



Ministry of
Development, Industry
and Foreign Trade



**OECD GLOBAL CONFERENCE ON
BETTER FINANCING FOR ENTREPRENEURSHIP**

AND SME GROWTH

Brasília - DF, Brazil

27-30 March 2006

**The OECD Brasília Action Statement
for
SME & Entrepreneurship Financing**

THE OECD BRASILIA ACTION STATEMENT

FOR SME AND ENTREPRENEURSHIP FINANCING

1. On the invitation of the Brazilian Government, the OECD Global Conference on *Better Financing for Entrepreneurship and SME Growth*, took place in **BRASILIA** on 27-30 March 2006. Convened in the framework of the OECD Bologna Process on SME & Entrepreneurship Policies¹, the meeting brought together the key stakeholders – *Small and medium-sized enterprises (SMEs), the financial community, and government participants at senior levels* – from OECD member countries, as well as from non-member economies.

2. Taking into account the perspectives of SMEs, the financial community and governments, the Conference assessed to what extent the potential contribution of SMEs is held back by various constraints. Access to financing represents an important issue for SMEs. Financing gaps may arise due to agency problems², asymmetric information and other market and policy imperfections that can give rise to incomplete financial markets and constrain SMEs access to financing. Analysis reveals not one, but several kinds of financing gaps. Many OECD countries have partial gaps, which tend to be severe especially in the early-stage firms. However, financial gaps are more pervasive in emerging, transition and developing economies. The Conference particularly examined issues related to two types of SME financing: *Debt and Credit* and *Risk Capital*. Taking stock of current facts, practices and issues, the Conference proposed ways forward to improve statistical data, and to identify and diffuse innovative and appropriate solutions for SME financing, spanning the role of markets, governments and international organisations while recognising the need to develop further work.

3. Access to appropriate types of financing structures and facilities are especially required to allow SMEs and entrepreneurs to take advantage of the opportunities provided by innovation, notably through the diffusion of information and communications technology (ICT). They are also needed for SMEs with new business models and high growth prospects, as they make a very important contribution to economic growth accompanied by job creation and social cohesion.

4. Building on the outcome of the first OECD Conference for Ministers responsible for SMEs on "*Enhancing the Competitiveness of SMEs in the Global Economy: Strategies and Policies*", held in **BOLOGNA** on 13-15 June 2000, and the second on "*Promoting Entrepreneurship and Innovative SMEs in a Global Economy*" in **ISTANBUL** on 3-5 June 2004, which provided major opportunities to advance the global policy dialogue on enhancing *entrepreneurship and SME innovation*, **Participants recommended this Action Statement.**

¹ The *OECD Bologna Process on SME and Entrepreneurship Policies* is a dynamic political mechanism that:

- Fosters the entrepreneurial and SME agenda at the global level through extended analytical work;
- Promotes high-level dialogue on SME and Entrepreneurship policies worldwide; and
- Encourages co-operation between OECD countries and non-member economies, other international organisations/ institutions, and non-governmental organisations in the field of SMEs and entrepreneurship.

² There is no precise generally accepted definition of a financing gap, but the term implies that a sizable share of economically significant SMEs are unable to obtain adequate financing. Agency problems arise because it is impossible to write complete contracts and the interests of the contracting parties may not coincide. See further OECD (2006), *Keynote Paper "The SME Financing Gap: Theory & Evidence"*, OECD, Paris.

Main findings and actions required:

5. The financing gaps are not insurmountable and can be mitigated by a series of actions. Participants considered a number of issues that can create problems, some of which are discussed below. Examples of initiatives that respond to these programmes are also provided for consideration in the context of the proposed actions.

Put in place the appropriate broader framework	The overall economic, legal, institutional and regulatory framework is a critical determinant of SME financing. A predictable and stable macroeconomic policy environment is fundamentally important, along with reliable governance, tax, regulatory and legal frameworks that provide a level playing field for all economic entities irrespective of size. For law enforcement to be efficient, national and regional administration - including tax authorities - must possess the appropriate competencies to address SME-issues, and adopt rationalised and trustworthy practices. Of key importance is an environment that supports entrepreneurship, protects intellectual capital, and fosters science/industry linkages that promote high-tech commercialisation.
Strong focus on early stages while maintaining flexibility	SMEs in mature stage have often been able to access finance through a broad range of financial instruments, including asset-based SME-lending, leasing, non-financial sector loans, securitization and trade credit. In early stages, however, access to finance is often lacking, suggesting a need for public policy to focus on firms in formative stages. Appropriate and timely financing can nonetheless be an issue at all stages of SME-development, which calls for some degree of flexibility.
Bolster early stage finance to innovative SMEs (ISMEs)	A lack of appropriate financing notably represents a hindrance to the creation and expansion of innovative SMEs (ISMEs), putting a drag on job creation and hurting economy-wide competitiveness. Comprehensive efforts are needed to bolster the early stages (i.e. pre-seed, seed and start-up) of ISMEs, which are marked by negative cash flows and untried business models. This can be done by entrepreneurs themselves leveraging the capital lying dormant in their personal assets, or by “business angel networks” or venture capital markets. Efforts to integrate mutually supportive activities include for instance the New Zealand Venture Investment Fund which assists growth in early stages, while also managing a Seed Co-Investment Fund designed to stimulate investment by business angels. Successful approaches to developing early stage venture capital markets include both tax-based programs and programs that use government’s ability to leverage private risk capital.
Encourage SMEs to join the formal sector	Whereas informal sources of funding are greatly important, especially in transition and developing economies, incentives are needed to induce SMEs to move into the formal sector. One approach, applied by Brazil in its SIMPLES program, is to simplify procedures and facilitate tax compliance for micro and small businesses. Another is to induce closer collaboration between MFIs (micro-credit schemes and micro-finance institutions) and banks, which can serve both to enhance the financial sustainability of the former, and to provide a basis for transferring clients to banks as their financing needs increase.

Reduce barriers to cross-border funding	Financial markets are becoming increasingly global but remaining regulatory and institutional compartmentalisation continues to hamper financial cross-border collaboration, the internationalisation of SMEs and associated resource and knowledge flows. This has a special impact on SMEs from emerging, transition and developing countries, which have difficulty in accessing foreign financing. In these countries, SMEs receive a small share of overall domestic credits, with the majority dependent on informal channels operated outside the formal financial system. New instruments and mechanisms are needed for handling risk associated with the cross-border funding of SMEs.
Use principle of risk-sharing and apply assessments to guide public programmes	Public policies aimed at promoting SMEs should be focused, aimed at making markets work efficiently and at providing incentives for the private sector to assume an active role in SME finance. The principles of risk sharing should guide public programmes, with official contributions encouraging partnership with entrepreneurs, banks, businesses, and universities. Assessments and evaluations should be applied rigorously to phase out ineffective public policy, and where market activities are maturing and prepared to take over.
Inform SMEs of financing options through targeted programmes	Informing SMEs of the range of financing options available, e.g., public guarantee programmes, business angels, and bank loans will ensure greater take-up of schemes. Awareness- and competence-building should spur qualified demand for financing among SMEs. Special targeting and adaptation of communication is needed to bridge between regional, sectoral, ethnical and cultural divisions, or special features of entrepreneurs (gender, age, educational profile, etc.).
Measure and value intellectual assets more effectively	Methods of measuring and disclosing intellectual capital should be developed, diffused and linked to the upgrading of financial services especially for ISMEs. These methods need to be developed in ways that can enable their widespread application. Intellectual assets, if better measured and valued, can be used as collateral, thus underpinning the development of financial services that are more effective in supporting ISMEs. Innovative approaches, such as enabling knowledge economy societies which examine ways to evaluate and develop comparable reporting of intangibles, could make a valuable contribution.
Better leverage social capital	Trust, tacit knowledge, and reputation matter in the development of entrepreneurship. Better leveraging of social capital, e.g. embedded in local networks of entrepreneurs, can help strengthen SMEs' access to finance. Approaches such as those developed by the CONFIDI consortia in Italy could be further applied.
Foster local development financing tools	Business incubators, clusters of innovative SMEs, science and technology parks, and development agencies play an important role in facilitating appropriate access to financing for SMEs at local and regional level. Cities and regions can underpin and strengthen this function through partnerships with private financial institutions and universities. Appropriate financial incentives can correct market failures and stimulate equity investment in local enterprises.

Use a pluralism of tools adapted to specific needs	Each stage of firm development requires an appropriate financing tool. Public policy must recognise the need for flexibility, including a plurality of tools in relation to the specific needs of the local and regional context. At the same time, it is important to recognize the role of cooperative credit banks and savings banks in addressing the financial need of handicraft, the self-employed, and micro enterprises. Specialised financial institutions, such as Shorebank in Chicago, are playing a crucial role in urban regeneration programmes creating sustainable communities.
Engage SMEs in policy design	Entrepreneurs and SMEs are agile and flexible but vulnerable to fixed costs such as those caused by heavy administration, excessive bureaucracy, reporting practices, and intermediation rates by banks. Improving access to financing for SMEs requires removing unduly barriers to entrepreneurship and innovation, e.g. by cutting red tape, reducing transaction costs, and improving contractual conditions. Often, entrepreneurs and SMEs are not sufficiently represented in traditional policy-making, nationally and internationally. In order to make reforms less reactive and more appropriate, SMEs should be engaged in the design of relevant policies from the outset, to ensure that their perspectives and needs are well understood and taken into account.
<p>6. Furthermore, Participants concluded that innovative approaches should be adopted to overcome constraints and diffuse viable solutions in SME-financing through debt and credit, and through risk capital. On debt and credit financing, actions include:</p>	
Ensure that banking systems are market based and well functioning	Banking regulatory systems should be reformed based on market-principles, barriers to foreign competition should be dismantled, and other measures introduced as needed to ensure healthy competition in these markets.
Improve SME financial knowledge and management	Expertise and working practices should be advanced at firm level, e.g., to improve knowledge on funding techniques, raise credibility and elevate bargaining strength vis-à-vis banks. Processing of lending to SMEs should be improved within banks while government policies that increase costs to banks should be minimised in order to make small business lending profitable. Creation of private sector credit bureaus could increase collaboration among lending institutions. This would benefit all parties as credit-risk information compiled in the credit bureau would be available to help mitigate problems of fixed costs hindering lending to SMEs, while maintaining an adequate degree of diversity in credit risk measurement methods. There is a rationale for speeding coordinated use of new technologies, including ICT, while countering common problems as regards privacy, authentication and fraud.
Enhance guarantee funds and make better use of related public funds	Guarantee schemes are among the most effective instruments governments can use to ease SMEs' access to credit financing. However, measures have to be taken to promote appropriate risk sharing with private lenders and SMEs themselves. Initiatives which help reduce the risks assumed by guarantee funds may be applied to facilitate the access to a guarantee. As in the case of FOGAPE in Chile, appropriate regulation and supervision can be applied to induce banks to compete in using the guarantees provided by the funds. Another example is the Counter-Guarantee System run by the European Investment Fund (SME Guarantee Facility). The Polish guarantee fund POLFUND, like the Spanish Guarantee System, significantly improved access to guarantees for entrepreneurs after obtaining EIF counter-guarantees in 2005.

Keep fees and guarantee schemes affordable	Fees paid by SMEs for guarantees can usefully be differentiated to balance selectivity and financial sustainability. Fee levels should take into account market imperfections and other considerations that lower affordability for SMEs. The Italian State Fund for guarantees to SMEs has managed to keep default rates and operating costs low by exploiting the risk balancing effect and economies of scale in the scheme.
Expand the scope of micro-credit and micro-finance schemes	Micro-credit and micro-finance institutions (MFIs) fill important gaps, especially in developing countries, based on proximity to local entrepreneurship and the adoption of a flexible formula. An example is Novobanco, active in Africa and Latin America, which provides credit to micro-businesses based on no-fees account with no minimum balance, informal guarantees (house assets and a guarantor), and a continued relationship with loan officers. Agreements between MFIs and private providers of non-financial services should be promoted to ease capacity constraints, whereas regulatory barriers that often prevent MFIs from extending their lending activities to micro-businesses should be dismantled. In emerging and developing economies, ICT can help diffuse the use of MFIs and counter costly fragmentation in rural markets.
7. In most economies, only a very small percentage of SMEs seek risk capital. However, it is a form of financing of particular importance to high-growth ISMEs. In this regard, Participants stressed the need of the following actions in the area of risk capital:	
Promote awareness among SMEs of the value of equity finance	There is a need to promote enhanced awareness, educate and communicate more broadly the value of equity financing, including raising the recognition among entrepreneurs of fair value and transparency in valuing investments.
Facilitate access to institutional capital	The channelling of further funding by institutional investors should be facilitated through flexible regulation consistent with prudent investment management principles
Ensure that the regulatory framework is neutral among different sources of finance	The combined legal, tax and regulatory framework should ensure that risk capital is not discriminated against, including by safeguarding orderly, equitable and transparent exit routes. Taxes should not put SMEs, entrepreneurs or their financial backers at a disadvantage. There should be neutrality between alternative sources of risk capital, such as domestic versus foreign venture capital funds. Maintaining neutrality between debt and equity should also be an aim for tax policies.
Steps should be taken to improve the exit environment	The exit environment in many countries is not favourable to venture capitalists. Liquid stock markets either do not exist or are too fragmented, and listing requirements may be too stringent. Also, local specifics hinder trade sales/mergers and acquisitions, and barriers to these activities should be removed.
Use public schemes to leverage competencies and serve as catalysts for private equity funding	Public programmes can make an important contribution by enhancing SME skills in accessing and using risk capital, as practiced by Vaekstfonden in Denmark. With appropriate incentives for management, public equity funds can operate so as to help catalyse and leverage the provision of private risk capital. Measures strengthening market access for SMEs, for instance along the lines of the US SBA programmes, should be further developed.

Provide additional guidance on the application of fair value guidelines for venture capital investments

While venture capital associations have developed credible fair value guidelines for private equity investments (AFIC/BVCA/EVCA and PEIGG), valuing venture capital remains judgemental and approximative. Further guidance and training on applying such guidelines can increase investors' confidence in the consistency and reliability of valuations of venture capital investments. The valuation of investments in venture capital funds for accounting purposes is one of those areas that should be more clearly examined.

Help venture capitalists and business angels flourish

There is no venture capital without venture capitalists and business angels greatly enhance the effectiveness of informal finance. Representing an evolving entrepreneurial breed, these actors thrive on their ability and courage to assume risk. Obstacles should be identified and eliminated. Effective role models can also be promoted to spur the dynamism of these actors. Ways should be explored to facilitate the establishment of "business angel networks", which may greatly enhance information and capital flows.

Reduce obstacles to cross-border risk capital markets

Efforts should be made to reduce obstacles to the creation of cross-border markets for private equity and venture capital. Cross-border venture capital and private equity funds could be encouraged as a means to strengthen information exchange and enhance the competitiveness of SMEs in global markets.

8. Finally, **Participants called upon the OECD to work further** in developing better data and statistical information as a basis for measures to address the issues of SME financing. Gaps in data and statistical information, and the huge variation between countries, make it difficult to determine to what extent a financing gap hampers SMEs and entrepreneurship in a general sense. A new partnership should be put in place to overcome current obstacles to SME financing. More focus needs to be brought to improving the availability of statistical data, and identifying and diffusing best policy practices in financing of SMEs and entrepreneurship. Building on the valuable work of the *OECD Working Party on SMEs and Entrepreneurship* and the *OECD Committee on Financial Markets*, Participants invited the OECD to further develop the following areas (subject to the availability of resources):

Recommendations for further work by the OECD

In order to improve the availability of **data and statistics**, as well as the **understanding of outstanding issues** in financing of SMEs and entrepreneurship, the OECD should:

- Prepare a handbook of definitions (including what constitutes a “financing gap”), indicators and statistical methodology for gathering data on the supply of financing available to SMEs and the demand for financing by SMEs.
- Encourage use of this handbook to survey SMEs and suppliers of finance on a regular basis to provide policy-makers and market actors with more accurate and detailed information, help them determine if and where a financing gap exists, better understand the functioning of the national, regional and global financial markets as they pertain to SMEs, and to identify deficiencies or impediments in their operations.
- Take the lead in developing better data and statistical information, thereby allowing the establishment of international benchmarks to facilitate comparisons of the relative performance of markets in providing financing to SMEs and entrepreneurs; and, to shed light on outstanding financing gaps and issues.

In order to support **the adoption and diffusion of best policy practice** for financing SMEs and entrepreneurship, the OECD should *inter alia*:

- Analyse and assess current policies relevant for SMEs and entrepreneurship, including the related financial regulatory and policy landscape, and promote the sharing of experience among policymakers on best policy practice (and on policies which have proven less successful) to address funding gaps.
- Explore appropriate mechanisms for the development of stronger public/private partnerships in SME financing and of appropriate instruments for furthering the role of institutional investors.
- Examine the fragmentation of markets resulting from inconsistent tax/regulatory regimes and improve conditions for cross-border capital formation programmes.
- Examine how training, skills transfers, and programmes promoting financial education, better accounting practices and awareness more generally, best underpin the information and competencies within SMEs that are required for effective access to finance. Strong involvement of non-member economies should be sought in this project.
- Examine how to develop further information flows and transparency on SMEs.

In order to build a new partnership to **address the existing obstacles** to SME financing, the OECD should work with non-member economies and the key stakeholders to:

- Establish an *OECD Global Forum for Tripartite Dialogue*, convening Governments, the Financial Community and SMEs in OECD and non-OECD economies, to periodically review progress in strengthening SME and entrepreneurship financing. The work would be jointly conducted by the relevant OECD bodies, i.e. the Working Party on SME and Entrepreneurship and the Committee on Financial Markets, in co-operation with other international organisations/institutions.

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