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

Istanbul, Turkey
3-5 June 2004

PROMOTING SMEs FOR DEVELOPMENT

OECD

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Pursuant to Article 1 of the Convention signed in Paris on 14th December 1960, and which came into force on 30th September 1961, the Organisation for Economic Co-operation and Development (OECD) shall promote policies designed:

- To achieve the highest sustainable economic growth and employment and a rising standard of living in member countries, while maintaining financial stability, and thus to contribute to the development of the world economy.
- To contribute to sound economic expansion in member as well as non-member countries in the process of economic development; and
- To contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

The original member countries of the OECD are Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The following countries became members subsequently through accession at the dates indicated hereafter: Japan (28th April 1964), Finland (28th January 1969), Australia (7th June 1971), New Zealand (29th May 1973), Mexico (18th May 1994), the Czech Republic (21st December 1995), Hungary (7th May 1996), Poland (22nd November 1996), Korea (12th December 1996) and the Slovak Republic (14th December 2000). The Commission of the European Communities takes part in the work of the OECD (Article 13 of the OECD Convention).

www.oecd.org

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 of the ten reports being linked to a specific Workshop of the Ministerial Conference. This report is the main background documentation for *Workshop 4: Enhancing the Role of SMEs for Development*. An earlier version of the report was 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 on an earlier version. 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.

The report was prepared by the OECD Secretariat – the Development Co-operation Directorate, the Development Centre and the Directorate for Financial and Enterprise Affairs, in cooperation with the SME Unit of the Directorate for Science, Technology and Industry – and with the contribution of Ms. Nilgun Tas, tas@metu.edu.tr External Consultant to the OECD.

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

TABLE OF CONTENTS

Promoting SMEs for Development:
The Enabling Environment and Trade and Investment Capacity Building

EXECUTIVE SUMMARY

Recent assessments of growth point to an understanding that the rate at which countries grow is substantially determined by 1) their ability to integrate with the global economy through trade and investment; 2) their capacity to maintain sustainable government finances and sound money; and 3) their ability to put in place an institutional environment in which contracts can be enforced and property rights can be established.

As globalization proceeds, transition and developing countries and their enterprises face major challenges for strengthening their human and institutional capacities to take advantage of trade and investment opportunities. While governments make policies in trade and investment areas, it is enterprises that trade and invest. Therefore, supply-side bottlenecks in the trade and investment areas and how governments, development partners and the private sector itself address these constraints have direct implications on the economic growth potential of transition and developing countries.

SMEs play a key role in transition and developing countries. These firms typically account for more than 90% of all firms outside the agricultural sector, constitute a major source of employment and generate significant domestic and export earnings. As such, SME development emerges as a key instrument in poverty reduction efforts.

Globalization and trade liberalization have ushered in new opportunities as well as challenges for SMEs. Presently, only a small part of the SME sector is able to identify and exploit these opportunities and deal with the challenges. The majority of SMEs in developing and transition countries, however, has been less able or unable to exploit the benefits of globalization and, to add to the situation, are frequently under pressure on the local or domestic markets from cheaper imports and foreign competition. A major objective of work to promote the development of the SME sector is therefore to change the balance between these two groups of SMEs and to equip SMEs to better meet the challenges of globalization and to benefit from its opportunities.

SMEs, due to their size, are particularly constrained by non-competitive real exchange rates, limited access to finance, cumbersome bureaucratic procedures in setting up, operating and growing a business, poor state of infrastructure and lack of effective institutional structures. The removal of these constraints is a daunting task calling for holistic SME support, i.e. an enabling environment for SME development consisting of functioning macro, meso and micro level institutions.

Basic Lessons Learned in SME Development

On the basis of analysis to date, the following lessons seem to hold true, independent of region and level of development among countries:

- SME development requires a crosscutting strategy that touches upon many areas (e.g. ability of governments to implement sound macroeconomic policies, capability of stakeholders to develop conducive microeconomic business environments, *inter alia*, through simplified legal and regulatory frameworks, good governance, abundant and accessible finance, suitable infrastructure, supportive education, sufficiently healthy and flexibly skilled labour as well as capable public and private institutions, and the ability of SMEs to implement competitive operating practices and business strategies). Thus, SME development strategy must be integrated in the broader national development strategy and/or poverty reduction and growth strategy of transition and developing countries.

– Dialogue and partnerships between the stakeholders (public sector, private sector and civil society) fosters ownership of these strategies, engenders them more implementable (by better addressing SME needs), making them politically credible, and sustainable.

– Access and integration into local, national, and global markets require substantial investments in sustainable institutional and physical infrastructure development and service delivery to SMEs in all areas, including those that are rural and/or remote. Continued dialogue and partnerships between stakeholders into implementation and review of supportive measures, particularly, those related to capacity building in executing institutions, yields improved outcomes.

– Enhancing women's ability to participate in SME development should be taken into account at every level, as women account for an important share of private sector activity and contribute most to poverty reduction. Gender dimensions need to be mainstreamed throughout SME development strategies and programs, with additional specific, targeted initiatives directed at critical roadblocks.

Building up Trade and Investment Capacity of SMEs

SMEs must be able to respond quickly and efficiently to international market signals to take advantage of trade and investment opportunities and reap the benefits of the international trading system. This means they need to be competitive and productive. Effective business support systems are needed to enhance competitiveness and productivity of SMEs.

Development of an effective business support system is also a key condition for the success of both trade and investment capacity building. It requires business support agencies (including financial institutions), which are customer-oriented and which have a demonstrated capability of penetrating the SME sector. Specific recommendations include:

- Take steps to increase the capacity of financial institutions to construct profitable SME lending programmes, while prioritizing the development of innovative solutions to collateral issues, such as the acceptance of more flexible forms of collateral, particularly for SMEs with few fixed assets; the use of group guarantees and loan guarantee schemes for SMEs; more emphasis on cash flow than balance sheets in assessment of borrowing capacity; easy and effective loan application assessment methodologies;

- Take steps to strengthen the business support system, through an intermediary role, by building capacities in business services, both public and private (e.g. market, product and process information provision, accounting, market analyses and research, legal advice, transportation, express delivery, advertising);

- Develop a national strategy for export development and promotion, led by the appropriate Ministry, but which involves participation by all key stakeholders. The overall objective should be to increase the volume and value of exports and the number of exporting companies. The strategy should seek to address the needs of firms at different stages of export market development. It should also seek to integrate export support and promotion into a well developed and effective business support system.

- Set up a single export promotion agency, which could be combined with an FDI function. Based on good practice in mature market economies, the establishment of such an agency should separate policy making from policy implementation. The agency should:

  – Operate in a commercially oriented manner;

  – Be result rather than procedure oriented;

  – Be staffed by people with relevant, practical business experience;

  – Seek to be customer-oriented,

  – Include private sector representation on its Management Board,

  – Be funded commensurate with its objectives.

- Develop export support, which includes:

  – The provision of information about specific markets and potential customers;

  – Help in making contact with potential customers or appropriate public and private intermediaries and business service providers;

  – Assistance with market visits.

- Develop an SME-FDI linkage ‘offer’, based on the ‘fit-to-supply’ principle and, which includes the following elements:

  – Improving the flow of information about potential local suppliers to potential MNC purchasers and about supply opportunities to potential suppliers through the development of a national Website and/or business directories, supplemented by 'meet-the-buyer' events.

  – Targeting suppliers on the basis of proven abilities and commitment to future improvements,

  – Working closely with MNCs by inviting them to help potential suppliers to (a) understand their supply requirements (b) identify areas in which they have good opportunities to supply and (c) draw attention to weaknesses they must overcome in order to succeed. Such an intermediary role helps to build mutual understanding and trust between MNC and potential supplier.

  – Helping SMEs/suppliers identify needs and then to access the public and private support services they need.

– Offering some form of monetary incentive to MNCs and local SMEs to participate in the linkage programme. This could include contributing to the salary costs of engineers & managers in MNCs who devoted time to supplier upgrading (Singapore); cash grants to promising suppliers to help with initial investment costs (Ireland); and subsidized training and consultancy necessary for enhancing supplier capability (Chinese Taipei).

– Developing capacity building programmes that include supply chain and cluster initiatives, which recognize the potential for developing tiers of suppliers to maximize trickle down effects, including to micro enterprises as lower tier suppliers.

- Setting up industrial parks, and when viable, business incubators in order to provide an appropriate infrastructure for SME suppliers, launch cluster development initiatives, where possible, through public-private partnerships.

Improving Policy Coherence and Aid Effectiveness

Obviously, policy coherence and a joined-up government on the transition and developing country side are essential for the successful implementation of SME development strategies. Development partners need also to understand that trade and investment capacity building has to go hand in hand with market access and that improved coordination among donors, better attention to local conditions and further capacity building on their side are building blocks to success, if the world is going to adopt new approaches and invent new ways of working together to foster competitiveness of SMEs in transition and developing countries.

Box 1. **Key Policy Recommendations**

- **Embed strategies toward the private sector and SMEs in countries' broader national development and poverty reduction programmes.** Encourage and help SME associations to participate effectively in national dialogues that help set the strategic frameworks for development, so that the contribution and the policy and support needs of SMEs are fully recognised as central to growth, employment and poverty reduction.

- **Strengthen SME capacities to improve their competitiveness in domestic, regional and global markets.** Encourage and support private sector associations and enterprises able to provide information on markets and standards, advice on strategies, and access to technology and innovation coupled with appropriate financing packages. Promote tools, such as value chain analysis, which enable entrepreneurs to see what problems and challenges they need to address within and beyond their own borders and what kind of partners they need to help them.

- **Promote policy coherence at regional, national and international level.** Work to support whole of government approaches so that trade and investment policies and standard setting are aligned with development co-operation objectives and policies. Support completion of the Doha Round of multilateral trade negotiations, including a reduction of barriers to trade in manufacturing and agricultural sectors with major benefits and opportunities for developing countries.

- **Maximise the spillover of management skills and knowledge from multi-national enterprises to local SMEs.** Spillovers of knowledge and management skills to local firms are one of most critical benefits of foreign direct investment for host countries. Support policy frameworks and multi-national enterprise behaviour that facilitate such spillovers and better document real-world cases to increase public understanding of the contribution of foreign direct investment in progression of development.

Promoting SMEs for Development:
The Enabling Environment and Trade and Investment Capacity Building

INTRODUCTION

There is worldwide consensus that high rates of economic growth contribute to economic and social development and poverty reduction. At the same time, there is growing recognition that poverty reducing growth depends on the quality of growth: its composition, distribution and sustainability[1].

Recent scholarly assessments of growth converge on the view that "the rate at which countries grow is substantially determined by 1) their ability to integrate with the global economy through trade and investment; 2) their capacity to maintain sustainable government finances and sound money; and 3) their ability to put in place an institutional environment in which contracts can be enforced and property rights can be established"[2].

As globalization proceeds, transition and developing countries and their enterprises face major challenges in strengthening their human and institutional capacities to take advantage of trade and investment opportunities. This has become a top priority on the global development agenda and features prominently in the final statements of key international meetings over the past few years, including the Doha Declaration and the Monterrey Consensus.

While governments make policies, including in trade and investment areas, it is enterprises that trade and invest. In market economies, the enterprise sector is predominantly private and spans through the whole spectrum of economic activity in agriculture, manufacturing and services, including trade, and increasingly also infrastructure and social services. Within the private sector, there are different types of market players: the self-employed, micro, small, medium and large enterprises and multinational companies.

Private small and medium sized enterprises (SMEs) typically account for more than 95% of all firms outside the primary agriculture sector, constitute a major source of employment and generate significant domestic and export earnings in the OECD, transition and developing countries[3]. Improved SME competitiveness could obviously contribute to economic and social development and poverty reduction.

This background report will look at how to enhance SME competitiveness in developing and transition economies in a globalizing world, with a particular focus on what governments, development partners (OECD governments and others), and SMEs need to do to: i) build local SMEs' capacities to trade

1 See, for example, World Bank (2000), CIDA (2003), DFID (2001), Sida (2003a) and UNDP (2003).

2 Lawrence Summers (2003): Note how Mr. Summers, the President of Harvard University, emphasizes "abilities" and "capabilities" to get certain growth outcomes accomplished rather than advocating specific policies. Rodrik (2003) argues that these "abilities" and "capacities" do not map neatly into the standard policy preferences, and can be generated in a variety of ways, p. 6.

3 See OECD (2002), APEC (2000), FUNDES (2002).

and take up expanding regional and international trade opportunities, and ii) strengthen SMEs' linkages with foreign investors and thus enhance FDI benefits to the local economy.

In Chapter 2, the characteristics and contribution of SMEs to development is briefly reviewed. Chapter 3 emphasizes the need to embed the SME development strategy into national frameworks and links the constraints SMEs face in legal, regulatory and administrative environments, access to finance, the institutional support structure, infrastructure and human resource development to good practice recommendations. In Chapter 4, specific measures for enhancing SME exporting and FDI-SME linkages are discussed. The paper concludes with a brief discussion on improving aid effectiveness and sets out the main components of an SME strategy.

Characteristics and Importance of SMEs

The definition of SMEs

Small and medium-sized enterprises (SMEs) are a very heterogeneous group. SMEs are found in a wide array of business activities, ranging from the single artisan producing agricultural implements for the village market, the coffee shop at the corner, the internet café in a small town to a small sophisticated engineering or software firm selling in overseas markets and a medium-sized automotive parts manufacturer selling to multinational automakers in the domestic and foreign markets. The owners may or may not be poor; the firms operate in very different markets (urban, rural, local, national, regional and international); embody different levels of skills, capital, sophistication and growth orientation, and may be in the formal or the informal economy.

Statistical definition of SMEs varies by country[4] and is usually based on the number of employees, and value of sales and/or value of assets. Due to its ease of collection, the most commonly used variable is the number of employees. The EU and a large number of OECD[5], transition and developing countries set the upper limit of number of employees in the SMEs between 200-250, with a few exceptions such as Japan (300 employees) and the USA (500 employees).

At the lower end of the SME sector, a large number of countries define a group, which is a mixture of the self-employed and "micro" enterprises, with less than 10 employees. Irrespective of the level of development of an economy, a significant proportion of micro and, sometimes, small enterprises are found in the informal sector or the shadow economy. Schneider (2003)[6] compared the size of the informal sector in 22 transition (former Soviet Union and Central and Eastern Europe) and 21 OECD economies from 2000-2002 and found that the size of the informal sector amounted to an average of 16.7%, 29.2% and 44.8% of GDP in OECD, Central and Eastern Europe and the former Soviet Union economies, respectively.

Contribution of SMEs to Development and the New Challenges

The notion of SME and entrepreneurship development was introduced into the growth and development landscape as early as the late 1940's with the introduction of targeted policies (grants, subsidized credits, special tax treatment, etc.) and the establishment of small business or SME support

---

4 Ayyagari, Beck and Demirgüc-Kunt (2003) also provide official SME definitions for 74 OECD, transition and developing countries, including references to the sources of data.

5 OECD (2002), p. 4.

6 Schneider (2003).

agencies by governments (*e.g.* publicly funded SME agencies were set up in 1948 in Japan, 1953 in USA, 1954 in India, 1966 in Tanzania, 1976 in Turkey).

Despite a long history of development efforts, SMEs, including the informal sector, were perceived rather as a synthetic construction mainly of "social and political" importance[7], especially throughout the 1980's and up to late 1990's. Although domestic SMEs and the informal sector constituted most of what could be and what are still deemed as "the" private business activity in most developing countries, private sector development strategies advocated for and implemented in these countries were skewed towards the needs of large-scale business, including foreign invested ones. This type of policy advice was partly motivated by the rather disappointing[8] results achieved through extensive SME support systems operated in developed countries since the 1970's.

Recent empirical studies show that SMEs contribute to over 55% of GDP and over 65% of total employment in high-income countries, Figure 1. SMEs and informal enterprises, Figure 2, account for over 60% of GDP and over 70% of total employment in low-income countries, while they contribute over 95% of total employment and about 70% of GDP in middle-income countries. Figures 1 and 2 also show that the relative importance of SMEs and the informal sector (shadow economy) are inversely associated with economic development. In low-income countries, especially in the least developed economies, the contribution of SMEs to employment and GDP is less than that of the informal sector, where the great majority of the poorest of the poor make a subsistence level of living. Therefore, an important policy priority in developing countries is to reform the policies that divide the informal and formal sectors, so as to enable the poor to participate in markets and to engage in higher value added business activities.

Figure 1. SME Sector's Contribution to Employment and GDP (Median Values)

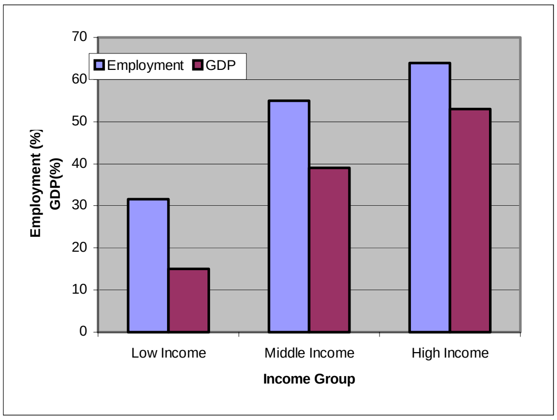
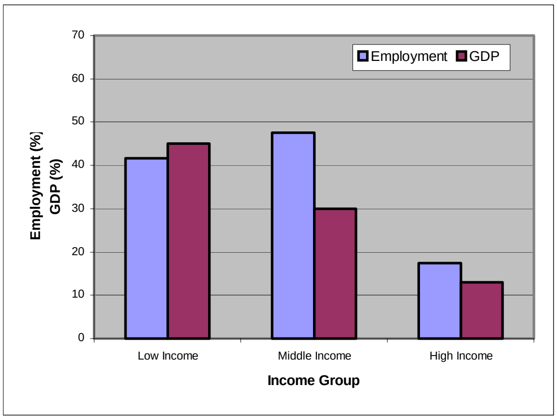


Figure 2. Informal Sector's Contribution to Employment and GDP



Source: Ayyagari, Beck and Demirgüc-Kunt (2003), p. 27-28.

In middle-income countries, formal SMEs contribute about 20% more to employment and GDP than the informal enterprises. Thus, in these countries, eliminating factors that discourage informal enterprises from entering the formal SME sector would also bring about gains in economic terms. This is evidenced by the fact that SMEs contribute over 3 times as much as the informal sector in both total employment (~65%) and GDP (~55%) in high-income countries, and that these countries are also taking initiative to bring as many informal enterprises as possible into the formal sector.

---

7 Halberg (2001), p 5.

8 See for instance Meyer-Stamer, Jörg and Frank Waltering (2000).

SMEs are an important source of export revenues in some developing economies. Table 1 provides information on the SME shares of manufactured exports in selected East Asia and African developing economies and OECD countries. An interesting observation is that SMEs contribute a larger share of manufactured exports in more industrialized East Asian economies (56% in Chinese Taipei, more than 40% in China) and in India (31.5%) than the less industrialized African economies (<1% in Tanzania and Malawi). Table 1 also seems to support the intuitive understanding that medium-sized enterprises have higher export potential than small enterprises with up to 50 employees (see SME definitions in Tanzania, Malawi and Mauritius in comparison to those in other developing and OECD countries). These observations show that policies for the promotion of SME export potential and SME exports must be targeted.

SMEs contribute to employment and income generation and export revenues. However, in order to tap into the potential of SMEs for development and poverty reduction, transition and developing country governments, development partners and SMEs themselves need to address a number of challenges:

- The domestic SME/private sector has to expand, through:
  - The creation of new and innovative firms and
  - The graduation of as many informal enterprises as possible into the formal sector.
- SMEs have to become more competitive and productive at their home base.
- At least a proportion of these nationally competitive SMEs have to achieve a level of competitiveness that will enable them to integrate into the global value chains through trade (exports and internationalization) and investment, including linkages with FDI.

Table 1. SME Shares of Manufactured Exports in Developing and OECD Economies

Economy	Year	Definition of an SME (a)	% SME manufacture exports
Developing Economies			
Chinese Taipei	Early 1990s	<100 employees	56
China	Early 1990s	<100 employees	40-60
Korea	1995	<300 employees	42.4
Vietnam	Early 1990s	<200 employees	20
India	1991/1992	<Rs 30 M investment in plant & machinery	31.5
Singapore	Early 1990s	<100 employees	16
Malaysia	Early 1990s	<75 employees	15
Indonesia	Early 1990s	<100 employees	11
Thailand	Early 1990s	<100 employees	10
Mauritius	1997	<50 employees	2.2
Tanzania	2002	<50 employees	<1.0
Malawi	2003	<50 employees	<1.0
OECD			
Denmark	Early 1990s	<500 employees	46
France	1994	<500 employees	28.6
Sweden	Early 1990s	<200 employees	24.1
Finland	1991	<500 employees	23.3
Japan	1991	<300 employees	13.3
USA	1994	<500 employees	11
Average for 6 OECD countries			24.4
Note: (a) Definition adopted by each study, which may be different to the official national definition of an SME.			
Studies: Korea (Kim and Nugent, 1999), India (Badrinath and Others, 1997), Mauritius (Wignaraja and O'Neil, 1999), Tanzania and Malawi (estimates based on Wignaraja's fieldwork), the remaining countries (OECD, 1997).			

Source: Wignaraja, Ganesh (2003).

Dealing with these challenges is becoming even more complex and demanding as globalization proceeds. On the one hand, globalization has the potential to open up access to new markets, technologies, skills and capital for SMEs. On the other hand, further economic integration brings with it a striking increase in competition from imports, the entry of new foreign investors and the strengthening of domestic, large firms that start to take over traditional, mostly local SME markets.

Challenges are multi-dimensional. As trade barriers, transport and communication costs fall, SMEs are required to add more value to their products to stay ahead and compete with lower cost rivals. Consumer demand is changing rapidly as incomes rise and choices increase when imported products become easily available in domestic markets. Technological advances create new products and transform almost every stage of business from production to marketing, sourcing and logistics. New rules introduced through the multilateral trade system and foreign buyers require SMEs to comply with higher technical (*e.g.* technical barriers to trade), environmental (*e.g.* ISO14000) and labor standards in domestic and export markets. Multinational enterprises seeking out new markets and investments offer capable SMEs the opportunity to insert themselves into global value chains through subcontracting linkages, while those that are unable to do so increasingly face the danger of losing their existing markets. Competition within the developing world for export markets, foreign investment and resources is also intensifying. Against this backdrop of increased global competition, SMEs, SME associations, support institutions and governments in transition and developing countries have to adjust and adopt new approaches and invent new ways of working together to foster SME competitiveness.

Strengthening SME Competitiveness in Transition and Developing Countries

Metcalf, Ramlogan and Uyarra (2003) argue that competitiveness is embodied in the characteristics of the firm; namely,

- The current efficiency and effectiveness of the use of resources,
- The willingness and the ability to relate profitability to growth of capacity (i.e. the willingness to invest), and
- The ability to innovate to improve technology and organization and thus improve efficiency and effectiveness.

The authors state that competitive advantage, which must be measured in relation to rivals in markets, is determined by how efficient and effective the prevailing markets for products, labor and capital are. They further add that entrepreneurship; the introduction of new productive combinations, and innovation is the driving force that continually creates new competitive advantages and opportunities for profit and growth.

Meyer-Stamer (1995) concurs with the view that competitiveness is created at the firm level, but that it is partly derived from a systemic context and emerges from complex patterns of interactions between government, enterprises and other actors, and will therefore exhibit different forms in each society.

SME development strategies will necessarily be country and context specific. Each country will have its own challenges, opportunities and priorities for change. Resources available for implementation will vary by country, so that results achieved will also be different. For example, in the 1980s and most of the 1990s, enterprise policy in European countries focused on employment creation, and initiatives supporting new business creation were prominent. Then, emphasis changed to one of achieving international competitiveness and programs encouraging business growth, support for technology based businesses and creation of an enterprise culture within the society started to gain in importance.

Notwithstanding such specificity, past and present experiences and practices of developed countries and scholarly assessments of results accomplished are of value and offer a menu of lessons and best practices for transition and developing countries. The responsibility rests with the transition and developing countries to make their choices based on sound assessments of their own context. OECD and other development partners can assist developing countries by building capacities in conducting such assessments, and when they make the choices, by providing capacity building assistance towards implementation.

To date, the following SME development lessons seem to hold true, independent of region and level of development among countries:

- *Peace and stability is a key requirement* for the development of SMEs and for attracting foreign investment. Studies show that war and crime are main deterrents of private investment, in particular for foreign investors.
- *SME development requires a crosscutting strategy,* (i.e. its success depends on the *ability* of governments to implement sound macroeconomic policies, the *capability* of stakeholders to develop conducive microeconomic business environments, and the *ability* of SMEs to implement competitive operating practices and business strategies). Good policies come in clusters. Thus, SME development strategy must be integrated into the broader national development strategy and/or poverty reduction and growth[9] strategy of transition and developing countries.
- *Dialogue and partnerships between the stakeholders is essential* (public sector, private sector and civil society) Dialogue and partnership foster ownership of SME strategies, engenders them more implementable (by better addressing SME needs), politically more credible, and more sustainable.
- *Investments in physical infrastructure and business services and the implementation* capacity of policy makers, local level administrators and support structures determine success. Access and integration of SMEs into local, national, regional and global markets require substantial investments in sustainable physical infrastructure development and business service delivery to SMEs in all areas, including those that are rural and/or remote. Continued dialogue and partnerships between stakeholders into implementation and review of supportive measures, particularly, those related to capacity building in institutions at all levels, yields improved outcomes.
- *Enhancing women's ability to participate in SME development* should be taken into account at every stage and level, as women account for an important share of private sector activity and contribute most to poverty reduction. Gender dimensions need to be mainstreamed throughout SME development strategies and programs, with additional specific, targeted initiatives directed at critical roadblocks.

A crosscutting SME strategy embedded in the national development framework

SMEs cut across sectors. Improving SME competitiveness requires policies that act on the economic, political and social institutions within the country, on the resulting markets and on the organizations that regulate, stabilize and legitimize these markets. As such, an SME development strategy has to bring to the forefront the challenges that SMEs face due to size effects and address the deficiencies

[9] The recent trend is to the include 'growth' as a goal into the poverty reduction strategies. See for example, Vietnam's Comprehensive Poverty Reduction and Growth Strategy (CPRGS), approved by Government in May 2002, for prominent poverty reducing role accorded to SMEs, the reforms underway and needed to promote SMEs for development.

in institutional and organizational structures, with a view to enhance SME competitiveness. First, taking a bird's-eye-view of how the macroeconomic policies and the microeconomic environment (the business environment) affect an SME, the prime decision-maker to invest in growth and competitive advantage, is justified.

Sound macroeconomic policies

Predictability of the business environment is a crucial factor determining business decisions. Not only SMEs, but also large firms, including foreign invested ones, depend on the ability of government to implement sound and consistent macroeconomic policies. Low budget deficits, low inflation, and a stable and transparent currency regime, yielding competitive exchange rates in an economy, help secure the minimum stability that businesses needs to make sound business decisions. Shiffer and Weder (2001) confirmed through a worldwide survey[10] that inflation affected SME growth more than larger enterprises and that exchange rates also affected SMEs more, due to lower hedging opportunities available to smaller firms, but that policy instability affected all firms equally, Table 2. At the macro level, policy makers have to be aware of these size biases, if SME competitiveness is to be improved.

Microeconomic environments conducive to business

Improving the capability of stakeholders to create microeconomic environments conducive to business is a many-pronged endeavor. In an ideal case, a microeconomic environment conducive to business (an enabling business environment) may be characterized by, *inter alia*, simplified legal and regulatory frameworks, good governance, absence of corruption, plentiful and accessible finance, suitable infrastructure, an abundance of flexibly skilled and healthy labor force, an appreciation of enterprise among the society at large, access to non-labor inputs at competitive prices, etc. Simply said, it is where SMEs interact with the institutions, markets and organizations to gain competitiveness. A multitude of stakeholders, each having different levels of capabilities, operate in and interact with each other in this environment.

Table 1. Ranking: Percentage of Firms that Considered Obstacle to be Major

Rank	All Firms		Small Firms		Medium Firms		Large Firms	
1	Financing	36.5	Financing	38.9	Financing	38.0	Policy instability	29.8
2	Inflation	34.6	Inflation	36.9	Taxes and regulation	37.2	Financing	27.9
3	Policy instability	34.4	Taxes and regulation	35.5	Inflation	36.1	Inflation	26.2
4	Taxes and regulation	33.5	Policy instability	35.0	Policy instability	36.0	Street crime	23.9
5	Exchange rate	28.0	Street crime	30.6	Exchange rate	29.7	Corruption	23.4
6	Corruption	27.7	Corruption	30.1	Corruption	27.4	Exchange rate	22.4
7	Street crime	27.2	Exchange rate	28.9	Street crime	25.5	Organized crime	21.7
8	Organized crime	24.5	Organized crime	26.9	Organized crime	23.4	Taxes and regulation	21.4
9	Anti-competitive practices	21.9	Anti-competitive practices	23.8	Anti-competitive practices	21.9	Infrastructure	18.2
10	Infrastructure	17.0	Infrastructure	16.3	Infrastructure	17.2	Anti-competitive practices	16.9
11	Judiciary	13.7	Judiciary	13.8	Judiciary	14.4	Judiciary	11.6
Note: (a) Major means that firms chose 4, the highest possible obstacle level. Lower obstacle levels are: 3, moderate obstacle; 2, minor obstacle; and 1, no obstacle								

Source: Shiffer and Weder (2001).

[10] Survey covered 80 countries and the territory of West Bank and Gaza and collected information from 10 090 firms.

Shiffer and Weder (2001) clearly show that there are size-based policy biases against SMEs, and more so against smaller firms in the microeconomic environment. These biases cover all areas: legal and regulatory frameworks, governance issues, such as bureaucracy and corruption, access to finance and property rights. Interventions on all fronts are required. The existence of such biases point out to either market or government failure and is closely related to the capacity of the stakeholders involved. At times, markets may correct these failures. However, in some cases, removal of failures in the business environment may require adopting structuralist (selective intervention)[11] approaches rather than market-friendly approaches, as market forces may not be sufficient to remedy the capacity deficits in the system. The choices made will be political, but they should be based on sound analyses.

Competitive SME business practices and strategies

It is up to the SMEs to implement competitive business operating practices and business strategies. However, the options available to SMEs are also closely related to the quality of institutions, markets and organizations that constitute the business environment. It is the efficiency and effectiveness of institutions, markets and organizations that encourage or discourage SMEs to take their cues for learning new ways of doing business, compare their own competitive characteristics with those of their rivals, and make their decisions to invest, including the introduction of innovations into their business strategies. If the environment is weak, SMEs' ability to detect market signals that would enable them to invest and grow will also be weakened.

Presently, transition and developing countries seem to have a plethora of policies and strategies that relate to the private sector in one way or another: private sector development strategy, SME development strategy, trade and investment policies and strategies, export strategy, and so on. Yet, the responsibility for implementing these various national policies/strategies and programmes are disbursed throughout the public sector institutions, where both capacities and authority to coordinate are weak. Furthermore, there is need to establish dialogue and partnerships between the government, SMEs, the civil society and the academia to appropriately assess and prioritize SME challenges and to implement remedial actions. Governments usually consult with the private sector, though mostly with large and foreign investors, when setting policies since public-private dialogue enhances ease of implementation, political credibility and sustainability strategies. However, there are also capacity deficiencies that must be overcome on the side of SME membership organizations as discussants.

As illustrated above it is necessary to ensure that there is concerted and coordinated action at all levels to improve the competitiveness of SMEs. This can be achieved by embedding the SME development strategy into the national development strategy, so that effects of relevant policies on SMEs are seriously considered at every stage and level (a joined-up government, strengthened private sector organizations), appropriate interventions for correcting market and government failures are prioritized and capacity building interventions for SME stakeholders are implemented. The title of the SME development policy of United Kingdom, "THINK SMALL FIRST, 2001" reflects very well the government's attempt in mainstreaming SME issues into national development frameworks, Box 2.

[11] Lall (2001) argues that developing countries in which market failure is particularly diverse and widespread may require coordinated strategies to move their economies from low-skilled, low technology activities to higher valued activities and proposes a structuralist (selective intervention) rather than a market-friendly approach to overcome impediments to development.

Box 2. SME Policy Priorities-United Kingdom

Think Small First | 2001

Priority Areas

5. In order to meet the challenges of the next few years the Government aims to focus on three priority areas:

i) the prevailing culture and environment, including macro-economic stability and the policy environment;

ii) the regulatory framework for business; and

iii) support for business at each stage of the business life cycle, including people, skills, advice, workspace, IT, finance and international trade.

Source: www.sbs.org.uk

It must also be clear that inserting an arbitrary notion of "SME" into the national development framework or into an existing private sector development strategy would not be sufficient. Anti-SME biases must be assessed in detail within the context of the country: as to the legal, regulatory frameworks and administrative practices, in access to finance, in respect of entrepreneurial support structures and infrastructure, and with a genuine concern for effective use of human and natural resources.

Enabling legal, regulatory and administrative environments

The legal and regulatory frameworks establish the "rules of the game" in a society and govern the way in which the government, enterprises and civil society interact with each other. The rules influence investment decisions, the opportunities and rewards available to economic actors. Governments set these rules to raise tax revenues for investments in public goods, among others, defense, protection of law and order, and to maintain health and safety of consumers, and the environment. Compliance with the rules comes with costs of doing business. Some examples of legislation that affect the private sector, including SMEs are listed in Box 3.

Bannock, Gamser, Juhlin and McCann (2002) argue that when imposed at unrealistic levels and inadequately enforced, regulation divides the economy into formal and informal sectors and erects barriers between the two, which perpetuates the division. The passive acceptance by governments in transition and developing countries that regulation cannot be fully enforced in the informal sector is a recognition of the fact that the level of regulation is too high and too costly to be applied to all forms of economic activity: *i.e.* if enforced they would deprive a large proportion of the population from earning a living.

Box 3. Examples of Legislation Relevant for SMEs/private sector

- Company, commercial and contract laws
- Property laws, including property rights
- Taxation laws
- Accountancy law
- Bankruptcy law
- Laws concerning compensation for damage
- Laws concerning consumer safeguards,
- Laws concerning environmental protection
- Labor laws, minimum wage laws, working safety laws
- Rental laws
- Laws of association
- Credit legislation, banking and financial market laws
- Stock exchange law
- Insurance laws
- Intellectual property rights law
- Laws concerning competition, including anti-trust laws

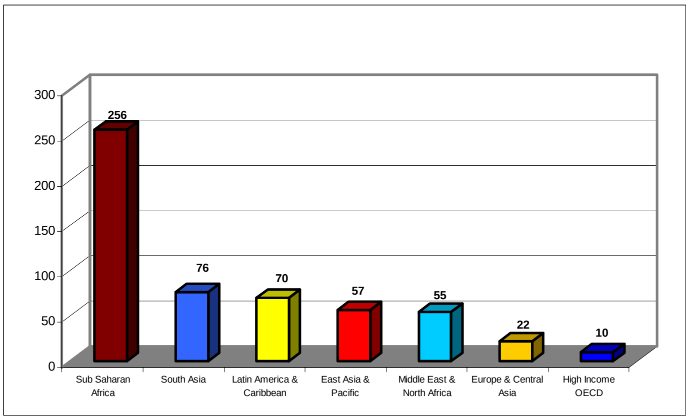
An SME "friendly" legal, regulatory and administrative environment would be characterized, among others, as one where:

1. Property rights are clearly recognized,
2. Contracts are easily enforced,
3. A simple, transparent and low-compliance-cost tax system is operational and it is perceived as fair,
4. Businesses are able to register with authorities through a simple and inexpensive system, preferably by remote access through the Internet,
5. Business licensing requirements are minimized, and when they are enforced, the objective is to safeguard health and safety of consumers and labor rather than being a source of revenue for local and/or central government,
6. Labor regulations are balanced and flexible, protecting the rights of labor and the firm equally,
7. SMEs, whether they are exporting or importing, interact with a streamlined customs administration that is efficient, simple and transparent,
8. Financial sector regulations (banking, insurance, leasing) recognize SME constraints and have introduced appropriate legal and regulatory instruments that enable commonly available SME assets to be used as collateral,
9. Public administrators at local levels appreciate entrepreneurs as contributors to economic growth, treat them fairly and are committed to limiting corruption to a minimum,
10. Legislation and regulation is gender insensitive, rule of law and rules of the game apply equally to men and women,
11. SMEs can easily set up and join membership organizations,
12. Bankruptcy legislation does not impose unduly high penalties on the entrepreneur or the SME.

While recent studies[12] make a strong case regarding the role of efficient and effective market institutions on economic development compared to global integration and geography, other studies[13] support the insight that getting all of these institutions to function according to the ideal case is a great challenge. In fact, these studies show that in the industrialized countries, most of these institutions evolved to their present state over a period of more than two to three centuries, and that they were not present when the now industrialized economies were at the initial stages of industrialization. Moreover, industrialized economies of the present are still exerting great effort to adjust their institutions to the global trends, investing tremendous amounts. Obviously, institutions rule economic development. However, in the scope and space of this paper, we will only suffice to discuss a selected number of institutions with the aim of demonstrating their effect on SME development.

The World Bank's *Doing Business* database provides indicators of the cost of doing business in 133 economies, as of March 2004: it identifies specific regulations that enhance or constrain investment, productivity, and growth. Indicators are built on studies of prevailing regulations and cost estimates collected in the field directly from firms (small, independent, limited liability firms employing 5-50 employees), and interviews with organizations charged with administering institutions. The database differs from existing reports[14] on the effects of the business environment on firms, in that; previous studies tend to rely on business perceptions surveys and analyst assessments.

Figure 3. Cost of Starting a Domestic SME (% of GNI per capita)



Source: http://rru.worldbank.org/doingbusiness

Figure 3 shows that an entrepreneur in a Sub-Saharan Africa economy incurs registration costs amounting to 2.5 times that of GNI per capita, in cash, while the same start up in a high income country would need to spend only 10% of GNI per capita. While the same costs vary from 22% to 76% in transition and developing countries in the other regions of the world, they are still prohibitively high and discourage firms from setting up and formalizing.

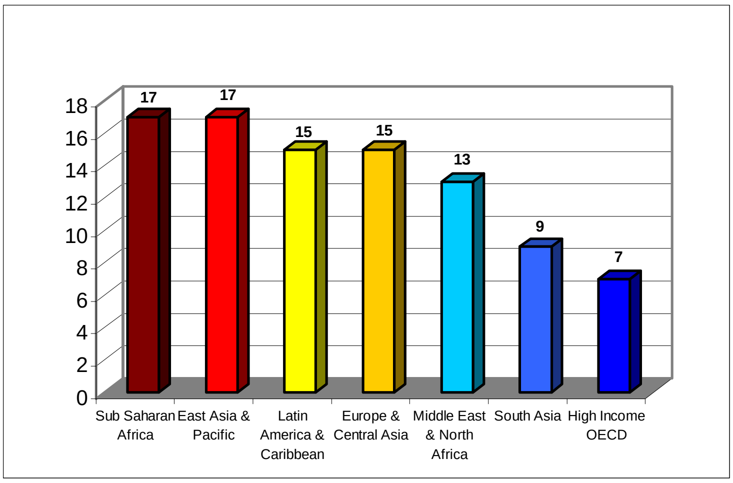
12 See Rodrik, Subramanian, Trebbi (2002) and Acemoglu (2003).

13 See Chang (2001) and Bannock, Gamser, Juhlin and McCann. (2002).

14 See, for example, Fries, Lysenko, Polanec (2003) for an analysis of EBRD Business Environment and Enterprise Performance Survey 2002.

Figure 4 shows that entrepreneurs in East Asia and Pacific would forego 17% of their estate when exiting, while the same cost would be 7% in high-income countries. It is also interesting to note that there is not much of a difference among developing countries with respect to exit costs. Market exit costs also influence the to-be-entrepreneur's decisions of entry: the higher the cost of exiting, the more difficult will be the decision to invest[15].

Figure 4. Cost of Closing a Domestic SME (% of estate)



Source: http://rru.worldbank.org/doingbusiness

If one of the objectives for SME development is to expand the formal SME sector, including innovative small firms, legal and regulatory costs of business have to be rationalized. A case in point is the recent amendment of company law in Vietnam. The new Enterprise Law came into effect as of 1st January, 2000. In the following two years, more than 26 000 new enterprises registered for business. Nearly 70% of these entities were new businesses, and the rest constituted of informal household enterprises that entered the formal SME sector[16].

The informal sector/the shadow economy does not only consist of the self-employed and the micro enterprises. Businesses that formally exist also tend to conduct at least some of their operations informally, as the costs of doing business increase. There are a large number of empirical studies[17], which show that there will be observable; annual increases (decreases) in the size of the shadow economy as the tax and social security contribution burdens and the intensity of regulation increase (decrease) within an economy.

Costs of compliance with business regulation cannot be quantified only by the cost of official fees and tariffs that come with the procedures. There are also costs incurred in time, the business lost when dealing with regulation and unofficial fees paid due to corrupt bureaucratic practices. Governments may adopt "good regulation" principles to decrease such costs. Good regulation is defined by its proportionality, transparency, accountability and consistency, Box 4. There are roles both for the government and the private sector, if good regulation principles for SMEs are to take root.

15 Ability of an economy to adjust to rapid change through easy entry and exit from business, sometimes qualified as "creative destruction" has been shown to increase overall productivity, thereby enhancing growth potential.

16 UNDP (2002), p. 40.

17 Schneider (2003), Djankov, Lieberman, Mukherjee and Nenova (2003), Schneider and Enste (2000), Johnson, Kaufmann and Zoido-Lobaton (1998a, 1998b), Johnson, Kaufmann and Schleifer (1997) among others.

Box 4. Principles of Good Regulation for SMEs

Proportionality

- The impact of regulation on small business is identified, establishing an appropriate balance between risk and cost.
- Needless demands are not placed on regulated small business.

Transparency

- Policy objectives, including the need for regulation, are clearly defined and effectively communicated to those involved.
- Those being regulated understand their obligations and know what to expect from the enforcing authorities.

Accountability

- Proposals are published and all those effected are consulted before decisions are taken.

Consistency

- New regulations are consistent with existing regulations.
- Regulations are applied consistently across the country.

Source: Conclusions from the Cambodia Workshop: "Trade Capacity Building and Private Sector Development in Asia", Regional Workshop, 2-3 December 2003, Phnom Penh, Cambodia.

On the side of the government, there must be high-level political commitment to change the way bureaucracy functions: *i.e.* clear identification of regulatory objectives, assessments of cost on SMEs of new regulation, communication of regulatory proposals to the SMEs for consultations, and clear instructions on how to comply with it, and, as required, capacity building in the civil service administering regulation. SMEs, on the other hand, would need to take initiative to become informed and qualified discussants with the civil service through their membership organizations, make a genuine effort to understand regulation, and to comply with it, once it is issued after the consultative process. These processes are used in a number of OECD countries, where governments conduct Regulatory Impact Assessments (RIAs, *e.g.* in UK and Ireland), and Small Business Impact Assessments. In a number of other OECD countries there are acts that aim to simplify the forms filled and the steps to be completed (*e.g.* USA), share information collected on firms, so that SMEs do not have to provide it many times to different government agencies (*e.g*. Sweden) and have tax information declared on-line (*e.g.* Italy).

Women entrepreneurship contributes to income generation and poverty reduction significantly in least developed economies[18], and in most developed economies such as USA and Canada, growth in the numbers of women owned businesses is out-pacing those owned by men[19]. Yet, one of the key deficiencies in legal, regulatory and administrative frameworks is gender bias against women's participation in economic activities. Many of these biases are based on tradition and socio-cultural contexts: rights to inheritance, rights to own land, right to set up business in own name may legally be denied to women. In other cases, while such rights are in the legislation, in practice, they are not exercised. While keeping a whole half of a country's population out of the formal economy should not be acceptable by any standards,

18 See Ulusay de Groot (2000) and (2001).

19 See OECD (2000).

more needs to be done to encourage implementation, where such rights are legally recognized. Similar to good regulation principles, legislation and regulation should be systematically assessed for gender balance and the civil service should be sensitized to gender biases through regular assessments.

Creation of enabling legal and regulatory frameworks and administrative practices has to go hand in with the intentional promotion of an appreciation of enterprise and the entrepreneur by the civil service. In most transition and some developing countries, the overhang from the era of planned economies still persists, where perceptions about entrepreneurs are skewed towards the negative. Moreover, low pay levels of civil servants and increasing demands on them through downsizing under public administration reform programs in transition and developing countries continue to encourage rent-seeking behavior. Finally, for improved frameworks for SMEs to become the norm, members of the civil service would have to develop an appreciation of the contribution SMEs make to "economic" development in the country. Considering the fact that an appreciation of SMEs' economic contributions have been slow to emerge at the international level, and that reforms are both very costly, and require high-levels of commitment over extended periods of time (*i.e.* political stability is a pre-condition), it is likely that it will be some time before transition and developing countries will catch up with OECD countries in this respect. OECD and other development partners can expedite this process by offering assistance to developing countries not mainly for drafting appropriate frameworks, but also extending assistance for capacity building at administering these improved frameworks. In fact, it must also be noted that legislation and regulation that is not enforced is worse than having no regulation at all.

Access to finance

SMEs identify financing, especially medium to long-term finance, as their topmost obstacle to growth and investment. These obstacles come at two levels. In least developed economies, and in some transition and developing economies deficiencies in both the macroeconomic and microeconomic environments pose challenges: high budget deficits and unstable exchange rates and legal, regulatory and administrative environment poses major obstacles to access of SMEs to financing. In some economies, capital may just not be available[20], property rights regimes may not allow ownership of land, markets for transfer of immovable assets may be very underdeveloped, credit and collateral legislation may not allow certain assets that SMEs commonly have access to, to be used as collateral (*e.g.* future acquired property), absence of registries for mortgages and pledges may increase risks to lenders, contract enforcement and asset liquidation may be hampered due to weaknesses in legislation and in the judiciary.

The second level of obstacles may be due to organizational capacity weaknesses: For example, in least developed economies, business services markets in accounting, auditing, financial management and legal counsel may be so underdeveloped that SMEs may not be able to access or afford such services: essential services they would need when they approach banks and other types of lenders.

In more advanced developing countries, where there is reasonable progress in the fundamental institutions, SMEs may still face challenges in accessing formal finance in the form of bank loans, guarantees, venture capital, leasing and so on. For instance, although SMEs are by far the largest group of customers of commercial banks in any economy, loans extended to SMEs are often limited to very short periods, thereby ruling out financing of any sizable investments. Moreover, due to high-perceived risks in SME loans, access to competitive interest rates may also very limited. Finally, in many developing economies, banks prefer to lend to governments, which offer less risk and higher returns, crowding out most of the private sector from the financial system.

---

[20] Compare US$ 100 million available as government sponsored equity for technology-based SMEs in India in 1999 with US$ 5 billion available of the same in Germany per annum, Dossani and Kennedy (2002), p. 24.

In industrialized countries there has been a long tradition of providing subsidized loans and grants to all types of SMEs to enhance their competitiveness. A more recent trend in OECD economies is a focus on exporting and technology-based SMEs, generally removing subsidies from asset and operating capital financing and shifting to subsidies for promoting exports and technology upgrading, providing loan and exchange rate guarantees, and providing grants for quality improvement[21]. Some governments in the developing world have also introduced specialized banks for SMEs (*e.g.* in India, Small Industries Development Bank of India, in Turkey, the Halkbank) to the same effect. However, size of programs in the developing world are usually much smaller.

Innovations introduced by commercial banks in OECD economies have obtained good results in servicing SMEs. However, the infrastructure and capacity building needed to implement these innovations have yet to reach most developing countries, Box 5.

Box 5. Challenges in Access to Finance and Recent Financial Innovations

SME Constraints in Access to Finance	**Banks' Response to Access Constraints**
• SMEs are regarded by creditors and investors as high-risk borrowers due to insufficient assets and low capitalization, vulnerability to market fluctuations and high mortality rates. • Information asymmetry arising from SMEs' lack of accounting records, inadequate financial statements or business plans makes it difficult for creditors and investors to assess the creditworthiness of potential SME proposals. • High administrative/transaction costs of lending or investing small amounts do not make SME financing a profitable business.	• Reducing information asymmetry of SMEs and high perceived risks by using credit scoring systems, external information providers, risk self-assessment for the SME entrepreneurs, pricing to the level of risk; sharing risk with third parties (loan guarantees) using covenants as an alternative to loan guarantees, and setting up special support units for high risk customers such as start-ups, • Reducing costs of lending by applying latest information technologies; streamlining the organization and simplifying the lending process; • Developing products better adapted to SME needs; • Improving financial services for SMEs through training of bank staff and the segmentation of SME customers • Cooperating with SME organizations and other business development providers in order to reduce risks and costs and combine financial with non-financial services.

Source: UNCTAD (2001)

In addition to loan financing, SMEs have the option to cooperate with venture capital investors. Venture capital involves the provision of investment finance to SMEs in the form of equity or quasi-equity instruments not traded on recognized stock exchanges. It is long-term risk finance where the primary return to the investor is derived from capital gains rather than dividend income. Venture capital investors are actively involved in the management of the firms they invest in, to assure the success of the venture. Venture capital investors actively seek SMEs in high growth sectors, Box 6.

21 See, for example, UNCTAD (2001) and Dossani and Kennedy (2002).

Box 6. Precisioair (Venture Capital Funds in Africa)

Name: Precision Air Services Ltd. (Precisionair)

Description: Private airline in the United Republic of Tanzania

Established: 1993

Jobs created: 145

Owners: Founder Michael N. Shirima, local venture capital funds

Financing: Raised more than US$733,000 in critical early-stage venture capital through the Africa Project Development Facility.

Precisionair, the first privately owned commercial airline in the United Republic of Tanzania, is an example of how finance is essential for an SME to grow.

Starting small: The founder of Precisionair, Mr. Shirima is a model of entrepreneurship in Africa. He started his small business in 1987 with only two planes, aerial sprayers serving large farms. A few years later, a severe drought in Tanzania forced him to change to another field: passenger service, and he identified tourists as the prime target. For this new venture, Shirima required new airplanes but he did not have all the capital needed. However, he continued his plans and opened Precision Air Services Ltd. in 1993.

Recent trade and investment liberalization contributed to a significant development of tourism in the United Republic of Tanzania, a country with spectacular wildlife and natural wonders. However, many of the key sites were far from the main international arrival points. Thus, Shirima's aim was to provide tourists with a suitable means of transport, to easily reach popular destinations.

Raising funds: Shirima, a former executive at the "defunct" East African Airways, knew that for building Tanzania's first privately owned airline would require substantial outside capital. Therefore, he approached the Africa Project Development Facility (APDF), which after a thorough feasibility study confirmed the viability of the project and found potential investors. Thus, Precisionair could raise US$333,000 in equity financing from the Tanzania Venture Capital Fund (TVCF). This financing, used for acquiring new airplanes, was critical for building the enterprise. Since then, the company has expanded considerably. In 1996, Precisionair approached the APDF again in order to replace the airplanes with larger and faster airplanes. This time it was able to raise US$400,000 from the East African Development Bank. Today, Precisionair has seven aircrafts that can transport 176 passengers each.

Impact: Precisionair has contributed remarkably to Tanzania's recent tourism boom through its regular scheduled air services that enables tourists to reach key attractions. Moreover, the company provides affordable and reliable domestic transport for the local business community.

Source: SME FACTS, www.ifc.org, January 2001.

Other significant forms of SME financing include leasing[22], trade credit, and fiscal incentives in the form of tax breaks. In developing countries leasing and trade credit systems require the existence of appropriate legal and regulatory frameworks: while a legal basis for leasing needs to be present, enforcement of contracts have to be ensured for both leasing and trade credit mechanisms to work well. Developing economy governments sometimes set up fiscal incentive schemes for SMEs, however, cumbersome procedures of tax authorities may render incentive schemes inaccessible or too costly.

[22] See, for instance, www.orix-pak.com for information on leasing operations of Japanese firm Orix in Pakistan.

In developing countries there are a large number of microfinance schemes targeting the self-employed and micro enterprises. These schemes usually provide small amounts of working capital and a majority caters to traders and very small agriculturalists, Box 7. Micro scale, rural based, women entrepreneurs are among primary target groups. Women's lack of access to land renders them as non-customers of formal financial institutions in most of least developed countries. Furthermore, gender-biased attitudes prevailing among bank staff, who are mainly men, low level of education and training among women entrepreneurs and lack of access to information about sources of financing are also major barriers for women entrepreneurs[23].

Box 7. KUPEDES: Indonesia's Model Small Credit Program

By 1983, years of heavy losses and fiscal cuts had made the vast network of village banks belonging to the state-owned Bank Rakyat Indonesia unsustainable. Shutting the banks down risked serious unemployment and the loss of an important credit delivery mechanism. The government responded by taking a novel approach. It established a new, market-based rural small credit program, the Kredit Umum Pedesan (KUPEDES), aimed at transforming village banks into self-sustaining full-service financial units. The program's principal goals were to provide credit to small borrowers at market rates and to mobilize rural savings. By the time the World Bank's $102 million loan to KUPEDES was approved in 1987, the program was already working with a profit. By loan completion in 1992, the program's assets had grown 21 times over the 1984 level. The village banks were reaching 5 percent of the country's households with loans and 15 percent with deposit services.

A recent World Bank audit draws two major lessons from the KUPEDES experience. First, it is possible to create a micro-lending program that serves the poor and is profitable and self-sustaining. But to succeed the bank units will need to lend at market rates, use their income to finance their operations, and devise appropriate savings instruments to attract depositors. Second, developing a savings instrument for the poor is at least as important as providing them with loans. In Indonesia, SIMPEDES, the village savings program, attracted thousands of depositors. And by mobilizing rural savings, it not only provided the banks with a stable source of funds, it also kept financial savings in rural areas, thus helping continue development in the countryside.

Finally, the audit highlights the main reasons for village banks' success: simplicity of loan design, which enabled the banks to keep costs down; effective management at the unit level backed by close supervision and monitoring by the center; and appropriate staff training and performance incentives. By themselves, however, these factors would not have been enough for the program to succeed. The presence of an existing institutional network of village banks and a thriving economy that had spread to many rural areas were also critical.

Source: Precis No. 104, Operations Evaluation Department, World Bank, January 1996, www.worldbank.org/oed.

Access to finance is essential for improving SME competitiveness, as SMEs have to invest in new technologies, skills and innovation. Access to finance issues cannot be resolved by implementing financing schemes or programs in a vacuum. There are institutional issues covering a spectrum from the macro level to the micro, which are accompanied by capacity deficiencies. A wide spectrum such as this may only be tackled by mainstreaming SME development in national frameworks. It is also noteworthy to add that effort to resolve access to finance issues is not solely the responsibility of governments. SMEs need to take a better initiative than pointing it out as their number one obstacle: they need to mobilize joint advocacy and recommendations, based on sound analyses, through their membership organizations. Most significantly, SMEs must implement sound business practices and continuously invest in good internal management systems: in accounting, planning, financial, operations and human resource management.

---

23 Ulusay de Groot (2001).

Box 8. Institutional Structures SMEs Interact With	
Central Level	**Local Level**
Parliament and political parties	Provincial Councils
Line Ministries	Provincial Equivalent or Branches of Central Ministries
Judiciary	Courts
Regulatory Authorities • Tax • Customs • Business Registration & Licensing • National Standards Organization	Local Branches of Regulatory Authorities • Tax • Customs • Business Registration & Licensing • Branches of National Standards Organization
Education and Training Institutions • University • Technical and Vocational Schools	Education and Training Institutions • University • Technical and Vocational Schools • Vocational Centers, Adult Education Centers
Apex Business Membership Organizations • General • Sectoral • Professional	• Business Membership Organizations • General • Sectoral • Professional
Financial Service Providers • Banks • Microfinance Institutions • Leasing Companies • Insurance Companies	Financial Service Providers • Banks • Microfinance Institutions • Leasing Companies • Insurance Companies
Business Development Service Providers • Public Organizations-Central – SME Promotion – Export Promotion – Investment Promotion • Apex Organizations of Private BDS Providers	Business Development Service Providers • Public Organizations-Local Centers/Branches – SME Promotion – Export Promotion – Investment Promotion • Private Sector BDS Providers
Apex Trade Union Organizations	Local Trade Unions
Civil Society Organizations	Local, Community Based Organizations

Strengthened institutional support structures

The SME development strategy has to be inclusive and build on a consensus on SME challenges, goal and broad policy direction among key SME stakeholders. The strategy has to concert and coordinate efforts of institutional structures that make or affect policy (the parliament, provincial councils and political parties), the administrators of policy (line ministries, local government authorities and regulatory structures), and public support organizations (SME, export, investment, regional development, public sector education and training institutions and financial institutions)[24]. The private sector's roles and responsibilities have to integrate into the strategy through business membership organizations, organizations of business development service (BDS) and private financial service providers, trade unions and civil society organizations, Box 8.

Box 9. Public Private Dialogue- Mauritius' Joint Economic Council

In Mauritius, the Joint Economic Council (JEC), established in 1970, operates as the coordinating body of the nine major multi-sectoral institutions and industry associations in Mauritius (Chamber of Commerce; Chamber of Agriculture; Employers' Federation; Sugar Producers' Association; Export Processing Zone Association; Bankers' Association; Insurers' Association; Hotels and Restaurants Association).

The JEC is managed by a Council of 18 associates (2 per member), a Chairman who rotates every two years and a full-time Director. The structure and functioning of JEC enable an enhanced coordination amongst the different institutions while permitting to build an institutional expertise for each represented industry. Hence, sectoral issues are dealt with the relevant industry association, while crosscutting issues such as national budget, wage negotiations, international trade negotiations are dealt with all the JEC members. The dialogue takes place in a structured manner as well as on an ad hoc basis. The JEC is fully funded by its members.

Consultations with the private sector

Formal

1. Government/JEC meetings: chaired by the Prime Minister and attended by senior Ministers; held usually twice a year; on broad economic policies.
2. Tripartite wage negotiations
3. Private sector proposals for the National Budget: with Minister of Finance; once a year.
4. Representation in a number of joint Government/Private Sector committees: e.g. the National Negotiating Committee on Post-Lomé discussions; the WTO Standing Committee (the private sector was represented in all the WTO Ministerial Conferences); the Regional Cooperation Council.

Informal

1. Regular meetings between the relevant private sector organizations and relevant Ministries on sectoral issues
2. Joint promotional activities (conducted by the Government abroad).
3. Ad hoc Committees

Source: Laporte, Geert (2003); www.jec-mauritius.org.

[24] White and Chacaltana (2002), p. 19-21.

Public-private dialogue structures

Clearly, the multi-dimensional and multi-stakeholder nature of SME competitiveness strategies require on-going consultations between the public and private sectors, hence, institutionalized public-private dialogue mechanisms have emerged. In developed and developing countries, these institutionalized mechanisms are either lead by (*e.g.* in Thailand, Prime Minister chairs the SME Development Council) or report to (in the UK to the Prime Minister, in the Philippines to the Congress and the President) the highest level in government. While some public-private dialogue structures may bring representatives from both sectors together, other structures primarily represent the private sector, including SMEs, which then conducts formal, regular dialogue with high-level representatives in the government. When the structure is not specifically focusing on SMEs, interests of large, domestic and foreign invested businesses take their place on the agenda more prominently. An example of private sector based dialogue structure has been operational in Mauritius since 1970, Box 9.

SME/Private Sector Membership Structures

There are capacity deficiencies on both sides of the public-private sector dialogue structures. In the past, many poor countries and regions hardly considered the private sector as a real partner in SME development processes. While, top-down, control oriented attitudes by governments reduced the scope for private sector participation in policy formulation and implementation, non-constructive criticisms of governments by the private sector worked to strengthen confrontational attitudes and mutual mistrust. This situation is rapidly changing, for instance, in South and Southeast Asia, as demonstrated by the emerging public-private dialogue in agribusiness and garment sectors[25].

Business membership organizations, specifically those that are industry-based, are the channels through which the SME/private sector voices its needs and concerns to the government and lobby for its support, facilitate networking and partnerships between members (firms) and with similar institutions abroad and provide a number of other services to members.

Despite their important role in facilitating SME/private sector participation in policy making and development processes, business membership organizations in developing countries have problems related to representation of SMEs, capacity and funding. Despite their numbers in the economy, and also within the membership of associations, smaller firms do not seem to have the requisite weight and voice in these structures.

Due to lack of funding, business membership organizations usually operate without qualified and professional management staff and are unable to benefit from specialist inputs and research, upon which they should base their advocacy efforts. Lack of funding and "free riding" problems also constrain these structures in developing and delivering appropriate information, facilitation, and networking services to their membership. Their weaknesses work in almost a vicious circle eroding the expectations of members, in turn, resulting in further funding, representation and capacity problems.

Lack of effective mechanisms for structured public-private dialogue further reduces the motivation of SME/private sector stakeholders, including membership bodies, in investing in and learning to help themselves. There is growing consensus that public-private dialogue can help to (a) improve the ownership and quality of policy making in general and in SME development in particular, (b) consolidate the democratic legitimacy of governments, (c) foster conducive policy environments and increase national cohesion, (d) provide an instrument for interest mediation, and (e) improve service provisioning. Therefore, business membership organizations should seek and support opportunities to act as partners in

---

25 OECD (2003), see also, www.oecd.org/dev/cambodia.

structured, public-private dialogue, and governments and development partners should place capacity-building programmes for these structures on their agenda.

Policy Coordination and Monitoring Structures

Backstopping the work of institutionalized public-private dialogue institutions as well as policies and programmes resulting from these, are strong, independent or semi-autonomous, central level SME policy coordination and monitoring institutions (*e.g.* in the UK, Small Business Service, in the USA, the Small Business Administration, in the Philippines, the Bureau of Small and Medium Business Development and in Thailand, the SME Office), *(see Annex I for schematic depictions of a selected number of SME institutional support structures).*

Paradigm shift in SME support

There has been a gradual and global shift in the paradigm on how SMEs should be supported through institutional structures. Initial efforts, which date back to the early 1950's worldwide, perceived the SME sector through paternalistic lenses and identified it as *an entity to be protected*. Lessons learned, and advances especially, in biotechnology, information, communication and materials technologies and efforts to liberalize, shifted the paradigm to one of *SME promotion*, starting in the 1980's. The result was an enhanced focus on specific sub-sectors and activities; with considerably larger amounts of assistance and subsidies going to high technology oriented manufacturing and service firms and entrepreneurship development. With the advent of globalization and trade liberalization, the paradigm shifted again, and is now, one of *facilitation, where a holistic approach to competitiveness takes priority.* In the developing world, India was a leader in SME development, with extensive support structures dating back to 1954 and the Indian experience vividly illustrates how the institutional support to SMEs evolved as the paradigm shifted[26].

Accordingly, other important functions of these structures are to compile statistics on the state and health of the SME sector in collaboration with national statistics bodies, to conduct or commission research on various SME issues, to coordinate and monitor regulatory reforms affecting SME competitiveness and the implementation of "good regulation" principles, to develop guidelines on SME promotion program design, implementation and monitoring for national stakeholders, including those at the local level, to facilitate SME support programs by providing financial and technical assistance to local stakeholders, including business membership organizations, to coordinate SME related interventions of line ministries and regulatory agencies, to implement/coordinate programs to improve appreciation of the enterprise and the entrepreneurs among the civil service, including at local levels to act as an information clearing house for SME programs and policy progress within the country and to coordinate development partner assistance. Evidently, the functions listed may be considered those of an "*SME advocate*" within the public sector for an enabling environment and one of a "*facilitator*" for SME promotion[27].

In a large number of developing countries the paradigm shift has yet to occur or is experiencing difficulties in progressing: There may not be an SME development strategy; or the government and development partners may have agreed that a private sector development strategy would suffice to address SME development issues as well. Among some of the other reasons may be the following:

The existing SME development strategy may be one of public sector SME promotion only, *i.e.* design and public sector delivery of business development services (BDS) through a national SME

---

26 Jain, Pankaj (2003) and www.smallindustryindia.com

27 Here, promotion is used to mean support programs and schemes, such as a "technology upgrading program", "a membership organization capacity building project", etc.

agency and its branches at the provincial level, with large numbers of civil servants aiming to act as consultants to SMEs, albeit without significant results – such SME agencies were mostly set up with extensive development partner assistance throughout the 1980s and 1990s. Experience shows that it is difficult to reform these SME agencies.

A re-worked SME development strategy may have a more holistic approach, involving measures for creating an enabling environment, public-private dialogue and BDS facilitation. However, existing structures may be resisting change, may be politically entrenched, and hard budget constraints may be disabling governments to conduct major reorganization of existing structures.

While the partner government may be willing to adopt a facilitator's role and to reorganize existing structures, development partners may be reluctant to get involved in a "public" sector SME institutional assistance program, based on previous unsatisfactory experiences in the country or elsewhere. This is a situation that allows existing inefficient institutional structures intact, continuing to cause a drain on the budget and not so much to show for it.

Development partners, having been disillusioned with the public sector SME support structures in the past, may have opted to support only private sector structures such as business membership organizations, microfinance institutions, commercial banks, non-governmental organizations (NGOs) and civil society organization (CBOs). This approach is also not very productive, since it neglects the other side of the equation, the need to build up capacity in the public sector.

Achieving policy coherence

It is the government that has the responsibility to implement a strategy for improving SME competitiveness. And the need is to have policy coherence through a "joined-up government", collaborating closely with the SME/private sector, the civil society and the development partners. Without a lean, but capable policy coordination and monitoring structure at the national level, this is difficult to achieve. Policy coherence may be built up by building up the capacity of the public sector and SME membership organizations in conducting SME policy analysis based on hard facts, mechanisms for information sharing and coordination among multiple types and levels of SME stakeholders within the public sector, including development partners, and capacity for monitoring and evaluation of progress made as policies are implemented.

In least developed countries, the poverty reduction strategy (PRS) or the national development framework presents an opportunity for achieving policy coherence. However, growth policies, and hence SME development policies, have yet to be integrated into the PRS, except in a few cases such as Vietnam. Likewise, at a more operational level, development partners, in collaboration with the World Bank, support capacity building of governments in developing and using the "Medium Term Expenditure Framework-MTEF" as a planning, coordinating and monitoring instrument. In some countries, SME development issues have started to come up as elements of the MTEF; however, without the institutional capacity (a lean, national level SME development policy coordination and monitoring unit) and funding (for facilitation of measures) required, SME issues cropping up are fragmented at best.

Business Development Services (BDS) for SMEs

SMEs must be able to respond quickly and efficiently to market signals to take advantage of trade and investment opportunities and reap the benefits of the international trading system[28]. Among others, business development services (BDS) help SMEs to learn implement competitive business practices and

[28] USAID (2003), p. 9.

strategies. The Committee of Donor Agencies for Small Business Development define BDS to include training, consultancy and advisory services, marketing assistance, information, technology development and transfer, and business linkage promotion, Box 10. Disillusionment with the public provision of BDS has led to a market-based approach: traditional programs have been supply driven, they have crowded out potential private sector BDS suppliers with free or subsidized services, they have been limited in outreach, and of low-quality due to limited institutional capabilities (*e.g.* civil service based SME consultants without business experience).

Box 10. Scope of Business Development Services (BDS)

Business Development Services include training, consultancy and advisory services, marketing assistance, information, technology development and transfer, and business linkage promotion. A distinction is sometimes made between "operational" and "strategic" business services. Operational services are those needed for day-to-day operations, such as information and communications, management of accounts and tax records, and compliance with labor laws and other regulations. Strategic services, on the other hand, are used by the enterprise to address medium- and long-term issues in order to improve the performance of the enterprise, its access to markets, and its ability to compete. For example, strategic services can help the enterprise to identify and service markets, design products, set up facilities, and seek financing. The market for operational services may already exist, since there is often articulated demand and willingness to pay for these services. In contrast, markets for strategic services for SMEs have largely failed to develop, and they are the focus of most donor interventions in BDS.

Source: World Bank (2001), p. 1.

The Donor Committee has articulated the ultimate vision for BDS as one of a well-functioning market with a diverse array of high quality services that meet the needs of a large proportion of SMEs affordably. The approach does not totally discharge the public sector, including the development partners, of their duties, but rather limits their interventions to developing private sector BDS markets as "*financiers*" of BDS facilitators (may be private or public) and BDS providers (may be private or public). One of main operational features of the new BDS market-development approach is sub-sector and BDS market analyses, through which SME needs, potential demand for particular BDS and the state of the BDS market are assessed. Accordingly, the new BDS approach seeks to develop efficient and effective commercial BDS services that are more relevant and of higher quality. The approach approves both supply and demand side interventions, as required. The BDS market development approach also implies some general characteristics for BDS, BDS providers and BDS facilitators, Box 11.

A number of development partners have started to use the new approach and some interesting results are emerging. For example, a recent BDS market survey[29] conducted in a region of Tanzania indicated that micro and small enterprises (MSE) perceived "training in bookkeeping (69.2%), financial services (64.8%), marketing and sales promotion (62.9%), training in costing and pricing (54.9%), transport services (49.5%), and training in new product technologies (49.2%) as the most needed competitiveness improving services for their business. While the surveyed MSEs that acquired any of these services did not have any problem with paying for these services, the survey also revealed that there were a very small number of public or private suppliers of these services in the region.

BDS is one of the areas in which development partners have been most active in their support of developing and transition economies. This trend has to continue due to the important contributions BDS makes to building up human capital in SMEs and to facilitating sound business decisions and good business pactices.

[29] Swisscontact (2003).

Box 11. Business Development Services (BDS) providers and facilitators

Demand-driven

- Customer has to pay, at least partially, for BDS, so that demand could be objectively verified,
- Public institutions that provide BDS should take in private sector members to their executive boards or set up private sector based advisory bodies, etc.

Differentiated and customized BDS, using tools such as

- Sub-sector approaches,
- Professional market research findings on the amount and nature of demand.
- Value/supply chain methodologies,
- Cluster and network development,

Delivered in a business-like manner

- BDS providers, even if they are in the public sector should be managed according to business principles and not administered,
- Private service design and delivery is preferred, but public sector subsidies may be used to facilitate new product development and raising awareness for BDS.

Sustainable

- Institutional and operational sustainability linked with good management practices in service organization,
- Financial sustainability linked with demand for services, commitment of central, local governments to SME/private sector development, development partner priorities.

Source: Conclusions from the Cambodia Workshop: "Trade Capacity Building and Private Sector Development in Asia", Regional Workshop, 2-3 December 2003, Phnom Penh, Cambodia.

Development of human and natural resources

Empirical studies show that human capital is a significant determinant of growth[30]. While a large proportion of BDS involves short-term professional (for entrepreneurs and professional staff of SMEs) and vocational (for the workforce) training, it cannot substitute for deficiencies in the education and training system of an economy. The ability of SME to adjust to the competitive pressures that come with trade liberalization and globalization will very much depend on the level of skills that are available within transition and developing economies.

Transition and developing countries, particularly the least developing countries are investing significantly in their education (mainly basic) and training systems within the scope PRS. At the same time, the linkages between education and training strategies and SME/enterprise development strategies are

[30] Based on a new database, Bassanini and Scarpetta (2001) provide empirical support for the growth-enhancing role of human capital in OECD countries. Accordingly, one additional year of schooling would, on average, lead to about 6 per cent higher GDP in the long run. In Greece, Ireland, Italy and Spain, the improvement in human capital has accounted for over half a percentage point higher growth in the 1990s compared with the 1980s. These results contrast with earlier studies where an insignificant effect of education on growth was found.

still weak, resulting in weak market signals for policymakers and administrators. Although entrepreneurs may not be citing quality of education and training as a major obstacle to their business in large surveys (see Table 2), this may perhaps be due more to survey designs. A primary reason for such weak linkages has been the low level of prestige SME development has enjoyed in national development frameworks, including the PRS. A first step should be the mainstreaming of SME development into national development frameworks. A second reason may be traced back to the absence of effective public-private dialogue mechanisms in developing economies. Examples of consultations with the SME/private sector regarding needs while developing education and training strategies and curricula development are few. This is especially pronounced in the technical and vocational training systems in least developed countries, where some vocational programs are developed with great effort over some time, but cease to exist rapidly due to low level of demand from students, who are apparently more attuned to skills demand in the economy than the decision makers.

Although BDS cannot replace basic education, long-term technical and vocational training or university training, there may be benefits in linking education and training institutions as BDS providers to SMEs. A case in point is the experience of the Ho Chi Minh City University of Technology: the University was assisted to build up capacity as a short-term training and consultancy provider for SMEs in Ho Chi Minh City by a UNIDO project. The managers of the BDS programs reported that as a BDS provider for SMEs, they were able to bring hands-on experience into their curricula[31].

The education and training systems have the opportunity to influence the level of entrepreneurial activity in transition and developing economies, where new and innovative enterprise creation is a priority. A recent study conducted in 14 OECD countries indicate that 19% of entrepreneurs interviewed associated the level of entrepreneurial activity in their country with lack of financing, 17% with the lack of education and training for entrepreneurship, 16% with negative cultural and social attitudes, and 15% with burdensome regulations[32]. Developing an appreciation of enterprise in the wider society is a long-term undertaking and it can best be achieved through the education and training system. While this is so, there are very few, if any, attempts for incorporating entrepreneurship training in school curricula. For instance, vocational and technical schools produce a graduate with vocational and technical skills that would enable him/her to take either one of two career paths: as an employee in a business or as an entrepreneur. In a significant number of transition and developing countries, no provisions are made to enable these graduates to learn the basic entrepreneurship skills while at school. Entrepreneurship skills training seem to be available mostly as BDS for adults. A primary reason for this is the lack of appropriate linkages between SME policies and those of the education and training sector.

Incorporation of entrepreneurship training into secondary school curricula may also address skills deficiencies women have, as they launch themselves into business. A major shortcoming of women entrepreneurs is cited as lack of entrepreneurship skills in a large number of studies.

In some developing and transition countries, especially in Sub Saharan Africa, the health of the SME workforce and the level of entrepreneurial activity in economies are under the threat of diseases such as HIV/AIDs, malaria and tuberculosis. SME competitiveness is hampered, for instance, by increased costs due to increasing health related absenteeism, reluctance of business-owners in providing on-the-job training to their employees, lower level of skills in products of the education and the training system due to loss of teachers and so on. SME development strategies need to mainstream awareness raising regarding these health issues and include health into the public-private dialogue agenda for additional measures.

31 Tas and van Oyen (2000), p. 22.

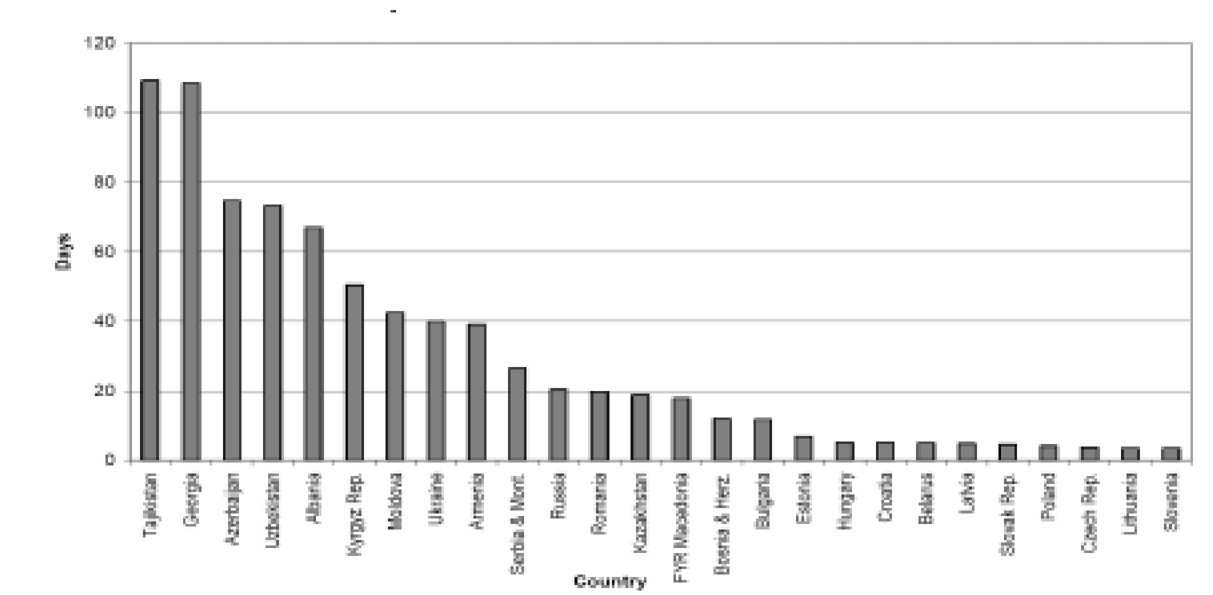
32 OECD (2001), p. 75.

While human resource development issues are fundamental to improving SME competitiveness, an SME development strategy should also address issues such as sustainable use of natural resources. Agriculture and agro-processing, including use of forest and marine resources and tourism figure predominantly among the industries where developing countries have comparative advantages. SME development strategies, while emphasizing environmental sustainability in a general sense, may also prioritize the promotion of good housekeeping practices in small businesses resulting in improved productivity without the need for major investments and utilization of cleaner production techniques to cut down production costs, thereby contributing to improved competitiveness.

Supporting Infrastructure

Infrastructure investments, such as those in transport, telecommunications, energy, water and sanitation, can enhance SME/private sector activity and ability to access local, regional and global markets. Furthermore, quality of available infrastructure has a significant influence on SME competitiveness (*e.g.* costs associated with inefficient infrastructure) as shown for a selected number of transition economies in Figure 5.

Figure 5. Total number of working days lost due to failures in provision of infrastructure services



Note:

1) Total number of working days lost due to failures in provision of infrastructure services is calculated for each country as an unweighted average of firm-level sums of days lost due to power outages or surges from the public grid, insufficient water supply and unavailable mainline telephone service.

Source: Fries, Lysenko and Polanec (2003), p. 21.

It is important that infrastructure services reach all segments of society – such as the poorest areas and rural areas – in order to enable SMEs of different sizes and from all areas to participate in economic activity. A case in point is an IFC-backed project that has installed and operated a nationwide cellular network in Bangladesh and extended its services to rural women entrepreneurs, who were enabled to purchase airtime at wholesale prices and retailed it at the village level. The Grameen Bank provided micro-credit for the cellular handsets. A pilot program showed that women were netting an average of $2 a day or $700 a year from the village phone operations – about twice the country's annual per capita income[33].

Infrastructure affects all size of business: power cuts, roads swept away by floods, absence of port and railway facilities affect SMEs as well as large scale businesses. However, incomplete or under-maintained infrastructure particularly affect the livelihoods of the rural poor in developing and transition countries, since large proportions of rural poor are involved in agriculture, agro-processing, including fisheries, for instance, and low quality infrastructure prevents the commercialization of production based on rural resources. Additionally, poor infrastructure results in low levels of entrepreneurial activity in rural areas, and large scale rural to urban migration, thereby putting pressure on urban infrastructure, employment in urban areas and so on. Starting around 1970s industrial estates for SMEs have been employed as an instrument for development of depressed regions in a large number of developing countries, Box 12.

Box 12. The Development of Korea's Cholla Region

For nearly three decades, Korea's economic miracle did not include the southern region of Cholla. Through the 1960s, as the country's economy expanded at a rate of nearly 10 percent a year, regional income disparities grew between Cholla and the two most industrialized regions, Seoul and Kyungsang. In the 1970s, despite government policies aimed at spreading population and jobs to less developed areas, industries seldom relocated to South Cholla, the country's poorest region.

Between 1975 and 1984, the World Bank approved three projects to help the government develop Cholla and reduce inter-regional inequalities. The projects were very complex, together covering seven cities and five islands in two provinces, South Cholla and North Cholla, with a total of 22 components. These included industrial, housing, and tourism estates (including national parks); city markets; bridges connecting islands to the mainland; fisheries; and urban services such as water supply, sanitation, and roads.

They had two major direct impacts: they triggered industrialization in the region and created the opportunity for local officials to learn and manage the development process, initially with help from central government agencies and later by themselves, with strong private sector participation.

Industrialization: A solid industrial base has been established. With the first industrial estate project, local and provincial governments successfully attracted some large "anchor" firms to the new industrial estates. Small- and medium-sized firms soon followed, investing in new plants and equipment. Subcontracting firms quickly cropped up. Demand for space grew so quickly that even before the first Bank-assisted industrial estate was fully occupied in 1984, it became clear that an expansion would be needed.

Industrial infrastructure has expanded to more than five times the project's original investment in the industrial estate of Kwangju. The study team found that the supply of electricity was better in the project area than outside. Firms also reported that utilities and other infrastructure services had improved for them inside the project's industrial estate. In interviews with the study team, private industrialists always stressed the Bank's catalytic role in initiating the development process in the region and the way that the projects brought together the public and private sectors.

Institutional learning: One of the most significant, yet unexpected, impacts of the program was the extensive and rapid learning achieved by local authorities, who had to operate project facilities and expand them urgently to meet additional demand. The projects offered both national and local government officials the first opportunity of its kind to learn project preparation and implementation for development of the region. They also gave local officials their first chance to work with central government officials as a team.

Source: Precis No. 145, Operations Evaluation Department, World Bank, April 1997, www.worldbank.org/oed

A number of developing countries, *e.g.* India, Korea, and Turkey, have been among the champions of industrial estate development for SMEs throughout the last few decades. Geographical agglomeration, although by itself not sufficient, can potentially help firms, especially smaller ones, overcome constraints associated with size, promote technological development and productivity enhancement, and enhance their ability to compete in local and global markets (*see Chapter 4 for more on*

33 World Bank (2002), p. 3.

cluster development as a strategy for export development and technology upgrading for SMEs). Among the OECD countries, Italy is well-known for breeding SME competitiveness among its geographically agglomerated SMEs, especially in Northeast and Central Italy.

Evidence shows that infrastructure investment in developing countries does not suffice and that poor maintenance is results in decaying of investments prior to achieving full benefits from them. Local SME involvement in the development (*e.g.* community based power generation through private SMEs in remote areas in a number of less developed economies) and maintenance of infrastructure projects has proved very successful in terms of sustainability. However, investment (both foreign and domestic) in infrastructure has fallen considerably, but realization of the negative consequences of this trend is causing the pendulum to swing back again. The time is therefore very opportune to examine the issues surrounding pro-SME (and pro-poor) infrastructure provision.

Building up Trade and Investment Capacity of SMEs

As we have tried to illustrate to this point, framework conditions for building up SME competitiveness include an SME enabling legal, regulatory and administrative environment, SME access to finance, a supportive SME institutional support structure, availability of appropriate skills and supporting infrastructure, mainstreamed into the national development framework. In this Chapter, the focus will be on a particular group of SMEs that are exporting or have export potential and those that are able to insert themselves into the supply chains of FDI enterprises.

***Supporting SME export development*[34]**

Globalization has created new opportunities for SMEs. Progressive globalization over the last two decades or so has created a new international environment for SME exports from developing countries. The process of world economic integration has involved a broadening and deepening of inter-relationships between international trade and foreign investment flows. Several influences – falling trade barriers, increasing technological progress, migration of technical and professional manpower and highly mobile multinational corporations (MNCs) seeking out new investments – have combined to drive globalization. The end result has been the creation of an international marketplace for goods and services that seems indifferent to national borders and state regulation.

But globalization also brings new challenges. The new international environment provides new opportunities for SME exports from developing countries. It has the potential to offer SMEs in developing countries with access to a global pool of new technologies, skills, capital, markets and hence faster export growth and profits than ever before. At the same time, however, globalization brings about a multiple array of trade challenges and a sudden increase in competition from imports and the entry of new foreign investors for SMEs in domestic markets. SMEs in developing countries have to adjust to the competitive strategies of MNCs in different countries, to public and privately set standards (*e.g.* sanitary and phytosanitary), to changes in international tastes, prices and competitive conditions.

The Doha Ministerial Declaration acknowledged these new difficulties. At the Doha Ministerial meeting in November 2001, WTO Ministers acknowledged the difficulties the new economic global context created for developing country governments and enterprises and committed to provide enhanced

[34] Based on Wignaraja (2003), Smallbone (2003) and OECD (2004): Summary Proceedings of the Regional Workshop on Trade Capacity Building and Private Sector Development in Asia. Two sub-sectors, agribusiness and garments, will figure more prominently in the discussions in this Chapter, as these sub-sectors earn a significant proportion of the export revenues in developing countries and are mostly populated by SMEs.

market access, balanced rules and well-targeted, sustainably financed technical assistance and capacity building programmes, to enable developing countries to secure a share in the growth of world trade commensurate with their economic development needs.

At the macroeconomic level, sound government policies and the ability to stabilize a competitive real exchange rate is the cornerstone of promoting exports. A competitive real exchange rate provides an incentive for exports. Moreover, an outward oriented, market-friendly trade regime, which emphasizes the dismantling of import controls and tariffs (permitting access to inputs at world prices), and streamlined bureaucratic procedures, *i.e.* export and import procedures, modern customs administration and efficient value added tax administration will facilitate exports, including from SMEs.

Wignaraja (2003)[35] suggests that globalization opens up new opportunities for export expansion and growth to about 5-10% of SMEs in developing economies. These dynamic SMEs have designed well-adapted marketing strategies and invested in their manufacturing capabilities to bring them up to world standards of price, quality and delivery (hence complying with new technical, environmental and labor standards in export markets). Some have even formed networks or industrial clusters with other SMEs or MNCs to stimulate the emergence of production networks among firms and increase value addition. Such SMEs have expanded their existing domestic market shares, broken into new export markets and continuously upgraded their products and processes. Experience of exporting SMEs from developing countries illustrates the fact that they have pro-actively upgraded themselves, Box 13.

Firm-level strategies are fundamental to development of exports by an SME. However, accomplishment of a pro-active upgrading menu, such as the one shown in Box 13, among others, requires easy and cost-effective access to information on consumer demand and new technologies, training and advisory services to upgrade management practices, a skilled pool of labor in the country to select from, testing, quality assurance and certification institutions, and most importantly access to finance to upgrade technologies.

To illustrate a few of the challenges; developing countries, especially the less developed are yet to reap the full benefits of spread of ICT. For exporting SMEs, which are financially better off, it is not so much a matter of the availability of ICT in the country, but more of reliability and cost of ICT services – a matter that hampers access to information.

35 Wignaraja's estimates are based on a 1997 OECD study of 18 OECD and 8 East Asian economies.

Box 13. Pro-active firm-level strategies

Business strategy

- Know what your consumers want and what your market is
- Be adaptable; think of new products
- Cooperate with other firms
- Pro-actively upgrade

Pro-active upgrading means

- Systematically acquiring production and product design capability
- Improving metrology (measurement), standards, quality and productivity
- Recruiting qualified staff and training
- Forging sub-contracting links with other firms
- Making use of technology institutions and other business services
- Actively seeking foreign buyers and marketing agents

Source: Wignaraja (2003) and others.

Technical assistance in the areas of quality management, productivity improvement and metrology is needed to help SMEs comply with the product standards and regulations applied in export markets. While the advance of trade liberalization brings down tariffs and quantitative restrictions, new barriers to trade, such as the technical barriers to trade, TBT, and sanitary and phytosanitary standards, SPS[36], require disproportionate efforts from developing countries and are perceived to be unequally and sometimes unfairly applied by developed countries. Indeed, for instance, market access of developing-country agribusiness products (an earner of significant export earnings) is increasingly hampered by TBT (*e.g.* regulations, product standards, testing and certification procedures) and SPS (*e.g.* food safety and animal and plant health standards).

In developing countries, particularly the less developed ones, technical advisory and consultancy services are scarce due to low levels of investment in developing engineering skills. Although management consultancies are emerging, the affordability of such services, especially for potential exporters are quite questionable. Services for ISO9000/ISO14000 certification are mainly provided by foreign invested consultancies and highly priced. Testing laboratories are mostly confined to the national standards organizations, which usually do not provide advisory services that are needed to deepen the understanding of product and process standards by SMEs that may have export potential. Private testing facilities are virtually non-existent or available only as in-house operations in large-scale firms and are not open to public use/SMEs. Sectoral business membership organizations are newly emerging and lack own finances to invest in technology upgrading services for SMEs.

Appropriate measures to maintain and to further improve the competitiveness of exporting SMEs and to draw additional SMEs into exporting might include grants for SMEs to obtain ISO9000/14000

---

36 Many poor countries confront a multitude of challenges in dealing with TBT and SPS requirements: they are unable to keep up with the "scientific" basis upon which these standards originate, they are unable to invest in the physical infrastructure to meet quality control, assurance and certification requirements, they are unable to invest in organizational, institutional and human resource development requirements in time with the changes, and at times, they are unable to counteract new TBT and SPS measures with equal force, due to the unbalanced power relationships between respective countries, even when they may have evidence that TBT and SPS are used as protectionist instruments. This issue requires joint action from developing countries in order to develop capacities to improve compliance with TBT and SPS.

certification, setting up accreditation facilities, establishing productivity and design centers to upgrade SME design to international standards; and assisting SME membership organizations, especially those at the sectoral level, to launch common technical facilities and centers for SMEs.

Access to SME trade finance at competitive interest rates can be strengthened through export credit guarantee schemes for SMEs; and subcontracting and specialist soft loans for SME export activities. Government should encourage state-owned banks (*e.g.* if available, the specialized SME Development Banks), as well as private enterprises (commercial banks, venture capital funds) to provide financial services tailored to SME export-related needs.

The agribusiness sector is important in almost all developing countries, including the more developed ones. The sector is characterized by SMEs that have high backward linkages with the rest of the economy, contribute particularly towards poverty reduction, job creation and improved health and nutrition. Stability of the agribusiness sector also requires diversity of both products and markets and primary attention to sustainability of resources.

The agribusiness/agro-industry sector can provide a domestic basis for scaling up of enterprises to the point where they become capable of export. There are also practical difficulties involved in starting up an agribusiness enterprise targeting an international export market from the beginning. In many cases, the domestic and regional markets tend to provide a stepping stone from which SMEs can learn important lessons concerning product quality, timely deliveries and managing risk involved in international business. Where there is an inadequate domestic market, or the products are only attractive for export, considerable effort needs to be put into strategic positioning and reliable production so as to reduce risk of failure. Such effort is obviously costly and requires capacity building of SMEs and export development institutions, including sectoral membership organizations.

Market access of developing-country agribusiness products is increasingly hampered by TBT and, specifically, by SPS-Sanitary and Phytosanitary Standards[37]. Moreover, the change in these non-tariff barriers can cause considerable fluctuations in returns from investment in agribusiness.

There is an important role industry associations can play in helping firms to deal with challenges such as SPS, developing vertical and horizontal linkages and upgrading along the value chain. Hence, agribusiness associations in specific sub-sectors are of central importance in dealing with export-related concerns of SMEs, which initially justifies both government and development partner support. While individual business interests might prevail over wider industry interests during early stages of the work of membership organizations, the ability to plan strategically and contribute to sector development emerges over time[38]. It is also important to accept at the outset that financial support for associations does not mean that the associations will always agree with the government or the development partner. The case of Vietnam, which has recently emerged as a successful exporter of seafood into OECD markets, is instructive, regarding the potential role of business membership organizations, Box 14.

---

37 Otsuki, Wilson and Sewadeh (2001) quantify the impact of standards on aflatoxins implemented by the EU on food exports from African countries. The authors estimate the impact of changes in differing levels of protection based on the EU standard and those suggested by international standards, for 15 European countries and 9 African countries between 1989-1998. The results suggest that the implementation of the new aflatoxin standard (2 ppb) in the EU will have a significant negative impact on African exports of cereals, dried fruits and nuts to Europe. The EU standard, which would reduce health risk by approximately 1.4 deaths per billion a year, will decrease these African exports by 64 percent or US$ 670 million in contrast to regulation set at an international standard (CODEX guidelines of 9 ppb), p. 18.

38 Dengate (2003).

Box 14. Vietnam Association of Seafood Exporters and Producers (VASEP)

VASEP was established in 1998 and has 176 members. The association represents and protects the rights and interests of the seafood industry of Vietnam.

It provides its members various benefits, including:

- Supply of information regarding export markets and market price (e.g. through weekly and monthly Seafood Trade Newsletters; reports posted on their website, etc.)
- Strategy to deal with non-tariff barriers: VASEP calls for tighter quality control and tracking of suppliers; lobbies government for higher investment in testing facilities; provides information regarding SPS requirements, and represents the industry during disputes.
- Advice for business management
- Participation in international seafood events (*e.g.* trade fairs)

Source: Nguyen (2003); www.vasep.org

Additional advantages that are contributing to Vietnamese seafood exporters' success are the availability of a highly qualified workforce at competitive costs, relatively well-established testing facilities, a closely-knit network of overseas Vietnamese in OECD markets, who act as sources of information on foreign markets and consumers as well as foreign buyers, and the early streamlining of import and export procedures and modernization of customs facilities by the Vietnamese government.

What is critical in agribusiness/agro-industries is that measures must be in place at a very early stage to ensure high standards of traceability and hazard control throughout the entire value chain. As this requirement cannot be added later, a significant proportion of trade-related technical assistance in the agribusiness sector has to be devoted to improving capacities in satisfying TBT and SPS. Sometimes joint ventures with foreign firms and business relationships with buyers – such as supermarkets – can help meet quality and safety standards (*e.g.* Thai firms engaging in joint-ventures with Japanese buyers have increased their ability to meet stringent quality requirements of the Japanese market, yet have also become dependent on their partners for marketing and distribution)[39].

In a significant number of developing economies, the garments sector constitutes the majority of light manufacturing and more than 50% of exports. For instance, taking a closer look at some of the South and South Asia economies reveals that garments account for 50% of exports in Laos, 52% in Sri Lanka, 85% in Cambodia, 75% in Bangladesh and 67% in Pakistan. Similarly, other light manufactures such as footwear and electronic equipment represent an important share of exports in Thailand and Vietnam.

Globalization is progressing rapidly. Unfortunately, governments and firms in developing countries have been slow in responding to upcoming changes such as the phasing out of quotas as per the Agreement on Textiles and Clothing (ATC) on 1 January 2005. The ATC had allowed a 10-year transitional period, for the elimination of quotas that were carried over, when the Multi-fiber Arrangements (MFA) expired in 1994. Developing countries have been scrambling to adjust to an era of more intensive global competition in textiles and clothing trade by seeking duty free access to large OECD markets through bilateral trade agreements. Some have been successful and some are still trying. Diverse interests have prevented the formation of collective approaches within regions. However, at the national level, motivated by a sense of urgency, it is possible to observe high level, joint public-private sector committees (at times headed by Prime Ministers) convening at short and regular intervals to identify solutions to the looming challenge in textiles and garments trade.

[39] Nikomboriak (2003).

The prospects of intensive competition have also given the stakeholders an impetus to assess the weaknesses and strengths of their garment industries. Developing countries having diversified product ranges, including high-end products and markets (*e.g.* branded intimate apparel in Sri Lanka), and countries that have invested in backward linkages (*e.g.* investments in selected inputs in Bangladesh) and started developing forward linkages are in a better position. Strategies that would support diversification, differentiation and specialization within economies, sectors and at the level of firms appear viable and need to be given consideration in designing trade-related technical assistance. A value chain approach to identify bottlenecks and opportunities for designing strategies aimed at strengthening the competitive edge of firms may be appropriate.

Purchasers' codes of conduct and business practices, particularly, in the textile and garment sectors have come to play a greater role in purchase decisions made by OECD-based buyers. Requirements may be limited to worker rights undersigned internationally and environment-friendly process requirements, but they may also include among other things stringent and detailed factory standards regarding the technical specifications for storage and social spaces, and audits to confirm compliance. Adherence to corporate social responsibility standards and codes requested are a double-edged sword. On the one hand, they may burden the firms disproportionately, as each buyer may require different standards; on the other hand, they can lead to improvements in the industries, add to competitiveness and ethical sourcing and buying, and respond to a less price-elastic, niche-type demand.

Developing and transition economy governments do have an option to confront the challenge of improving export competitiveness of their SMEs. This may be achieved by developing a national strategy for export development and promotion, led by the appropriate Ministry, but which involves participation by all key stakeholders, as emphasized in Chapter 3. The overall objective should be to increase the volume and value of exports and the number of exporting companies, including SMEs. The strategy should seek to address the needs of firms at different stages of export market development. It should also seek to integrate export support and promotion into a well developed and effective business support system.

The export-supportive institutional infrastructure already discussed in this Chapter, should be firmly embedded into the SME institutional support structure portrayed in Chapter 3. Furthermore, a single export development and promotion agency, which would pursue the national export development strategy, would be needed. Based on good practice in mature market economies, the establishment of such an agency should separate policy making from policy implementation. The agency should:

- Operate in a commercially oriented manner;
- Be result rather than procedure oriented;
- Be staffed by people with relevant, practical business experience;
- Seek to be customer-oriented;
- Include private sector representation on its Management Board; and
- Be funded commensurate with its objectives.

The export development and promotion agency, which could be combined with an FDI function, should develop an export support "offer", including:

- Provision of information about specific markets and potential customers;

- Help in making contact with potential customers or appropriate public and private intermediaries and business service providers;

- Assistance with market visits.

Cluster development strategies are attracting more interest as local SMEs are linking to global value chains, as a result of targeted initiatives, Box 15.

Box 15. Marketing and Export Consortia in the Bangalore Hand Tools Cluster: UNIDO support

The objective of this specific project intervention was to increase market reach for the smaller firms of the cluster through joint marketing. As a by-product of the process, an enhanced level of mutual understanding was expected to lead to a broader platform for collaboration among these units. This objective was tackled by first spelling out in detail marketing-related problems, followed by the creation of a pilot network whose members had an ideal mix in terms of production leading to trust building among firms (from relatively simple joint marketing ventures to more complex ones). The results thus achieved were then actively disseminated by the cluster development agent (CDA) to replicate the experience throughout the cluster.

The diagnostic study and the ensuing two validation workshops (one with manufacturers and the other with support units) revealed that marketing was the principal area of concern for the cluster firms. Moreover, informal visits and discussions that followed revealed that proactive marketing was perceived as a high cost proposition. In small group meetings, however, some firms agreed that common marketing could be a viable solution for such a problem.

One of these informal groups displayed a rapid change in attitude as a result of the inputs provided by the CDA and established itself as a informal network of 8 firms supplying complementary machine tool products. With active stewardship by the CDA, group members built up trust in each other, eventually accepting to legally register their consortium as the Bangalore Machine Tool Manufacturer's Association. At this stage, firms agreed to hire a common consultancy firm for quality upgrading (ISO-9001). Although this was not an area of immediate concern, firms agreed to experiment joint action on this front as it required little sharing of "critical information" and returns were high and relatively certain. Initially, entrepreneurs would not agree to meet other consortium members within their premises. As inhibitions faded away, however, the entrepreneurs were paying group visits to each other's shop floors.

While work on quality upgrading was under way, the members agreed to produce a common brochure, which would help them identify potential customers in their endeavour of proactive marketing. Thereafter, they participated jointly in fairs. The success derived from these new marketing channels gave them confidence in jointly exploring new export destinations, namely the Chinese and Brazilian markets. At this stage firms started sharing orders with other consortium members.

The message of success soon spread around the cluster and another group of small manufacturers with complementary products settled directly for a common marketing brochure and joint participation at fairs. They rapidly went on to appoint a marketing agent in Bangalore. Confidence gained in the process led the two consortia to invite large firms to visit their factories, so they could evaluate their production capacity. New orders started to be registered through these new channels. Very soon, 6 new networks came into existence and were exploring new marketing channels: a common web site, common dealers and common advertisements.

Initially, the project supported up to 50% of the costs of the initiatives launched by the consortia. Gradually, this was reduced and the groups were covering all expenses related to marketing by themselves.

Presently, 45 cluster firms (nearly one third of the cluster population) are organised in five consortia that had generated additional sales worth little under 1 million USD by the time the project was operationally completed in December 2002 (when business enquires for further 10 million USD had been received by the consortia). Three new Indian markets and two new export destinations were actively explored and generated new orders. Member firms produced eight new common brochures and four joint marketing set-ups, two common marketing offices within India and two common web sites.

Source: UNIDO (2004), p. 20.

The 1995 cluster development policy checklist that Nadvi drafted (Box 16) still seems to hold true. The checklist emphasizes the importance of creating enabling environments at macro, meso and micro levels through sound macroeconomic policy, capacity building of support structures, and business strategies based on differentiation, niche markets to achieve competitiveness based on quality, consumer preferences rather than low costs. In this respect, cluster development strategies serve both improving competitiveness and improving the ability of local SMEs to insert themselves into global supply chains through linkages with FDI and may be a useful tool for an SME export development and promotion agency, with or with a function in promoting linkages with FDI:

Box 16. Eight point programme & policy checklist for supporting SMEs in industrial clusters

1. Identify existing clusters and networks of SMEs, however nascent. Such forms of production organization generate significant economies for small producers, encourage backward and forward linkages and raise prospects for collective action. Attempting to set up clusters and networks by administrative fiat, it should be noted, rarely succeed.

2. Policy must concentrate on groups of producers and not individual small firms. Furthermore, intervention needs to be targeted, sector specific and strategic. Generalist support programmes tend to have limited impact.

3. Focus on demand led product markets and the imperatives that they engender: namely achieving competitiveness on the basis of quality consciousness, fashion sensitivity, reliability, rapid delivery and not price alone.

4. Concentrate on institutions and instruments that facilitate the inter-face between producers and the market, such as trade fairs, export visits and external buyers, for accessing marketing information, product development, fashion trends and for acquiring technical know-how.

5. Support local and sectoral institutions that provide producer services such as technical training, technology support and market information. Use local levels of government for such support intervention and collaborate closely with representative business organizations and local self-help institutions.

6. Use large firms as important agents of change by promoting supplier upgrading programmes, also as part of industrial restructuring strategies of large producers.

7. Work towards a macro-economic framework that provides for a leveled playing field and an incentive structure that allows SMEs to operate on fair terms.

8. Finally, do not smother. Intervention appears to be far more effective in cases where policy agents have acted as facilitators and enablers. This gives scope for private initiatives and entrepreneurial energies to come to the fore and to strengthen the development of clusters and networks.

Source: Nadvi (1995), p. 74.

Strengthening SME-FDI linkages[40]

Trends in FDI in developing and transition economies

The vast majority of FDI originates from the developed world, with 30 host countries making up 95% of the total in 2002 (UNCTAD, 2003). Similarly, developed countries remain to be the main destinations for FDI, accounting for three-quarters of the world's total. However, FDI inflows can represent significant sums for developing countries, several of which record levels of FDI that are large

[40] Based on Smallbone (2003).

when considered in relation to the size of the domestic economy (OECD, 2002a). On the other hand, the distribution of FDI between developing and transition economies is very uneven. For example, recent evidence indicates that FDI to Africa and Latin America represents a smaller proportion of the world's total than it did in the mid-1990s (Morisset, 2000), although the volume has increased.

There are also medium sized firms from mature market economies investing abroad – an FDI by SMEs (*e.g.* Japanese SMEs following Japanese FDI as first tier suppliers to transition and developing economies, or Chinese Taipei SMEs expanding markets to lower labor cost locations), Box 16. Such developments offer both opportunities and threat for local SMEs: opportunities for sub-contracting linkages as second tier suppliers to SME-FDI; threats may be that by bringing their own suppliers, MNCs may be raising entry barriers to local SMEs as suppliers, at least in the short-term.

Box 17. FDI Activity by SMEs in Chinese Taipei

As a small open economy, development in Chinese Taipei depends on international trade. Despite lacking in experience and resources, domestic SMEs are playing a major and increasing role in the economy's outward FDI. Analysis of the motives of SMEs to go abroad emphasized low capital intensity (because of the desire to export more labor intensive processes to cheaper labor locations, e.g. China); the greater involvement of larger firms within the SME size range; higher export ratios; and R&D intensity. The key motivating factors identified in relation to domestic SMEs investing abroad were utilizing local labor; to be close to expanding markets; and following major customers, which may enable firms to reduce operating risks overseas.

Source : Kuo, and Yang, 2001.

FDI-SME linkages and spillover effects

Many studies outline the potential benefits of FDI to host economies. These benefits include sources of external capital, technology and knowledge transfer, employment generation, skills enhancement and human capital development, and enterprise development through linkages and spillover effects. They also include increasing international trade integration.

The potential benefits of FDI to host economies and local SMEs have been summarized in five main types of linkages and spillover effects:[41]

1. *Backward Linkages with Suppliers:* This refers to the extent to which components; materials, and services are sourced from within the host economy, since this can create new market opportunities for local firms. Such linkages can range from arms length market transactions to deep, long-term inter-firm relationships. The productivity and efficiency of local suppliers can benefit from this type of spillover as a result of direct knowledge transfer, higher quality requirements and increased demand levels. Backward linkages with suppliers have traditionally been seen as the main vehicle to promote technological and other spillovers from MNCs into host economies.
2. *Forward Linkages with Customers:* These can include marketing outlets, which may be outsourced. Examples include petrol stations and restaurant chains; and linkages with industrial buyers, through, for example, value added after-sales services.
3. *Linkages with Competitors:* Foreign investors may set new standards, which local firms may seek to compete with. Although MNCs may hold a strong market position in relation to local firms, it

[41] Dunning (1992).

should be noted that linkages with competitors may refer to second and third tier suppliers to leading inward investors, and not just first tier suppliers to the MNCs themselves.

4. *Linkages with Technology Partners:* Some MNCs may initiate common projects with indigenous SME partners, including joint ventures, licensing agreements and strategic alliances, which are an important potential source of technology and know-how for firms in the host economy. Whilst such co-operation may be a more common feature of more mature market economies, the number of inter-firm technology agreements involving partners from developing countries rose in the 1990s compared with the 1980s.[42]

5. *Other Spillover Effects:* These include demonstration effects, as inward investors demonstrate new and better ways of doing things to local firms, representing a source of, and stimulus to, innovation. They also include human capital spillovers, when, for example, trained personnel leave the inward investor to work for a local enterprise and/or set up their own business.

Enhancing FDI-SME linkages in developing and transition economies

Understanding the rationale for clients (MNCs) outsourcing products and services to suppliers (SMEs with capability to meet stringent quality, cost and delivery standards of MNCs) would clarify implications for SMEs and their development for enhanced FDI linkages. Studies indicate four main rationales for outsourcing:

- *Productivity gains:* Where suppliers are able to produce specialized inputs, the SME partner has a certain bargaining power. Such linkages are based on mutual specialization, typically going beyond arms-length transactions. They may involve a long-term commitment on the part of the customer, with considerable transfer of technology and knowledge. At the same time, it has been suggested that for FDI to have a positive impact, the 'technology gap' between domestic and FDI enterprises must be relatively limited[43].
- *Factor cost advantages: e.g.* lower wage costs. In such situations, the supplier is potentially much more vulnerable than where productivity gains is the main rationale, because price competition is typically fierce, with continued downward pressure on prices and costs.
- *Numerical flexibility:* this involves occasional or overflow subcontracting, in response to demand peaks. In such circumstances, suppliers have to accept short-term contracts and face little security or stability.
- *Functional flexibility:* This also involves responding to fluctuations in demand, but in this case through active, functional flexibility, based on a multi-skilled workforce and flexible equipment. Such circumstances are more favorable for the supplier than the case of numerical flexibility, although the supply base required is less commonly found in a developing/transition context.

Assuming that sound macroeconomic policies and political stability characterize the business environment (since these framework conditions are the lowest minimum that will attract FDI), enhancing FDI-SME linkages is a matter of implementing support measures to improve the competitiveness of local SMEs. As discussed in Chapter 3 and for SME export development, SMEs would have to be immersed in an institutional environment that would encourage learning and innovations and trigger investments by SME to upgrade. Building the capacity of local SMEs will require facilitation by intermediaries.

---

42 UNCTAD, (1998).

43 OECD, (2002a).

Programs to establish and strengthen linkages between MNCs and SMEs would involve launching of technology and quality upgrading programs. In both cases, SMEs would have to be targeted on a "fit-to-supply" principle, as upgrading programs are costly, both for the "supporter" and the SME. A viable group to target may be SMEs that are already supplying large-scale enterprises within the country and those undertaking government contracts, since the clients usually implement more stringent conditions than the average client groups.

A program of FDI-SME linkage support would need to consist of two distinct components: a) a host of linkage promotion services, and b) technical and management upgrading services, including training and consultancies to internalize the requirements of the MNC, complemented by access to finance to integrate any new technologies into the existing production process.

The linkage promotion program may involve all or some of the following elements:

- Improving the flow of information about potential local suppliers to potential MNC purchasers and about supply opportunities to potential suppliers through the development of a national Website and/or business directories,
- Organization of "meet-the-buyer" events, including visits to MNC production sites, seminars where the MNC clarifies its procurement processes, quality requirements, etc.

UNIDO's sub-contracting and partnership exchanges (SPX) in transition and developing countries is an example of a linkage promotion service (Box 17). Basically, an SPX compiles detailed technical information from SMEs: types of machinery and equipment, their make, model, power, capacity, state of maintenance, etc. which is then coded and loaded into a database. Data collection has to be done using a complicated form, in the premises of the SMEs by a highly qualified engineer or engineers of different backgrounds, as required. On the supplier's side, detailed technical specifications of work orders/tenders need to be compiled, coded and loaded into to a database. Then, the database is used to inform clients and suppliers of matching needs and requirements. The databases have to be kept up to date, for the system to function efficiently. Information collection is complemented by seminars and meet-the-buyer events.

Box 18. UNIDO Industrial Subcontracting and Supply Chain Management Program

UNIDO provides technical assistance to developing countries for establishing "Sub-contracting and Partnership Exchanges (SPX), acting as a broker; setting up a list of subcontractors for large firms, as well as a roster of suppliers and main-contractors. The UNIDO website includes directories of SPX in every participating country (32 developing/transition countries). The principle underlying this programme is potentially transferable into other contexts and sectors.

Source: UNIDO SPX Programme information: http://www.unido.org/doc/4547

The capacity building program for technical and management upgrading would be quite costly and need long-term commitment from the SME, the MNC as well as the program sponsor. If the MNC has brought is first tier suppliers with it (as this is usually the case), then the first tier suppliers would have be target as partners in the first stage. Some of the elements in this part of the program may include the following:

- Working closely with MNCs/or its supplier by inviting them to help potential SME suppliers to (a) understand their supply requirements (b) identify areas in which they have good opportunities to supply and (c) draw attention to weaknesses they must overcome in order to succeed. Such an intermediary role helps to build mutual understanding and trust between MNC and potential supplier. However, MNCs and/or their suppliers would not get involved in this type of a program, unless there are some incentives: these may be contributing to the salary costs of engineers and managers in MNCs who devoted time to supplier upgrading (Singapore), cash grants to promising suppliers to help with initial investment costs (Ireland) and subsidized training and consultancy necessary for enhancing supplier capability (Chinese Taipei) – a notable issue is that most of these expenses would have to be publicly funded, either by the government or a development partner.

- Helping SMEs/suppliers identify needs[44] and then to access the public and private support services they need. Again, medium to long-term training and consulting expenses would need to be funded, as the SME would most likely be unable to cover such expenses over the long period of time needed to build capacity. Furthermore, access to investment finance (medium to long term) would be necessary to carry on with upgrading of technologies.
- Developing capacity building programmes that include supply chain and cluster initiatives, which recognize the potential for developing tiers of suppliers to maximize trickle down effects, including to micro enterprises as lower tier suppliers.

The Enterprise Center in Baku (Box 18) is a good example of an MNC initiated linkage program. The oil and gas industry have long term (40 year) agreements with the Government of Azerbaijan and due to the nature of the industry, significant cost advantages accrue to the oil consortium through local linkages. Azerbaijan has a comparative advantage in oil and gas related manufacturing industries, with a large number of technical institutes and universities specializing in industry related fields. Skills levels are high; salary levels are relatively low. As the case of the Enterprise Center illustrates a well-thought out promotion program, with relatively low levels of capacity building needs (not in technical fields, but mainly in management) has started yielding good results. A primary cause is the high existing level of human and physical infrastructure available.

[44] Needs assessments would also require use of capable external consultants and usually cover assessment of the production process, maintenance systems, engineering and labor skills available. Then, these deficiencies would need to be addressed through training and investment in upgrading equipment, at least partially. Additionally, installation of quality assurance and new management systems and practices such as cost accounting, staff incentives would be required.

Box 19. Enterprise Center-Baku

The Enterprise Center, Baku is an example of an MNE-initiated business development and linkage center for same-sector local suppliers. With its foreign partners, BP opened it in 2002; with the aim of helping local companies develop business in support of oil and gas developments in Azerbaijan. BP's primary stated business objective is to increase local content of its projects, which could result in considerable cost savings, as well as increasing local supplier capacity.

The Center is headed by a highly qualified Azeri business executive, compiles a database of "fit-to-supply" Azeri firms, and disseminates information on the Health and Safety Standards BP and the oil consortium uses. Additionally, the Center regularly runs executive level training courses for Azeri company managers: ISO9000/quality assurance systems awareness raising, social corporate responsibility, negotiation skills, etc. EC News is a daily, internet based newsletter, which announces procurement requests, information of Azeri businesses receiving quality certification, opening of new testing facilities in Baku, etc. The Center also provides consultancy on the requirements of the oil industry.

An example of an FDI-SME linkage arising from this project is between McDermott Caspian Contractors Inc. (an international manufacturing company for oil supplies), and local Azerbaijani suppliers and contractors. These local firms made up nearly 70% of all purchases MCCI undertook in connection with its own contract with BP between June 2002 and May 2003.

Source: (Enterprise Center News, (www.ecbaku.com/news)

Improving Aid Effectiveness

Obviously, policy coherence and a joined-up government on the transition and developing country side are essential for managing aid effectively. In fact, one of the objectives of implementing an SME development strategy and embedding it into national frameworks is to achieve policy coherence and joined-up government. Therefore, transition and developing countries need capacity building assistance at an early stage in the preparation of SME development strategies.

SME development has a long history of evolution in almost all donor countries, and different donors working different countries. There are also fundamental differences in donor approaches to SME development, including among the approaches of senior international experts fielded by donors during capacity building. The SME field is wide, and experiences are many. These considerations have the potential to introduce confusion on the part of the partners, with different donors giving non-complementary, at times, conflicting advice, also resulting in disconnected interventions. Donor coordination is crucial to improve efficiency and effectiveness of resources both on partner and donor sides. Such coordination should be based on joint analytical work towards assessing and prioritizing needs.

Implementation of an SME development strategy needs the participation and collaboration of numerous stakeholders. Getting the fundamentals right in the legal, regulatory and administrative frameworks have the greatest impact on SME development in most contexts. However, policy advice at this level should not be limited to drafting of policies, legislation and regulation. Without proper administrative capacities, especially at local levels, where the entrepreneurs have their contact with the improved frameworks, it would be difficult to achieve the intended results. Therefore, more and additional donor resources should be channeled to capacity building for "implementation" at central and local levels.

Functioning public-private dialogue mechanisms contribute a great deal to trust and consensus building among stakeholders, as well as ownership. Although so useful, it is difficult to build such relationships; they take time. Therefore, unrealistically tight schedules are bound to fail and cause discouragement all around. Having both national and international facilitators to backstop these processes, and facilitating study visits abroad to observe both “good” and “not-so-good” practices usually add value to the process.

Improved understanding of donor field staff of SME development issues would improve effectiveness of assistance. This would also enhance coordination among different donors.

Dissemination of best practices, especially from OECD economies, should always be accompanied by historical, contextual information. What has worked in one country, would most likely not work in another country. Recommendations made to domestic stakeholders should always be accompanied with cost information. Particular attention should be paid to establishing new institutional structures, which may not be sustainable due to unavailability of operating costs when donor assistance concludes.

SME development is not an answer to all the challenges, and due to significant amounts of institution/capacity building involved; it is a long term and costly investment. Unless sufficient resources are allowed, expected results will not be achieved. Furthermore, supply side capacity building should go hand in hand with market access. Members of the DAC should bring SME dimensions fully into the work of its Network on Poverty Reduction (POVNET) on how to promote the contribution of private sector development to pro-poor growth.

Conclusions

SME development cuts across sectors, involves multiple stakeholders and necessitates concerted actions by the public and private sectors. Therefore, SME development should be mainstreamed into the national development framework. Building up market institutions should be accompanied by capacity building of appropriate institutional structures.

Although competitiveness is a firm level phenomenon, macroeconomic and microeconomic environments influence market signals. To enhance SME competitiveness, therefore, requires the creation of enabling legal, regulatory and administrative environments, access to finance and capable institutional structures, and most importantly human capital and a sustainable environment.

Removing supply-side constraint to trade and investment, require firms to build up their competitive advantages. However, competitive advantage is measured in relation to rivals in the markets firms compete in. Integration into regional and global trade and investment networks will require much effort, although it is not an impossible proposition. Public and private sectors in transition and developing countries must work together to improve the functioning of markets at home, while intensifying efforts to integrate into the world economy.

Donors (OECD and others) have much to contribute to this process. They can help to expedite the learning processes involved by sharing good practices, they can technically and financially assist transition and developing countries in overcoming barriers, most importantly, they can ensure that improved market access complements improved competitiveness of SMEs.

Improving the investment climate for SMEs, and strengthening their capacities to respond to trade and investment opportunities, does strengthen the economic performance of SMEs and this in turn has a positive impact on growth and poverty reduction. A DFID commissioned study[45] covering Central Europe and Africa showed that countries that adopted enabling environment reforms also witnessed greater per capita GDP growth.

45 Bannock, Gamser, Juhlin and McCann. (2002).

There is, of course, no single way to support and strengthen SME competitiveness in a globalized world. Each country has to find its own way to strengthen the legal, policy and institutional frameworks in which SMEs operate and which set the quality of the enabling environment. A number of messages can be drawn from case studies[46]:

- Investment climate reforms need to take account of the national/local context and should be implemented in consultation with the private sector and with all levels of government;
- Prioritization and sequencing of investment climate reforms is important especially given the severe capacity constraints of most developing countries governments;
- Reforms and policies should be directed at generally helping the private sector to help itself (by removing obstacles) rather than providing direct financial or business support;
- More attention should be given to improving the enabling environment for indigenous private sector (in particular micro-business and SMEs) and this will also help attract foreign investment;
- What is good for the private sector in general is not necessarily equally good for small firms as the latter face proportionally more costs and biases than larger firms.
- The six main obstacles to investment and business activity to domestic and foreign firms of all size are: corruption; lack of infrastructure; policy inconsistency and instability; regulatory complexity and unpredictability; inadequate legal frameworks (including uncertain property rights) and labor problems.
- Over-regulation (in areas such as business registration/licensing; ownership forms; labor and taxation) increases regulatory costs which bear most heavily on small firms;
- Foreign investors would generally rather see a good overall business environment than elaborate incentives; and
- Different countries coordinating their FDI policies at a regional level can bring benefits.

On the basis of the findings and analysis of this report, key components of an SME strategy include:

- **Embed national private sector/SME development strategies in the broader national development and/or poverty reduction and growth strategy through institutionalized, participatory processes**, as SME development entails improving: 1) the ability of governments to implement sound macroeconomic policies; 2) the capability of stakeholders to develop conducive microeconomic business environments; and 3) the ability of SMEs to implement competitive operating practices and business strategies. Enhanced public-private dialogue and partnerships with stakeholders (public, private, civil society and academia) are essential for identifying obstacles, effective tailoring and prioritization of support measures, and making effective investments in necessary infrastructure and institutions. Furthermore, institutionalized public-private dialogue and partnerships enhance ease of implementation, political credibility and sustainability of SME development strategies. Donors and multilateral organizations (OECD and others) can play an important role in facilitating such dialogue and partnership.

- **Increase efforts to develop and strengthen enabling legal, regulatory and administrative environments at local, regional and national levels,** where property rights are clearly recognized, contracts are easily enforced, transaction costs in setting up and doing business are

---

46 See, for example, DFID contributions to the World Bank 2005 World Development Report.

minimized through fair, simple and less costly taxation, customs, licensing, registration, financial, judicial, and other governance systems and procedures. Consistency in implementing the rule of law for all, at all levels, determination in fighting corruption and lowering costs of setting up and doing business would also help entrepreneurs to “move away” from the informal sector.

- **Facilitate availability of and access to loan and equity finance, particularly medium to long-term opportunities to improve trade and investment capacity of SMEs.** While maintaining sound government finances will help availability of finance for development purposes, access to finance may be enhanced by ensuring that: 1) contracts are easily enforceable (*i.e.* through functioning secured transactions and bankruptcy regulations and institutions); 2) issues of collateral and security are managed competitively (*e.g.* availability of loan guarantees for SMEs, computerized registration systems for pledges, mortgages, leases and where types of assets that may be used as collateral are expanded *e.g.* to future acquired property); 3) financial institutions are managed prudently and are trusted by depositors; 4) legal frameworks enable a sufficient number and type of financial instruments to be used (*e.g.* transfer of negotiable instruments and commercial paper such as checks, bills of exchange, promissory notes); 5) financial institutions other than banks are functioning (*e.g.* insurance companies, venture funds); 6) SMEs are encouraged to keep good accounting records. Without access to medium and long-term finance within the economy, SMEs would not be able to make the necessary investments in innovations and technologies to improve their trade capacity and act as partners to foreign direct investors (FDI).

- **Strengthen infrastructure services delivery to facilitate market access and reduce the cost of doing business.** More investment is needed in key areas such as energy, transportation and communications. Attention should specially be given to sustainably managed infrastructure, lowering of energy, transport (road, air and seaport) and communication (including international telephone and Internet usage) charges, while improving the reliability of these services. Facilitating public-private partnerships and attracting FDI into basic infrastructure as well as for establishment of industrial parks and (if viable, incubators) for SMEs are options that should be considered.

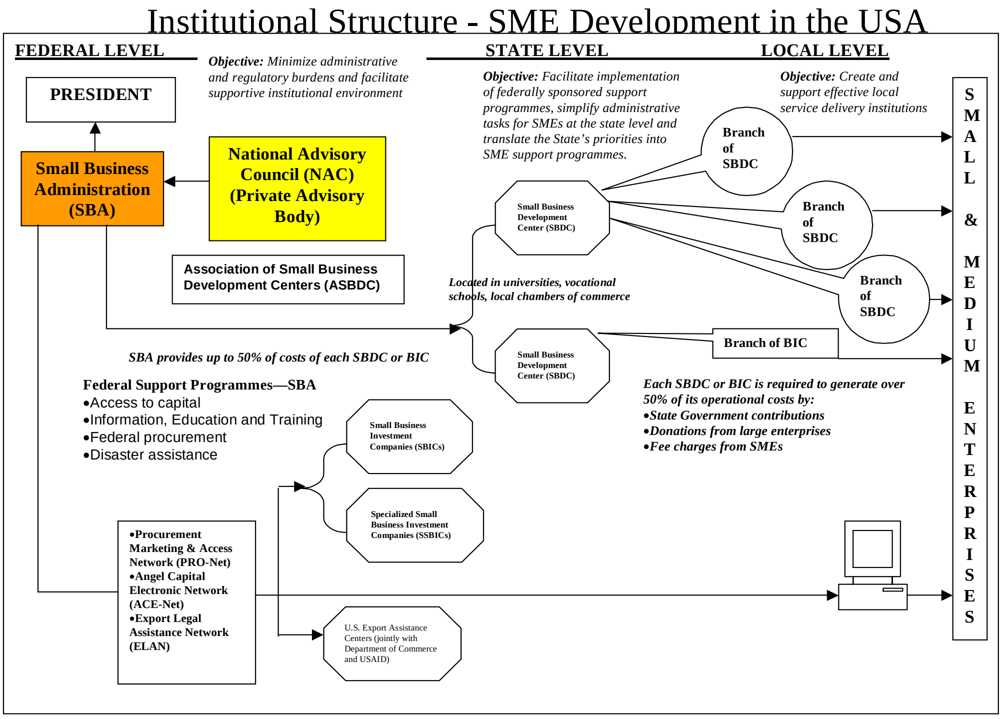
- **Reinforce support structures for private sector/SME development, particularly institutional support**. SME development strategy should be coordinated and monitored at the central level through a lean, but high level institution and progress should be reviewed jointly by public and private sector (via the public-private dialogue mechanism). SMEs need business services to improve their competitiveness (*i.e.* information, consulting, training, accounting, legal, advertising, marketing, courier services, technical and technology services, including testing for standards and certification requirements abroad, product upgrading, etc.). Support structures that provide these services can be public or private, but over time the trend should be towards greater private provision (with subsidies, as necessary), so that rapidly changing needs of SMEs could be met. Linkage programs between SMEs and FDI (*e.g.* for facilitation of subcontracting arrangements) should be based on the principle of ‘fit-to-supply’ and assisted by development partners. Sectoral and general business associations should be strengthened to improve their market access services (*e.g.* business-matching, trade fair participation). Cluster development initiatives can support both SME export development and SME-FDI linkages.

- **Strengthen the gender, environment and health (*e.g.* HIV/AIDS, malaria) dimensions of SME development.** Gender, environment, and, as required, health issues (*e.g.* HIV/AIDS) should be mainstreamed into private sector/SME strategies. Critical issues such as women’s access to collateral and property rights, education and training may need to be targeted with specific initiatives. Sustainable management of resources and the environment (*e.g.* in sectors such as agriculture, fisheries, tourism), and accelerating loss of economically active labor force due to prevalence of HIV/AIDS and other diseases such as malaria should also be included in SME strategies, as appropriate.

- **Enhance policy coherence at regional, national and international level and actively manage aid effectiveness** by: 1) joined-up government nationally; 2) country-based and international donor coordination and pooling of technical and financial resources at appropriate levels; and by 3) complementing official development assistance (ODA) made available to transition and developing countries for capacity building in trade and investment with appropriate market access.

ANNEX I. INSTITUTIONAL SUPPORT STRUCTURES FOR SMES

Figure 6. SME Institutional Support Structures (USA and the Philippines)



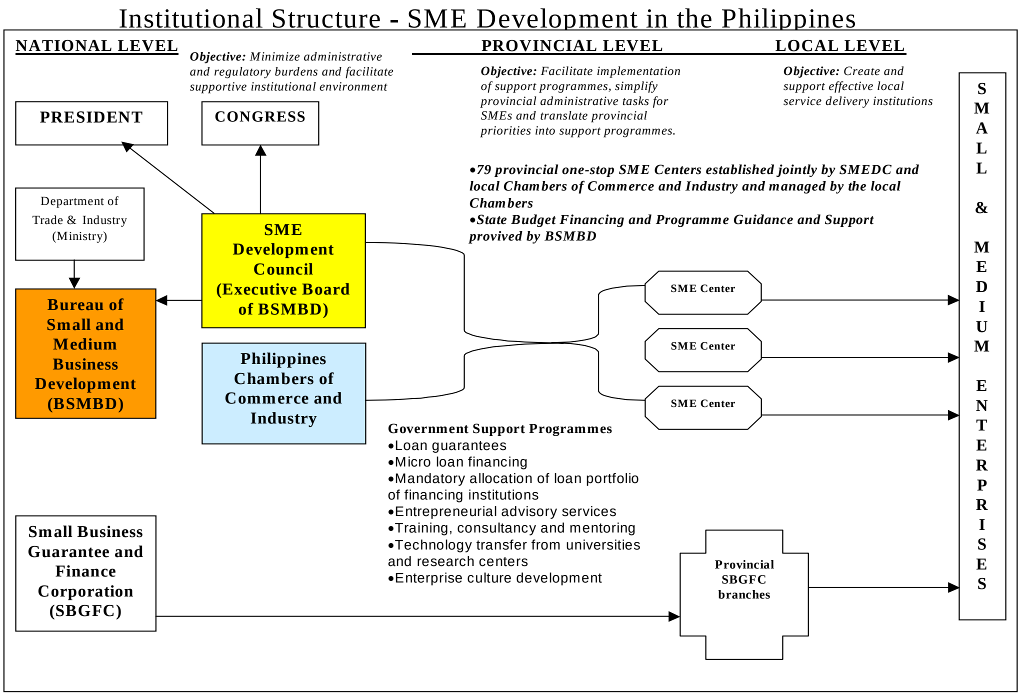
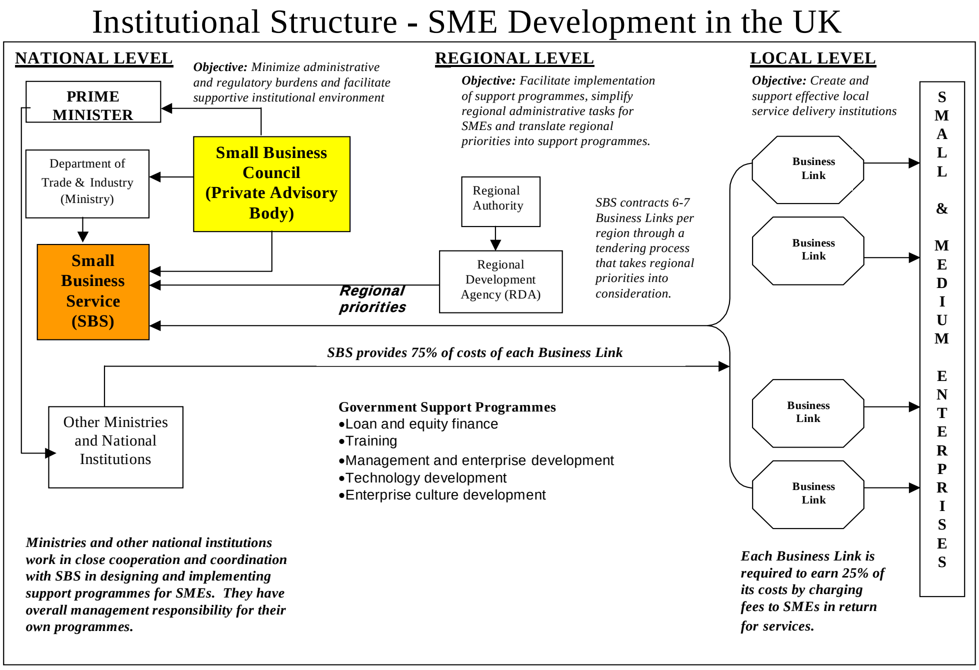
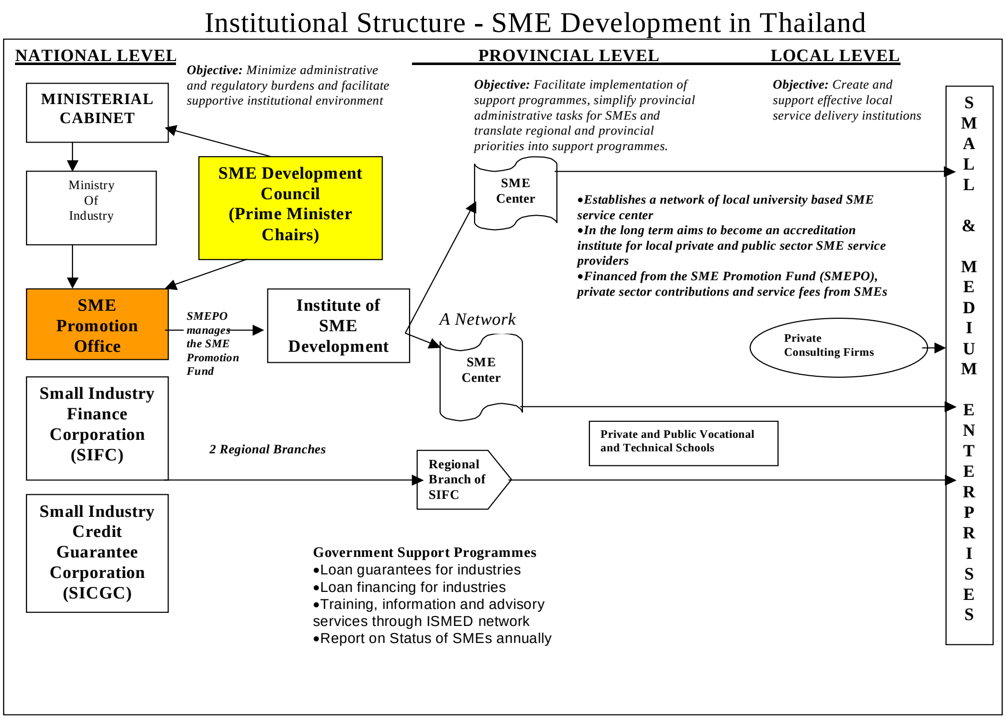


Figure 7. SME Institutional Support Structures (UK and Thailand)





Source: Tas, Nilgün (2002): Institutional structures reflect situation as of 2000-2001.

BIBLIOGRAPHY

Acemoglu, Daron (2003), "Root Causes: A historical approach to the role of institutions in economic development", *Finance and Development*, June, p. 27-30.

APEC (2000), "SME Guide", Second Edition, www.apecsec.org.sg.

Ayyagari, Meghana., Thorsten Beck, Asli Demirgüc-Kunt (2003), "Small and Medium Enterprises Across the Globe", World Bank Policy Research Working Paper 3127, August, Washington D.C.

Badrinath and Others (1997), "The SME and the Global Market Place: An Analysis of Competitiveness Constraints", UNCTAD/ WTO International Trade Center, Geneva.

Bannock, Graham, Matthew Gamser, Mariell Juhlin and Andrew McCann (2002), "Indigenous Private Sector Development and Regulation in Africa and Central Europe: A 10 Country Study", Bannock Consultants, London, August.

Bassanini, A and S. Scarpetta (2001), "Does human capital matter for growth in OECD countries? Evidence from pooled mean group estimates", *OECD Economics Department Working Paper No. 289*, Paris.

Chang, Ha-Joon (2001), "Institutional Development in Developing Countries in a Historical Perspective-Lessons from Developed Countries in Earlier Times", paper presented at the European Association of Evolutionary Political Economy, www.grc-exchange.org , Siena, 8-11 November.

CIDA (2003) "Expanding Opportunities through Private Sector Development", July.

Dengate, Howard (2003), "Experience with Agribusiness SME Export Development in Australia's Northern Territory", paper presented at the *Regional Workshop on Trade Capacity Building and Private Sector Development in Asia*, OECD and Government of Cambodia, Phnom Penh, 2-3 December.

DFID (2001), "Trade Matters: Eliminating World Poverty", London.

Djankov, Simeon, Ira Lieberman, Joyita Mukherjee and Tatiana Nenova (2003), "Going Informal: Benefits and Costs" in Boyan Belev, editor, *The Informal Economy in the EU Access Countries: Size, Scope, Trends and Challenges to the Process of EU Enlargement*, Center for Study of Democracy, p. 63-79, Sofia.

Dossani, Rafiq and Martin F. Kennedy (2002), "Providing Financing for Technology-based SMEs", background paper presented at UNCTAD Expert Meeting on *Improving Competitiveness of SMEs through Enhancing Productive Capacity: Financing Technology*, UNCTAD/ITE/TEB/Misc.8, Geneva, 28-30 October.

Dunning (1992), "Multinational Enterprise and the Global Economy", Washington D.C.

Fries, Steven, Tatiana Lysenko and Saso Polanec (2003), "The 2002 Business Environment and Enterprise Performance Survey: Results from a survey of 6 100 firms", *EBRD Working Paper* No. 84, November.

FUNDES (2002), "Small and Medium-sized Enterprises in the Fundes Region" (Argentina, Bolivia, Chile, Colombia, Costa Rica, El Salvador, Guatemala, Mexico, Panama and Venezuela), www.fundes.org.

Government of the Socialist Republic of Vietnam (2002), "The Comprehensive Poverty Reduction and Growth Strategy", Document No. 2685/VPCP-QHQT, 21 May, Hanoi.

Jain, Pankaj (2003), "Strengthening Support Structures-The Indian Experience" paper presented at the Regional Workshop on Trade Capacity Building and Private Sector Development in Asia, OECD and Government of Cambodia, Phnom Penh, 2-3 December.

Johnson, Simon, Daniel Kaufmann and Pablo Zoido-Lobatón (1998a), "Regulatory Discretion and the Unofficial Economy", *The American Economic Review*, 88/2, p. 387-392.

Johnson, Simon, Daniel Kaufmann and Pablo Zoido-Lobatón (1998b), "Corruption, Public Finances and the Unofficial Economy", World Bank Discussion Paper Washington, D.C.

Johnson, Simon, Daniel Kaufmann, and Andrei Shleifer (1997), "The Unofficial Economy in Transition", *Brookings Papers on Economic Activity*, 27/2, p. 159-221.

Kim, L. and J.B. Nugent (1999), "Korean SMEs and Their Support Mechanisms" in Levy B., Berry, A. and Nugent, J. B. (1999), *Fulfilling the Export Potential of Small and Medium Firms*, Kluwer Academic Publishers, Boston, MA,

Lall, S., (2001), "Competitiveness Indices and Developing Countries: An Evaluation of the Global Competitiveness Report", *World Development*, Vol. 29, No. 9, p. 1501-1525.

Metcalfe, J. S., R. Ramlogan and E. Uyarra (2003), "Economic Development and the Competitive Process", paper delivered at CONFERÊNCIA INTERNACIONAL SOBRE SISTEMAS DE INOVAÇÃO E ESTRATÉGIAS DE DESENVOLVIMENTO PARA O TERCEIRO MILÊNIO, November, p. 1-31.

Meyer-Stamer, J., (1995), 'Micro-Level Innovations and Competitiveness', *World Development*, Vol. 23, p. 143-148.

Meyer-Stamer, Jörg and Frank Waltring (2000), "Behind the Myth of the Mittelstand Economy: The Institutional Environment Supporting SMEs in Germany", Institute for Development and Peace at the Gerhard-Mercator-University Duisburg, Report No. 46/2000, Duisburg.

Morriset, J. (2000), "Foreign Direct Investment in Africa: Policies Also Matter", *Policy Research Working Paper No. 2481*, World Bank, Washington D.C.

Nadvi, Khalid (1995), "Industrial Clusters and Networks: Case Studies of SME Growth and Innovation", *UNIDO*, Vienna, October.

Nikomborirak, Deunden (2003), "The Agro-Industry: Case of Thailand", paper presented at the *Regional Workshop on Trade Capacity Building and Private Sector Development in Asia*, OECD and Government of Cambodia, Phnom Penh, 2-3 December.

Nguyen Huu Dzung (2003), "Vietnam Association of Seafood Exporters and Producers: A Case Study" paper presented at the *Regional Workshop on Trade Capacity Building and Private Sector Development in Asia*, OECD and Government of Cambodia, Phnom Penh, 2-3 December.

OECD (1997), Globalization and Small and Medium Enterprises, V. 1: Synthesis Report, Paris

OECD (2000), "Small and Medium-sized Enterprises: Local Strength, Global Reach", *Policy Brief*, Paris, June.

OECD (2001), "The New Economy Beyond the Hype", *the OECD Growth Project*, Paris.

OECD (2002) Small and Medium Enterprise Outlook, Paris.

OECD (2002a), "FDI for Development: Maximizing Benefits, Minimizing Costs", Paris.

OECD (2003), "Summary Proceedings", *Regional Workshop on Trade Capacity Building and Private Sector Development in Asia*, OECD and Government of Cambodia, Phnom Penh, 2-3 December, www.oecd.org/dev/cambodia.

Otsuki, Tsunehiro, John S. Wilson and Mirvat Sewadeh (2001), "A Race to the Top? A Case Study of Food Safety Standards and African Exports", *Development Research Group,* World Bank, February, Washington D.C.

Rodrik, Dani (2003), "Growth Strategies", this version was working draft for eventual publication in Handbook of Economic Growth, John F. Kennedy School of Government, Harvard University, September.

Rodrik, Dani, Arvind Subramanian, Francesco Trebbi (2002), "Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development", Working Paper, www.grc-exchange.org, October.

Schneider, Friedrich (2003), "The Size and Development of the Shadow Economies and Shadow Economy Labor Force of 22 Transition and 21 OECD Countries: What Do We Really Know?" in Boyan Belev, editor, The Informal Economy in the EU Access Countries: Size, Scope, Trends and Challenges to the Process of EU Enlargement, Center for Study of Democracy, p. 23-61, Sofia.

Schneider, Friedrich and Dominik Enste (2000), "Shadow Economies: Size, Causes, and Consequences", *The Journal of Economic Literature*, 38/1, p. 77-114.

Sida (2003a), "Policy Guidelines for Sida's Support to Private Sector Development", October.

Sida (2003b), "Making Markets Work for the Poor", October.

Summers, Lawrence H. (2003), “Godkin Lectures,” John F. Kennedy School of Government, Harvard University, 7 April.

Swisscontact (2003), “Baseline Survey of MSEs and MSFs in the Uhuru Corridor, Tanzania”, Final Report, *Swisscontact Tanzania*, Dar es Salaam, May.

Tas, Nilgün (2002), “International Experience in SME Promotion”, paper presented at the *Public-Private Consultation Workshop on SME Development*, UNIDO-Center for Industrial Research and Development, Vientiane, 25 April.

Tas, Nilgün and Leny van Oyen (2000), “Assistance to Industrial SMEs in Vietnam: Moving towards a conducive policy framework and improved business development services”, *UNIDO PSD Technical Working Paper No. 5,* March.

Ulusay de Groot, Tezer (2000), “Improving Women Entrepreneurs’ Access to International Markets: Networking and Enhanced Competitiveness through Technology”, presented at the 2nd OECD Conference on *Women Entrepreneurs in SMEs: Realizing the Benefits of Globalization and the Knowledge-based Economy*, Paris, 29-30 November.

Ulusay de Groot, Tezer (2001), “Women Entrepreneurship Development in Selected African Countries”, *UNIDO PSD Technical Working Paper No. 8*, February.

UNCTAD (1998), “Handbook on Foreign Direct Investment by Small and Medium-sized Enterprises: Lessons from Asia”, New York and Geneva.

UNCTAD (2001), “Best Practices in Financial Innovations for SMEs”, background paper presented at the Intergovernmental Expert Meeting on *Improving the Competitiveness of SMEs in Developing Countries: the Role of Finance to Enhance Enterprise Development*, UNCTAD/ITE/TEB/Misc.3, Geneva, 22-24 October.

UNCTAD (2003), “World Investment Report 2003, FDI Policies for Development: National and International Perspectives”, New York and Geneva.

UNDP (2002) Vietnam Development Report, Hanoi.

UNDP (2003) Human Development Report, New York.

UNIDO (2004), “Supporting Underperforming SME Clusters in Developing Countries: Lessons and Policy Recommendations from the UNIDO Cluster Programme in India”, paper prepared for the *Second OECD Ministerial Conference on Small and Medium Enterprises,* March, Vienna.

USAID (2003), “Building Trade Capacity in the Developing World”, *USAID Strategy No. PD-ABX-241*, March, Washington D.C.

White, Simon and Juan Chacaltana (2002), “Enabling Small Enterprise through a Better Business Environment: Donor Experiences in Supporting Reforms in the Business Environment”, *Committee of Donor Agencies for Small Enterprise Development, Working Group on Enabling Environment*, version 2, November, Washington D.C.

Wignaraja, G. and S. O'Neil (1999), "SME Exports and Public Policies in Mauritius", *Commonwealth Trade and Enterprise Paper* No. 1, London.

Wignaraja, Ganeshan (2003), "Promoting SME Exports from Developing Countries" paper presented at the *Regional Workshop on Trade Capacity Building and Private Sector Development in Asia*, OECD and Government of Cambodia, Phnom Penh, 2-3 December.

World Bank (1996), "KUPEDES: Indonesia's Model Small Credit Program", *Précis No. 104*, World Bank, January.

World Bank (1997), "The Development of Korea's Cholla Region", *Précis No. 145*, World Bank, April.

World Bank (2000) "The Quality of Growth", Washington D. C.

World Bank (2001), "Business Development Services for Small Enterprises: Guiding Principles for Donor Intervention", *Committee of Donor Agencies for Small Enterprise Development*, 2001 Edition, February, Washington D.C.

World Bank (2002), "Connecting with the Information Revolution", *Précis No. 210*, World Bank, Winter, p. 3.

World Bank (2004), *Doing Business Database*, http://rru.worldbank.org/doingbusiness March.