuous innovation (Coltorti and Venanzi, 2017).

In Germany, medium-sized enterprises (50-249 persons employed) represent 2.25% of the business population, but account for about 20% of jobs and value added (OECD, 2017b). Studies find that independent German companies in the range of 50-749 employees are more productive and efficient than their larger counterparts (Holz, 2013).

Increasingly, governments are focusing on enabling conditions for the scaling up of mid-size companies, and the growth of small firms into mid-size ones, as a lever to boost productivity growth and competitiveness. For instance, in France, since 2008, this attention has translated into an official statistical recognition, through the creation of a new category of observation and policy target, the ETI (Entreprises de Taille...
Intermediaire), including firms with 250-5 000 employees and turnover between EUR 50 million and 1.5 billion.

SMEs can achieve scale through different mechanisms, including external growth

The growth journey of SMEs can take different pace and forms, including organic (i.e. internally generated) and non-organic growth (i.e. through mergers and acquisitions, joint-ventures or alliances).

There are multiple driving forces that can push a SME into domestic and international strategic alliances, such as the increasing rate of technological change, globalisation of markets, and increased customers' demand for quality and timeliness (Hoffman and Viswanathan, 1997). Alliances enable small firms to access critical resources, complementary assets and markets, particularly international markets that typically require a larger scale. Moreover, alliances can strengthen trust-based relations in business networks. At the same time, forming and managing alliances can be costly and challenging for a small business, also due to power disparities and asymmetries among the partners (Das, 2015).

Mergers and acquisitions (M&As) represent another non-negligible channel to achieve external growth for SMEs. Over 1996-2007, across Europe and the US, M&As by SMEs accounted for 20% of total deals involving firms from the same country. Furthermore, evidence shows that acquiring SMEs tend to rely more intensively than large firms on M&As to grow rather than to limit competition, i.e. acquiring SMEs largely seek synergies with the target firm in order to seize growth opportunities and increase the value of the firm (Weitzel and McCarthy, 2011).

Digitalisation is a powerful engine to scale up, enabling new modes of growth

The digital economy opens a range of new opportunities for scaling up, reducing costs, and enabling the creation of new business models that can challenge existing ones in radically novel ways (Goldfarb and Tucker, 2017). SMEs can draw many potential benefits from digital technologies, such as better access to skills, talent or markets, better collaboration and communication, or greater access to novel technologies and applications. Recent evidence shows that the use of digital tools enables access to international market also for micro enterprises (OECD, 2017b). However, compared to large firms, SMEs’ uptake of ICT is lower and they face higher barriers to the adoption of several digital technologies in their operational activities (OECD, 2017c).

Competition in the digital economy appears to be affected by network externalities (among other factors), where the value of a product or a service to its users increases with the number of users. This may lead to the emergence of winner-take-most dynamics, the implications of which deserve particular attention (Autor et al.; Andrews et al., 2016).

These changes in the nature of competition can also be associated with the emergence of different forms of business growth, with some companies able to achieve a substantial scale via the use of digital technologies without an important mass of employees or other tangible assets.

To realise the full potential of the digital transformation, including to scale up, firms need to upgrade the skills of workers and management and to invest in complementary knowledge-based capital, such as research and development (R&D), data, and new organisational processes.
Participation in global markets and GVCs can also spur growth

While domestic demand remains central to most SMEs, global value chains (GVCs) present particular opportunities for SME growth, as they allow firms to specialise in specific activities within production networks, rather than compete along the entire line of activities, and can spur complementary investments in technology, process innovation or organisational change (Lileeva and Trefler, 2010; Caliendo and Rossi-Hansberg, 2012). GVC participation may also increase productivity, for example through increased foreign competition and access to new varieties of inputs and knowledge spillovers from foreign frontier firms (Amiti and Konings, 2007; Saia et al., 2015).

However, while trade and investment liberalisation and the digital transformation have contributed to an increased cross-border fragmentation, trade costs and restrictions remain which affect SMEs disproportionately. Also, the impact of GVCs on SME upscaling and growth is dependent upon the position in the global production network, the quality of infrastructures, the policy environment and access to strategic resources. For example, GVC participation typically requires additional capital to finance exports and address the working capital needs that may arise from the delays between production and payment from foreign customers (WTO, 2016). To fully leverage new sources of knowledge, including through FDI linkages, firms need to be able to upscale and make complementary investments in skills, management organisation and processes (Brynjolfsson and Hitt, 2000). Accordingly, policies that impede labour market flexibility may weaken the linkages between SMEs’ position within GVCs and their growth (Criscuolo and Timmis, forthcoming).

Policy can play a role in enabling SMEs to scale up

Policy can support SME scale-up, by fostering a dynamic business environment that facilitates entrepreneurship and enables firms of all sizes to reach their full potential, including through better integration in global markets and value chains. This includes adopting a broader, more inclusive approach to productivity growth that considers how to expand the productive assets of an economy and provide an environment, in which all firms have a chance to seize growth opportunities, including in lagging regions.

Targeted policies can ease access to and effective use of strategic resources by growth-oriented entrepreneurs and SMEs, including finance, skills, technology and knowledge. These policies must take place against the backdrop of sound framework conditions, including the institutional and regulatory framework, in order to incentivise risk-taking and experimentation by entrepreneurs, and ensure that business growth potential can be realised.

Improved access to finance is needed to boost SME scale-up

Difficulties in accessing finance are widely recognised as one of the major obstacles for starting and growing a business (OECD, 2006, 2015a). Lack of finance prevents SMEs from investing in innovative projects, improving their productivity, and seizing opportunities in expanding or new markets.

In credit markets, adverse selection and moral hazard are exacerbated in the case of young, innovative businesses without loan history or collateral to secure a loan. Due to their higher risk profile, fast-growing companies also typically suffer from higher loan rejection rates than averagely performing firms (OECD, forthcoming). At the same time,
traditional debt may be ill-suited for new, innovative and fast-growing companies, which have a higher risk-return profile. The “financing gap” affecting these businesses is in fact often a “growth capital gap”. Financing constraints can be especially severe in the case of start-ups or small businesses whose business model relies on intangibles which are highly firm-specific and difficult to use as collateral in traditional debt relations. Capital gaps also exist for companies seeking to undergo important transitions in their activities, such as ownership and control changes, or entry into new markets, including international ones.

Evidence shows that industries that are more dependent on external finance grow relatively faster in countries with more developed financial markets, i.e. where firms can access a range of alternative financing instruments. Appropriate access to finance also improves post-entry performance of firms, even when controlling for the size of entrants². Yet, in many countries, there are few alternatives to traditional debt for most enterprises (OECD, 2015a).

The G20/OECD High-Level Principles on SME Financing call for strengthening bank lending, while broadening the range of instruments available to SMEs and entrepreneurs at different stages of their life cycle, including asset-based finance, hybrid instruments (e.g. mezzanine finance) and equity finance (OECD, 2015b). In recent years, governments have been stepping up efforts to address SMEs’ growth capital gaps. For instance, in the EU, in the framework of the Programme for the Competitiveness of Enterprises and Small and Medium-sized Enterprises (COSME), the Equity Facility for Growth supports SME growth, research and innovation through investment in venture capital and mezzanine finance funds. Austria’s federal development and financing bank for the promotion and financing of companies (aws) offers guarantees of mezzanine investments in SMEs aimed at modernisation, expansion or acquisition of other companies. In Italy, in 2012 regulation was introduced for new debt security instruments (“mini-bonds”), which under certain conditions can be issued by unlisted SMEs.

Strong entrepreneurial and management skills and access to talent are necessary for SME growth…

High growth is a disruptive process that alters the organisational dynamics and management practices of an enterprise, and new leadership and management skills are often needed to cope with this process (OECD, 2010a). SME founders usually have specific expertise, while growth often requires an expanded skillset to channel the emerging complexities: from commercial (e.g. marketing and serving of new offers), to project management (e.g. logistics, organisations of events), financial (e.g. capital and cash flow management) and strategic thinking skills (e.g. building internal leadership, coordinating sets of actions to fulfil new strategic objectives). Smaller firms may face a particular challenge in this regard, as their limited human resources are focused on day-to-day running of the business (Hellman and Kavadia, 2016).

Upskilling of existing staff, including management, is key for SMEs to undertake growth-oriented strategies. However, there is evidence that SME training efforts are on average significantly weaker per employee than in larger firms (OECD, 2013a). Also, SMEs appear to be relatively behind in the use of company-level learning strategies, i.e. the use

² See Bravo-Biosca et al. (2016), Rajan and Zingales (1998), Aghion et al. (2007); and Klapper et al. (2006), among others.
of managerial practices and methods that promote workers’ learning and autonomy (OECD, 2015c).

Moreover, it is often very difficult for SMEs both to find and to retain skilled and high-qualified personnel in order to sustain growth. In Canada, a recent survey among SMEs shows that 55% of all SMEs and 80% of mid-sized businesses identify this as a major hindrance to growth (BDC, 2016). In the UK, around 20% of SMEs report that finding people with the right skills is a barrier to business growth (BIS, 2013a), a share that rises to 50% when considering high-growth firms (Coutu, 2014). Leaders of scale-up companies indicate that access to talent is their most pressing problem to address customer orders.

In this regard, policies that support skills development in SMEs and enable small businesses to attract and retain qualified personnel, both within and across the border, are essential to boost growth. For instance, in Ireland, the National Training Fund (NTF) supports training networks (“Skillnets”) formed by private sector businesses in the same sector and/or region that have come together to carry out training-related activities that may not be possible on their own. In 2015, SPRING Singapore launched the Human Capital Movement, which helps SMEs to attract and retain talent, through the sharing of best practices with experienced Human Resource Directors, human capital advocates, learning forums, workshops, career fairs and student events aimed at highlighting good career opportunities in SMEs. To address gaps in the skill set of high-growth firms, in 2015, the Business Development Bank of Canada (BDC) created a new division, BDC Advantage, devoted exclusively to providing high-impact firms with advice, formal management training, peer to peer networking and referrals to outside consulting (OECD, 2017d).

Furthermore, labour mobility can be important, since growth-oriented firms face inherent uncertainty about their future prospects. Evidence shows that stricter employment protection legislation leads to slower firm growth in sectors which are more labour-intensive, more innovative, or characterised by greater uncertainty. It increases the share of firms that neither grow nor shrink, but it also reduces growth among the best performing firms, and contraction among the underperforming ones (Bravo-Biosca et al., 2016; Calvino et al., 2016).

**…as are access to knowledge and the ability to innovate**

To seize market opportunities and grow, SMEs need to be able to access state-of-the-art knowledge and implement it in their operations through innovation. Importantly, innovation does not only involve research and development (R&D) activities, but also the introduction of new products, services, processes and business models. Policies aiming to support SME growth through innovation should thus go beyond traditional R&D policies and also focus on other modes of innovation. For example, they can provide advice and training to start-up entrepreneurs, who have strong technological knowledge, but lack market and commercial expertise, and they can promote corporate and university spinoffs with initiatives for proof-of-concept, pre-competitive research and seed funding (OECD, 2010b). For instance, in Germany, the EXIST-Transfer of Research programme provides support to research teams at universities or research institutes to develop proof for the technological feasibility of their product idea and to prepare business start-up.

Furthermore, SME innovation is often the outcome of collaborative efforts in which businesses interact and exchange knowledge and information with other partners, as part of broader innovation systems. In this regard, facilitating knowledge flows and promoting
partnerships among SMEs and between SMEs and large firms, investors, Universities and research centres, including at the local level, can enhance SME growth prospects. Soft innovation infrastructures, in the form of science parks and business incubators, may create opportunities for innovation partnerships and collaborative research, promote skilled labour mobility, and facilitate the commercialisation of university research. In knowledge-intensive sectors, which are characterised by strong spatial clustering, policies can stimulate knowledge flows, for example, through programmes that facilitate informal interactions among entrepreneurs and by encouraging universities to get involved in “third mission” activities, such as knowledge exchange, technology transfer and cooperation with private enterprises (OECD, 2010b). As a case in point, in 2015, the Catapult network was launched in the United Kingdom, consisting of world-lead centres focused on a specific area of technology and expertise with great potential, which connect nascent entrepreneurs and businesses of all sizes with academia and research institutions.

Foreign direct investment represents another relevant vector for knowledge and innovation that can benefit SME growth. Policies should foster a business environment that is conducive to inflows of foreign direct investment and promote links between foreign subsidiaries and domestic firms in the form of supplier-buyer relationships, joint ventures and joint technology development and training. Strengthening skills is especially important to enable SMEs meet requirements of multinational enterprises, absorb new technologies, and develop relationships that foster the diffusion of knowledge (OECD, 2017). The management of intangible assets (IA) is critical for turning SMEs’ innovation potential into market value, competitiveness and growth. However, SMEs are lagging behind larger firms in recognising, exploiting and protecting their intellectual property. To better enable SMEs to leverage their intangibles, policies should target both internal obstacles, such as lack of knowledge and strategic perspective, and the hurdles that affect the accessibility of the IP system for SMEs, such as administrative burdens and complex and costly litigation and enforcement mechanisms (OECD, 2011a). National guidelines on IA management and reporting exist in several OECD countries. For instance, in France, in 2011, the Observatoire de l’Immatériel, supported by the Ministry of Finance, released a methodology for the valuation of intangibles to complement existing business financial reporting, with the aim to improve firms’ communication on their IA and internal metrics (OECD, 2013b).

**Framework policies are critical to unleashing the growth potential of young firms and SMEs, especially in high-risk sectors**

Targeted policies for SME growth can only be effective against the backdrop of sound framework conditions. SMEs are typically more dependent than large companies on their business ecosystem and, due to their internal constraints, are more vulnerable to market failures, policy inefficiencies and inconsistencies, which may arise in different areas or result from the interaction of regulatory and policy approaches across different areas. Start-ups are particularly exposed to the policy environment and local and national framework conditions, due in part to credit constraints and weaker resilience relative to incumbents. The effect of policies on the growth of young firms is especially pronounced in high-risk sectors, such as telecommunications, scientific research and development and IT services (Calvino et al., 2016). Regulations may also be tailored to the prevailing technology adopted by incumbents, rather than to the innovative technology used by start-
ups. Even if this is not the case, entrants may be less familiar with the policy environment, which may increase their adjustment costs.

Institutional and regulatory settings are crucial to ensure that businesses of all sizes compete on a level playing field. An effective and transparent regulatory environment is key to business growth, and an increasing number of countries are adopting regulatory impact analysis (RIA) to assess the effects of proposed and existing regulations on businesses, including on SMEs. Also, regulatory policy bodies, with responsibility for regulatory oversight, have been established in many countries to ensure that regulation serves whole-of-government policy. An example of a central oversight body is the Regulatory Reform Committee (RRC) in Korea, set up in 1998 to provide strategic perspective to regulatory reforms, to monitor the improvement efforts of relevant agencies and ensure coherence between their actions (OECD, 2011b).

Public sector transparency and integrity and competitive neutrality are also essential for a level playing field, including between public and private firms. Opacity and corruption in the public sector, which are detrimental to all businesses, pose particular problems for SMEs; and market entry and growth by new and small businesses can be limited when state-owned enterprises (SOEs) benefit from an unfair edge in domestic and cross-border activities, such as through financial support that lowers the cost of capital, tax concessions, preferential treatment in public procurement, regulatory privileges that support monopoly advantages and legal immunities (OECD, 2012, 2017f).

**Effective contract enforcement and civil justice system support firm growth**

Bankruptcy laws that ensure strong guarantees for investors without posing an excessive burden on entrepreneurs in case of failure matter for business investment and growth. Improving the efficiency of corporate bankruptcy procedures can foster labour productivity and value-added growth, notably in sectors that are most dependent on external finance, and be positively associated with GDP investment share (de Serres et al., 2006; Succurro, 2012). Entrepreneur-friendly personal bankruptcy regulations seem also to be positively associated with entrepreneurship development (Lee et al., 2011; Klapper et al., 2006). To this end, several OECD countries have reformed their bankruptcy regulation to allow for automatic discharge, i.e. discharge takes place at the payment of the quota agreed upon in the enterprise insolvency proceeding, with no need for an additional court decision (OECD, 2017g).

The efficiency of the court and legal system is particularly important for SMEs, which typically need to divert a higher share of resources than large firms to resolving disputes (OECD, 2017g). Efficient judicial systems are intrinsically related to larger average firm size (Kumar et al., 1999; Giacomelli and Menon, forthcoming); and tend to improve the predictability of business relationships. Where courts are weak, on the other hand, firms are unwilling to interact with a new contractual partner, which particularly disadvantages entrants and limits their growth (Johnson et al., 2002). Weak contract enforcement is also associated with low relationship-specific investments which can further constrain start-ups’ post-entry growth prospects (Nunn, 2007). In many OECD countries, governments have taken steps to enhance efficiency in courts. In Australia, for example, an electronic case and court management system is in place, whereby ICT is used to automate and support case management and ease transfer of information through the judicial system.
Potential disincentives to scaling up should be considered when devising size-contingent policies

Levelling the playing field, i.e. addressing competitive disadvantages for SMEs that stem from market failures, coordination failures and policy inefficiencies, is a common objective of SME policy. However, the role and effectiveness of framework and targeted policies, as well as potential trade-offs or distortionary effects of policy interventions are the object of conceptual debate and empirical assessment. In particular, policies that target firms below or above a certain size threshold may create disincentives for scaling up. For instance, in the case of regulatory simplification for SMEs, efficient firms may choose to remain small to avoid the additional regulatory burden related to crossing a certain threshold.

A coordinated policy approach is needed to devise mutually reinforcing policies for SME scale-up

The policies and frameworks which influence SME scale-up are interconnected and often cut across the boundaries of different ministries, government agencies, levels of government and administration. Furthermore, supporting business growth requires a long-term perspective and coherence over time, since the impact of policies on firm growth performance are mainly visible in the mid- to long run. In this sense, a whole-of-government perspective is needed, taking into account policy synergies and trade-offs across different domains.

In recent years, a number of scale-up strategies have been launched, which recognise the need to consider SME growth opportunities over time and craft coherent and mutually reinforcing policies across different domains. These approaches typically reflect that SME growth requires efforts on a number of fronts, including institutional and regulatory frameworks, conditions to access local and international markets, and timely access to resources that are essential to seize growth opportunities, including finance, skills, knowledge and technology.

An important example of such an approach is the European Commission’s Start-Up and Scale-Up Initiative, launched in November 2016, which aims to address key challenges to business growth by articulating initiatives in a coherent way. In a similar vein, in 2013, the UK government launched the initiative "Small business: GREAT Ambition”, which encompasses all the government’s efforts to make it easier for small businesses to grow (BIS, 2013b).

Furthermore, several governments are taking initiatives to strengthen and consolidate services that are offered to scale-up firms, including by fostering synergies among the different players which provide growth-facilitating services or products. For example, in 2016, in Denmark five regional authorities and the Ministry of Business and Growth launched "Scale-up Denmark", a project to establish multiple "scale-up hubs" specialised in different sectors, with the aim to offer a full set of services to growth-oriented entrepreneurs and small businesses3.

SMEs are often embedded in local eco-systems, which represent their primary source of knowledge, skills, finance, business opportunities and networks. In this regard, it is important to consider factors affecting framework conditions at the local level, and how

3 https://scale-updenmark.com/
scale-up policies developed at the national level are tailored to local conditions and link with policies designed and implemented at the local level. Local authorities often play a key role in the development of a conducive business environment, including through partnership with the business community, research organisations and investors, and multi-level governance is an important dimension of any coordinated policy approach to SME growth.

References


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