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2018 OECD Ministerial Conference on SMEs

Key Issues Paper

This document contains the Key Issues Paper for the 2018 Ministerial Conference on SMEs, to take place on 22-23 February 2018 in Mexico City.

This document was discussed by the Working Party on SMEs and Entrepreneurship and the Committee on Industry, Innovation and Entrepreneurship. It will be presented to Ministers at the OECD Ministerial Conference on Strengthening SMEs and Entrepreneurship for Productivity and Inclusive Growth under the responsibility of the Secretary-General.

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ABSTRACT

SMEs are key to strengthening productivity, delivering more inclusive growth and adapting to the major transformations of our time. SMEs that grow have a considerable positive impact on employment creation, innovation, productivity growth and competitiveness. While the population of SMEs is very diverse, innovation and scale-up are at the reach of many SMEs. Digital technologies and global value chains offer new opportunities for SMEs to participate in the global economy, innovate and grow. However, SMEs are lagging behind in the digital transition and are disproportionately affected by market failures, trade barriers, policy inefficiencies and the quality of institutions. A conducive business environment, is essential to incentivise risk-taking and experimentation by entrepreneurs, and foster business growth potential. Access to entrepreneurship competencies, management and workforce skills, technology, innovation, and networks, is also critical to enable SME growth. A cross-cutting approach to SME policy can enhance SME contributions to inclusive growth.

JEL codes: F68, G28, L20, L26, O38, O40
Keywords: SMEs, Entrepreneurship, Productivity, Inclusive Growth, Government Policy and Regulation

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Summary

- Many countries are facing low productivity growth, weak trade and investment, and rising or persistently high inequality. In addition, major trends, including the new industrial revolution, the changing nature of work and demographic changes, call for innovative policy solutions.
- SMEs are key to strengthening productivity, delivering more inclusive growth and adapting to megatrends. SMEs that grow have a considerable positive impact on employment creation, innovation, productivity growth and competitiveness. SMEs can scale up and innovate at different stages of their life cycle. Fostering innovation in established SMEs can enhance aggregate productivity and narrow wage gaps.
- The population of SMEs is very diverse in terms of age, size, business model and the profile and aspirations of entrepreneurs. They vary in their characteristics and performance, including across sectors, regions and countries. These differences have implications for how policies are designed and targeted.
- Digital technologies enable SMEs to improve market intelligence and access distant markets and knowledge networks at relatively low cost, and stronger participation in international activity can boost SME growth. However, SMEs are lagging behind in the digital transition and are disproportionately affected by trade barriers, deficient intellectual property protection, and quality of infrastructure and institutions.
- A conducive business environment, including institutional and regulatory settings, is essential to incentivise risk-taking and experimentation by entrepreneurs, and foster business growth potential. Despite wide-ranging reforms in many countries, the complexity of regulation, high compliance costs and inefficient insolvency regimes remain a major obstacle to entrepreneurial activity.
- Micro firms, young, innovative and high-growth SMEs, and certain categories of entrepreneurs, including women business owners, face persistent challenges in accessing finance in the appropriate forms and volumes. The G20/OECD High Level Principles on SME Financing highlight that broadening the range of financing instruments requires comprehensive approaches to address both demand- and supply-side barriers.
- Access to entrepreneurship competencies, management and workforce skills, technology, innovation, and networks, is also critical to enable SME growth.
- A cross-cutting approach to SME policy can enhance SME contributions to inclusive growth, as can strengthening the monitoring and evaluation of policies.

Questions for discussion

- How can governments enhance SME contributions to productivity and inclusive growth?
- How can policies enable SMEs to contribute to addressing major trends and challenges in the economy and society?
- How can the OECD continue to support governments in designing and implementing effective SME policies?

SMEs are key to strengthening productivity, delivering more inclusive growth and adapting to the major transformations of our time

In many countries, governments are facing the challenges of low productivity growth, weak trade and investment, and rising or persistently high inequality of income, wealth and well-being. These challenges were exacerbated by the 2007-08 global crisis, but they also reflect structural conditions (OECD, 2016a, 2017a).

In addition, governments are seeking innovative solutions to seize opportunities and mitigate risks that emerge from major transformations in economy and society, such as increased globalisation, digitalisation, the new industrial revolution, the changing nature of work, demographic changes, and the circular economy and the transition to a low-carbon economy. These mega-trends have far-reaching consequences for productivity and income distribution, and for the role that policy can play to enhance inclusive growth.

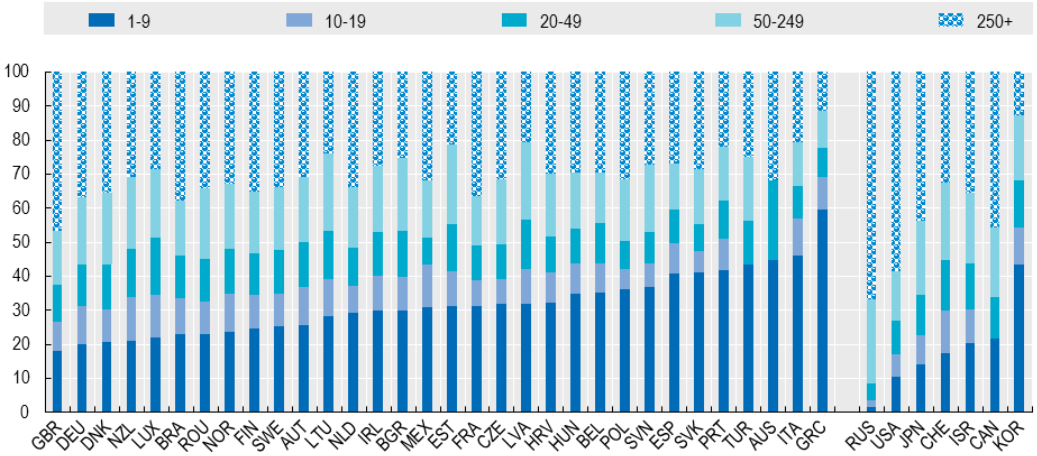
Small and medium-sized firms (SMEs) are central to the collective goal of increasing productive potential, reducing inequality and ensuring that the benefits from increased globalisation and technological progress are shared, as documented in OECD work on the productivity-inclusiveness nexus (OECD, 2016a). Furthermore, SMEs can help countries adapt to other major transformations in the global environment, seizing new opportunities and contributing to mitigate risks.

SMEs are the main source of jobs in the business sector

In the OECD area, SMEs represent almost the totality of the business population, account for 60% of total employment and generate between 50% and 60% of value added, on average (OECD, 2017b). SMEs contribute to more than one third of GDP in emerging and developing economies and account for 34% and 52% of formal employment respectively. In recent decades, employment in SMEs has steadily increased at the global level. Over 2003-16, across 132 countries, the number of total full-time employees in SMEs has nearly doubled, from 79 million to 156 million (ILO, 2017).

Figure 1. SMEs provide the main source of business employment

Percentage of all persons employed, total business economy, 2014 or latest available year



Note: For Canada, Switzerland, Israel, Japan, Korea, the United States and the Russian Federation, data do not include non-employers. Data for Korea and Mexico are based on establishments. Data for the United Kingdom exclude an estimate of 2.6 million small unregistered businesses. For Australia, Canada and Turkey the size class 1-9 refers to 1-19.
Source: OECD (2017b).

Innovation is often driven and diffused by new and established SMEs

Some SMEs are at the productivity frontier and amongst the most innovative firms, jump-starting entire new industries. These firms can exploit technological or commercial opportunities that have been neglected by larger companies and enable the commercialisation of knowledge generated by research organisations (Baumol, 2002; OECD, 2010a). Start-ups are a key source of radical and disruptive innovations, especially in sectors such as software, nanotechnology, biotechnology and clean technologies, including through increased competitive pressure they put on incumbent firms. More broadly, SMEs are often an essential channel for the diffusion and adaptation of innovations to different contexts.

SMEs are central to efforts to ensure growth is more inclusive

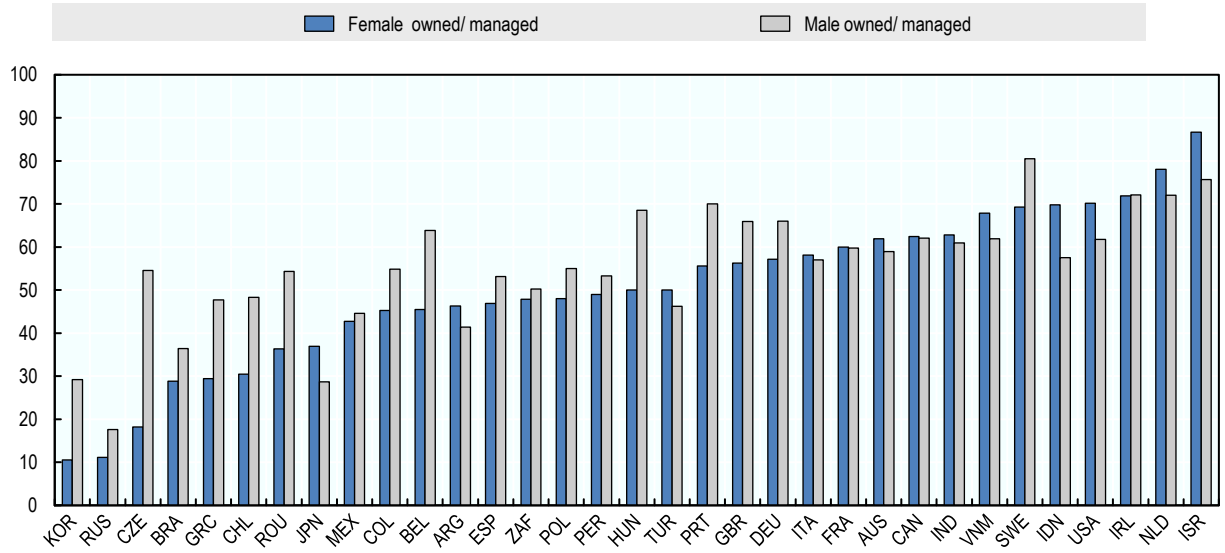
SMEs typically create job opportunities across geographic areas and sectors, employing broad segments of the labour force, including low-skilled workers, and providing opportunities for skills development. As such, SMEs that generate value added and quality jobs represent an important channel for inclusion and poverty reduction, especially but not exclusively in emerging and low-income economies. Small businesses also contribute to inclusion by serving locations, populations and markets that do not have enough scale to attract larger firms.

In addition, entrepreneurial opportunities represent an important vector for economic and social participation and upward mobility, by allowing disadvantaged or marginalised groups, including young people, women, seniors, migrants, ethnic minorities and the disabled, to participate in the economy. OECD work on inclusive entrepreneurship shows that while these social groups are heterogeneous, their members typically face specific barriers to business creation (OECD/EU, 2015). Increasing entrepreneurship among these

groups, as well as improving the quality of their business start-ups, represents an opportunity to increase participation in the labour market and boost productivity. For instance, while most countries in the OECD area show gender gaps in the perception of barriers to setting up a business, recent evidence suggests that, in most countries, despite these gaps, women feel as confident as men about their business and its future once it is up and running (Figure 2).

Figure 2. Once in business, women entrepreneurs feel as confident as men about the future

Positive evaluation of current business status, percentage of survey respondents (average 2016 - 2017)



Source: OECD (2017b), based on the Future of Business Survey, conducted by Facebook in collaboration with the OECD and the World Bank.

SMEs are very heterogeneous in their characteristics and performance

SMEs are a dynamic and evolving population, which is very diverse in terms of age, size, business model, performance, and the profile and aspirations of entrepreneurs. Their composition varies widely across countries and sectors (Figure 3), with implications for their contributions to innovation, productivity, quality job creation and growth. They also have implications for how policies are designed and targeted.

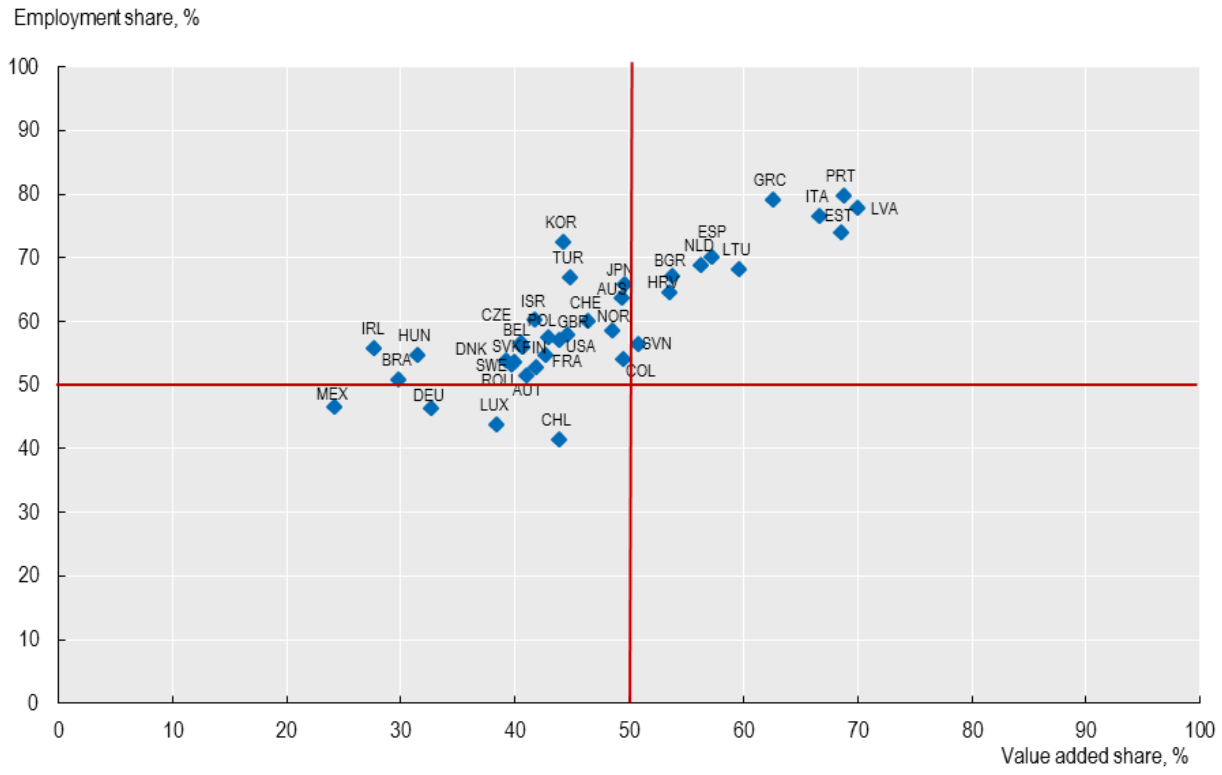
SMEs and young firms that experience rapid growth can have a considerable impact on employment creation and productivity growth, including through innovation, heavy investments in human capital, new demand for advanced products and services, knowledge spill-overs that other enterprises can harness, and impact on local entrepreneurial ecosystems.

Established medium-sized enterprises that innovate and scale up are the driving force behind growth in many OECD economies, often ensuring the coordination, upgrading and participation in supply chains of smaller suppliers (e.g. Coltorti and Venanzi, 2017). There are also many small enterprises in mid or low-tech sectors which are embedded in competitive local production systems, and which generate incremental innovation and contribute to employment, social inclusion and territorial cohesion.

At the same time, many SMEs do not extend their reach beyond small local markets. These firms, which produce limited innovation, and whose owners do not have strong growth aspirations, often remain small throughout their life cycle.

Figure 3. There are large differences in the SME contribution to employment and value added across countries, particularly in manufacturing

Percentage of total employment and total value added in manufacturing, total SME (1-249 employed persons), 2014 or latest available year



Notes: For Australia, SMEs refer to < 200 persons employed; for Japan and Korea, SMEs refer to < 300 persons employed; for Japan, the United States and Switzerland, data do not include non-employers. Data for the United Kingdom exclude an estimate of 2.6 million small unregistered businesses. For Chile, only enterprises with more than 10 employees are covered.
Source: OECD (2017b).

SME productivity performance varies across firms, and the persistent gap with large firms affects growth potential and income distribution

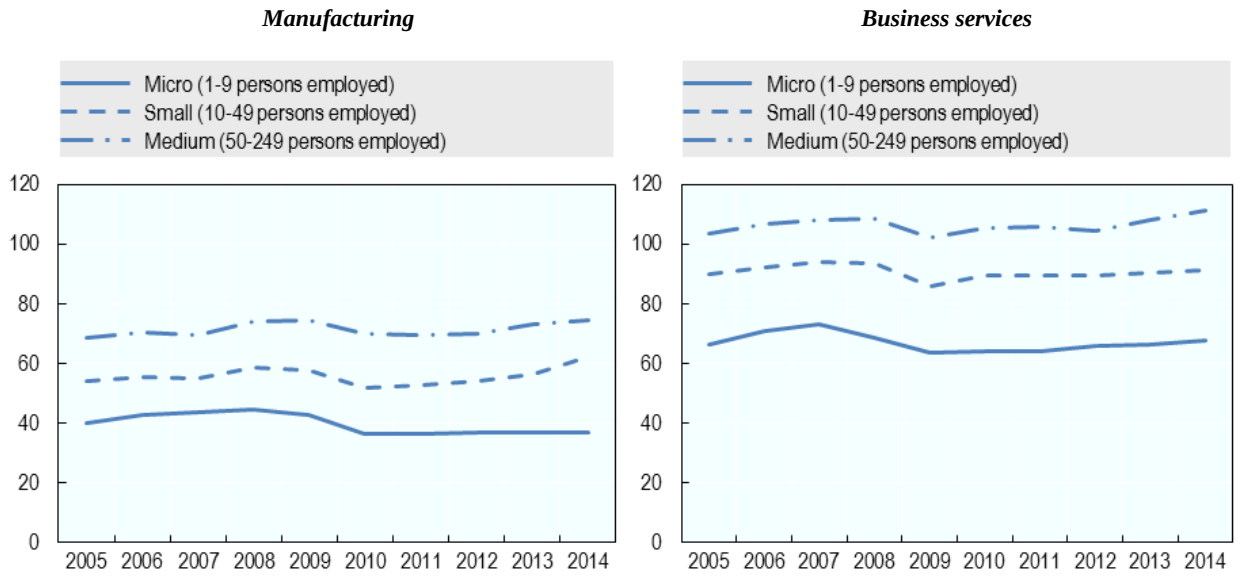
Across countries, there is in general a persistent productivity gap between SMEs and large firms. To the extent that large firms can exploit increasing returns to scale, productivity typically increases with firm size, although some variability across sectors and countries is observed. In particular, in the services sector, medium-sized firms outperform large firms in some countries, exhibiting competitive advantages in niche, high-brand or high intellectual property content activities, as well as the intensive use of affordable ICT (OECD, 2017b).

OECD work on productivity shows that, in some countries, the gap in productivity between SMEs and large firms increased in aftermath of the 2007-08 global crisis. While

for small and medium-sized enterprises there has been a reversal in this trend during the recovery, the larger gap has become persistent for micro-firms, especially in manufacturing, where production tends to be more capital-intensive (Figure 4). This gap is also an important driver of the observed rise in inequality, including wage inequality, in many countries (OECD, 2016b and 2017c).

Figure 4. The productivity gap between large firms and smaller SMEs has widened since the global crisis

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



Note: Data cover Austria, Czech Republic, Estonia, Germany, Hungary, Italy, Latvia, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, and United Kingdom. Data for manufacturing (10-33 of ISIC rev.4) and business services, excluding financial services (45-82 less K of ISIC rev.4).
Source: Source: OECD Structural Business Statistics (database), November 2017.

In many emerging and developing economies, the productivity gap between large firms and SMEs – and the resulting income gaps - are especially large, due in particular to a disproportionate concentration of employment in micro and small firms, often informal ones, with relatively little employment in medium-sized firms.

Enabling SMEs to scale up and innovate can have a considerable economic and social impact

In many countries, enabling SMEs to seize growth opportunities over time is a policy priority to address low productivity growth and widening wage and income gaps. SMEs that grow, in terms of employees, turnover profitability or market share, can have a considerable impact on employment creation, innovation, and the competitiveness of national and sub-national economies, as well as contribute to raising wage and income levels.

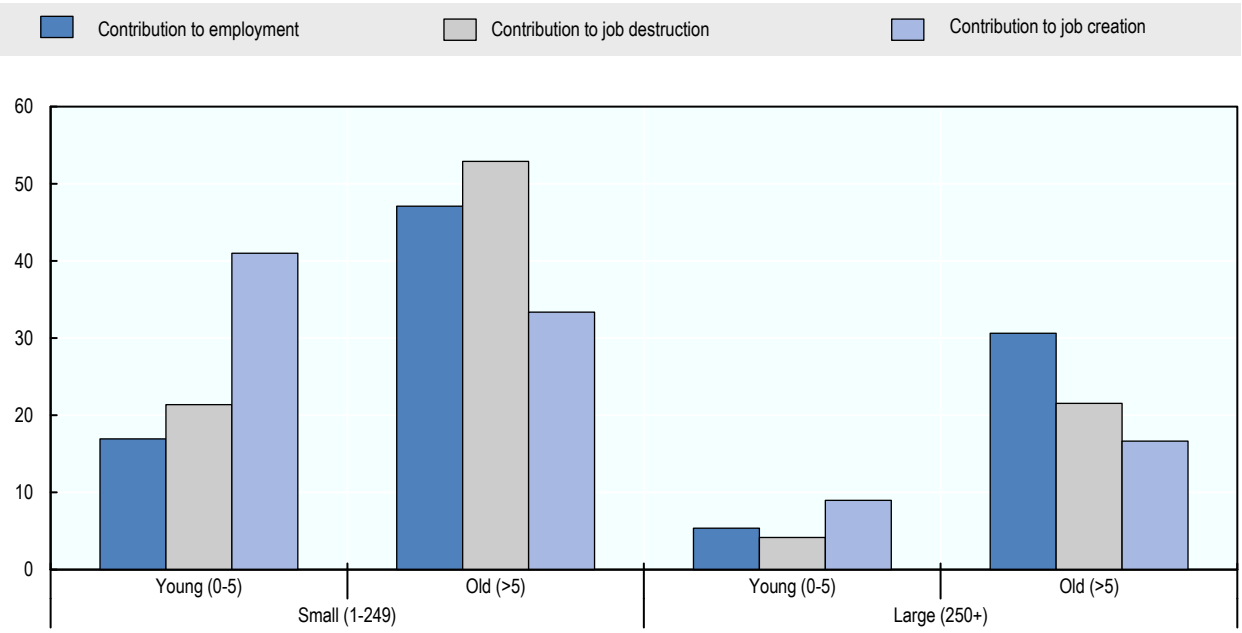
All kinds of firms, with different characteristics and across many sectors, can experience growth at various moments in their life cycle. Growth can be spurred to satisfy a major increase in demand, strengthen competitive position, or seize new opportunities in markets, and can take different forms, including organic (i.e. internally generated) and non-organic growth (i.e. through mergers and acquisitions, joint-ventures or alliances). At the same time, OECD studies illustrate that sustained growth is a transitory phase in the life of the firm, influenced by many factors, including entrepreneurs' skills and ambitions (OECD, 2010b).

Young and high-growth SMEs create jobs and bring a range of benefits to the economy…

OECD work shows that the share of young SMEs in total job creation is about twice as large as their share in total job destruction or in total employment. However, the majority of new enterprises fail in the first years of activity and post-entry growth varies widely across countries. Surviving start-ups scale up faster in high-risk sectors, such as telecommunications, scientific research and development and IT services. Older SMEs and older large firms continue to account for the bulk of employment across countries, but create fewer jobs than they destroy (Figure 5) (Calvino et al., 2016).

Figure 5. Young firms are a key driver of job creation

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



Note: Data cover eighteen countries and firms in manufacturing, construction and non-financial business services. Data refer to the 2001-11 for most countries. Owing to methodological differences, figures may deviate from officially published national statistics
Source: Criscuolo, Gal, and Menon (2014) based on the OECD DynEmp Express database.

High-growth firms (HGFs), i.e. firms that grow rapidly over a short period of time, typically represent a small share of total businesses, but account for a larger share of employment. For example, in Israel HGFs represented 4% of firms but accounted for

10% of employment when considering established companies with more than 10 employees, in 2015 (OECD, 2017b).

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

Scaling up and innovation are at the reach of many SMEs

Increasingly, governments are focusing on the growth journey of SMEs, that is, on enabling conditions for post-entry growth, growth of small firms into mid-size ones and the scaling up of mid-size companies, as a lever to boost aggregate productivity growth and competitiveness by ensuring coordination and upgrading of smaller suppliers.

The contribution of SMEs to innovation has increased in recent decades due to changes in the way innovation takes place in the economy. Enterprise innovation is often the outcome of collaborative efforts in which businesses interact and exchange knowledge and information with other partners as part of broader innovation systems. This shift towards an 'open innovation' paradigm, also facilitated by the digital transition, has reduced the need for innovation-related capital investments, making business innovation more accessible to SMEs (OECD, 2017c and 2010a).

In light of such developments, the importance of an open, competitive and pro-growth environment and of innovation systems that are conducive to knowledge flows and effective commercialisation of research has increased. Globalisation has also increased the importance of cross-border collaboration in innovation, but SMEs often find it difficult to identify and connect to appropriate knowledge partners and networks at the local, national and global levels.

Supporting innovation in established SMEs holds the potential to contribute to inclusive growth by enhancing productivity growth of small businesses and reducing wage gaps between SMEs and large companies. OECD studies show that while conducive framework conditions are essential to small business innovation, managerial skills and formal management practices play a key role for leveraging internal strategic resources towards in-house innovation and collaboration with external partners. Similarly, the effective adoption of ICT and Industry 4.0, which involves the use of automation and digitalisation in manufacturing, requires strong managerial skills in SMEs. In this regard, evidence suggests that targeted programmes that combine ICT solutions with management training and advisory services can be especially effective (OECD, 2017c).

Digitalisation offers new opportunities for SMEs to participate in the global economy, innovate and grow

Digital technologies allow SMEs to improve market intelligence and access global markets and knowledge networks at relatively low cost. The digital transition facilitates

the emergence of "born global" small businesses and provides new opportunities for SMEs to enhance their competitiveness in local and global markets, through product or service innovation and improved production processes. Furthermore, Big Data and data analytics provide a wide range of opportunities for SMEs, enabling a better understanding of the processes within the firm, the needs of their clients and partners, and the overall business environment.

In addition, the digital transition opens a range of new opportunities for scaling up, and different forms of business growth are emerging, with some companies able to achieve a substantial scale without an important mass of employees or other tangible assets. "Lean start-ups" are emerging that leverage the Internet to lower fixed costs and outsources many aspects of the business to stay agile and responsive to the market (OECD, 2017d).

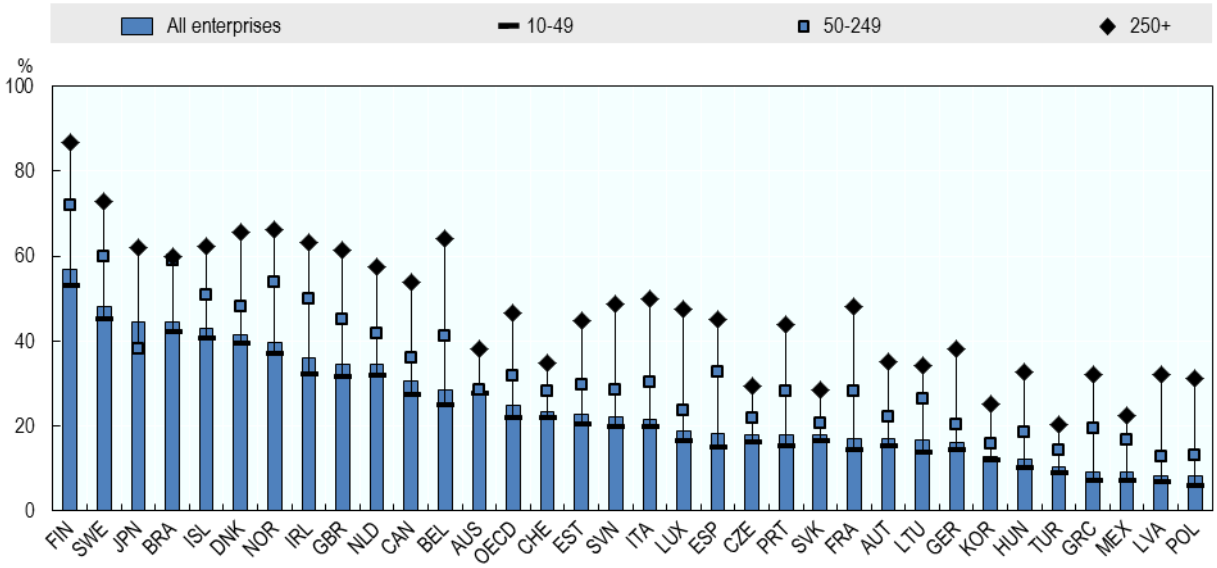
The use of digital technologies can also ease SMEs' access to skills and talent, through better job recruitment sites, outsourcing and online task hiring, as well as connection with knowledge partners (OECD, 2017d). It can also facilitate access to a range of financing instruments. Mobile banking and online payments have had an important impact on traditional SME financing and digitalisation has allowed new financial services to emerge, with innovative solutions to address information asymmetries and collateral shortages.

… but SMEs are lagging behind in the digital transition

To date, a large number of SMEs have not been able to reap the benefits of the technological transition also due to limited adoption of digital technologies. While, in most countries, the divide with large firms is narrow for simple connectivity and web presence, the gap broadens when considering participation in e-commerce and, especially, more sophisticated applications. For instance, across OECD countries, enterprise resource planning (ERP) software applications to manage business information flows are popular among large firms (78% adoption rate in 2016) but less used by SMEs (less than 28%). In many countries, a large adoption gap is also observed for cloud computing, i.e. the renting of computer power from an external provider, which can allow smaller firms to use Big Data, while overcoming some of the barriers associated with the high fixed costs of ICT investment (Figure 6).

Figure 6. SMEs lag behind in the adoption of more sophisticated digital technologies

Enterprises using cloud computing services by size, as a percentage of enterprises in each employment size class, 2016



Note: Cloud computing refers to ICT services used over the Internet as a set of computing resources to access software, computing power, storage capacity and so on. Data refer to manufacturing and non-financial market services enterprises with ten or more persons employed, unless otherwise stated. Size classes are defined as: small (10-49 persons employed), medium (50-249) and large (250 and more). OECD data are based on a simple average of the available countries.
Source: OECD (2017e).

As the OECD Going Digital project underlines, the adoption lag of SMEs is mainly due to lack of investment in complementary knowledge-based assets, such as R&D, human resources, organisational changes and process innovation, and this lag has implications for their capacity to turn technological change into innovation and productivity growth. Furthermore, SMEs face specific challenges in managing digital security and privacy risks, mainly due to lack of awareness, resources and expertise to assess and manage risk effectively (OECD, 2017e).

Policy can play a role in ensuring that SMEs reap the benefits of increased digitalisation. While affordable and widespread coverage of digital networks is essential, targeted policies can help diffuse digital technologies to SMEs and enable their effective use, while addressing related risks. This can be done through the development of appropriate skills and complementary investments in organisational change and innovation. Also, ensuring sound competition in digital markets is key to enable new firms to challenge incumbents, efficient firms to grow, and inefficient ones to exit (OECD, 2017e).

Better access to global markets and knowledge networks can strengthen SMEs' contributions

The structural shift in the international division of labour associated with the rise in global value chains (GVCs) offers SMEs new opportunities to participate in global markets, specialising in specific segments of production. SMEs can integrate the global economy in different ways, as exporters, suppliers to large firms that export, and

importers of competitively priced and higher quality foreign inputs, capital goods and technologies.

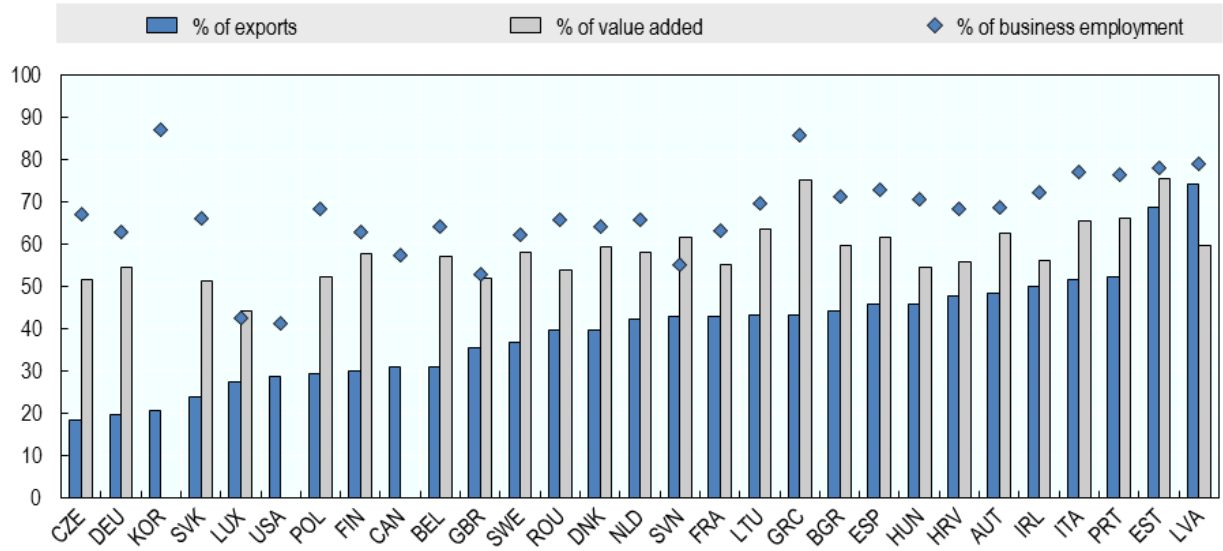
Stronger participation by SMEs in global markets creates opportunities to scale up and enhance productivity, accelerating innovation, facilitating spill-overs of technology and managerial know-how, broadening and deepening the skillset. International exposure, whether through imports, exports or foreign direct investment (FDI), goes frequently hand in hand with higher productivity and wages. For instance, in countries where SMEs have a relatively high share of exports, differences in average salaries between SMEs and larger firms are smaller.

Greater flexibility and capacity to customise and differentiate products can give SMEs a competitive advantage in global markets relative to larger firms, as they are able to respond rapidly to changing market conditions and increasingly shorter product life cycles. "Born global" firms and highly innovative SMEs are often fully integrated into global markets ("micro multinationals"), dominating some niches or serving as key partners of larger multinationals in developing new products or serving new markets.

On the other hand, across OECD and non-OECD countries, few SMEs export directly and for those that do, exports typically represent a lower share of trade turnover (relative to larger firms) and generally target neighbouring countries (OECD, 2016b). At the same time, when considering SMEs' indirect contribution to exports, as suppliers to larger domestic firms or multinational companies (MNCs) that export, SMEs in OECD countries can represent more than half of total exports in value added terms (Figure 7).

Figure 7. SMEs make a significant contribution to international trade in terms of value added

SME export activity, value added and employment shares, 2013



Source: OECD Structural and Demographic Business Statistics and Trade by Enterprise Characteristics databases.

Benefits from GVC participation, including in terms of productivity growth, depend on the position of the firm within global production networks and the nature of inter-firm linkages. Firms and industries positioned at the centre of complex production networks have access to a greater variety of foreign inputs, and potentially a broader range of

technologies, compared to those at the periphery. Smaller firms display faster productivity growth in those sectors that have become more central to global production, than those on the periphery, and also in sectors with stronger linkages to more productive foreign buyers/ suppliers (Criscuolo and Timmis, forthcoming).

Closer global integration also has implications for firms that operate in local markets, through increased competition, which can have disruptive effects on local economies and requires enhanced market knowledge and competitiveness by small businesses.

… but SMEs are more affected by trade restrictions than larger firms

GVCs and digitalisation amplify the importance of goods and services trade policies. Trade and investment openness, trade facilitation, intellectual property protection, and infrastructure and institutional quality, are all key to SME engagement in global markets. However, while some trade costs have fallen significantly in recent years, due also to the expansion of digital platforms, others remain. Reform of slow or cumbersome border procedures can cut costs of trading by 12%-18%, depending on a country's level of development (OECD, 2015a). OECD analysis shows that opening up services markets would primarily benefit SMEs. For instance, for cross-border exports of services, an average level of services trade-restrictiveness represents the equivalent of an additional 14% tariff for SMEs relative to large firms (OECD, 2017f).

The increasingly complex trading environment requires greater international cooperation to identify global solutions to global challenges, from traditional standards to new regulatory issues in the digital age. It also calls for a focus on domestic whole-of-government approaches, which address the constraints that SMEs face in internationalising, including access to information, skills, technology and finance, as well as trade facilitation and connectivity.

The new industrial revolution, changing nature of work and demographic trends present new opportunities and challenges for SMEs

The new industrial revolution and the changing nature of work, with greater demand for high-skilled and non-routine jobs, generate new opportunities for innovative entrepreneurs and are leading to the emergence of new business models. However, these shifts also pose challenges to SMEs that cannot offer attractive wages and job conditions.

Furthermore, in some markets, the expansion of platform-based transactions between professionals and consumers (e.g. the “gig economy”) is increasing competition by self-employed and may have implications for how firms operate and grow, with the potential to reduce firms’ shares and firm-based employment (OECD, 2016c and 2017d).

Another key trend shaping the economy is an increasing concern with achieving environmental sustainability. SMEs are central to this effort, in light of their large aggregate environmental footprint. The transition to a low-carbon and circular economy may pose specific challenges for SMEs to adopt more sustainable practices while maintaining or strengthening competitiveness in local and global markets, but it also opens new opportunities to small entrepreneurs, with respect to their role in supplying green goods and services and developing new sustainable business models (OECD, 2013a).

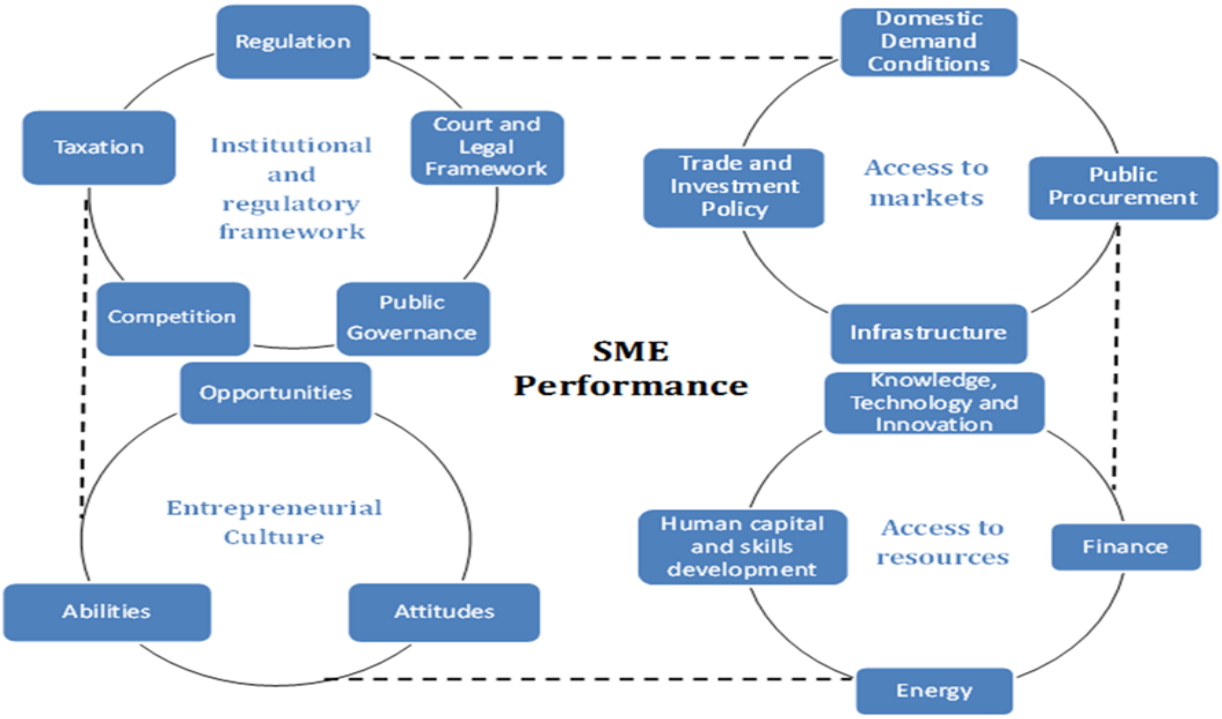
In addition, small businesses can represent an effective tool to address societal needs through the market, as in the case of social enterprises which fill gaps in general-interest service delivery (EU/OECD, 2016). Likewise, ageing populations in many countries are enabling the expansion of small businesses that address the needs of the senior population, through new technologies, products and services, and creating the conditions for greater engagement by seniors in entrepreneurial activities.

At the same time, demographic change brings about specific challenges for SMEs, such as skills shortages and business transfer needs. Across OECD countries, every year, a significant number of economically sound SMEs disappear from the market as a result of problematic business transfers, with implications for economic growth, employment, innovation and social inclusion. While business transfer is essential to the continuity of firm activity and value creation, it may also represent an opportunity for new entrepreneurs to start a business and for SMEs to rethink their vision and business model, innovate by bringing up-to-date knowledge, techniques and methods to a business, and seize new opportunities (Brigham et al., 2007).

A sound business environment is essential for SME competitiveness and growth

A sound business environment and a well-functioning entrepreneurial "eco-system" for business, including at the local level, is essential for countries and regions to foster participation of SMEs in a globalised and digital economy. Such a framework including institutional and regulatory settings, and conditions to access markets and resources, is indispensable to incentivise risk-taking and experimentation by entrepreneurs and ensure that business growth potential can be realised. An entrepreneurial culture is also important to offer attractive opportunities for entrepreneurship and develop the abilities and attitudes among the population which are necessary to seize them (**Error! Reference source not found.**8).

Figure 8. SME performance is strongly influenced by the business environment



Source: OECD (2017g).

Start-ups and SMEs are typically more dependent than large companies on their business ecosystem and, due to their internal constraints, are more vulnerable to market failures, policy inefficiencies and inconsistencies, which may arise in different areas of policy, or result from the interaction of regulatory and policy approaches across different areas. In particular, OECD studies illustrate that a transparent regulatory environment, efficient bankruptcy regulation and judicial system are essential to support the growth of start-ups and SMEs, especially in innovative, high-risk sectors (Calvino et al., 2016).

Public sector transparency and integrity and competitive neutrality are also essential for a level playing field for businesses of all sizes. Opacity and corruption in the public sector, while detrimental to all businesses, pose particular problems for SMEs, and market entry and growth of new and small businesses encounter limitations when state-owned enterprises (SOEs) benefit from an unfair edge in domestic and cross-border activities (OECD, 2012, 2017h).

The OECD report *Small, Medium, Strong: Trends in SME performance and business conditions*, the first instalment in a project to monitor SME performance and benchmark the effectiveness of policies in creating the appropriate conditions for SMEs to flourish and grow, documents developments in the SME business environment (OECD, 2017g). In recent years, in many countries, important progress has been made to reduce the administrative burdens on start-ups, lower legal barriers to entry, and reduce the costs for regulatory compliance in different areas. Policy efforts to simplify regulations and administrative procedures for businesses, and SMEs in particular, are widespread and include the use of ICT, as well as improved availability and provision of information. Regulatory policy bodies responsible for regulatory oversight have been established in many countries to ensure that regulation serves whole-of-government policy. Regulatory

impact assessments (RIA) have become a common practice in most OECD members, including in most cases SME impact assessments, although in some countries only for major regulations or selected regulatory instances. However, in several areas, such as license and permit systems, insolvency regimes and taxation, the complexity of regulatory procedures remains a major obstacle to entrepreneurial activity and business growth.

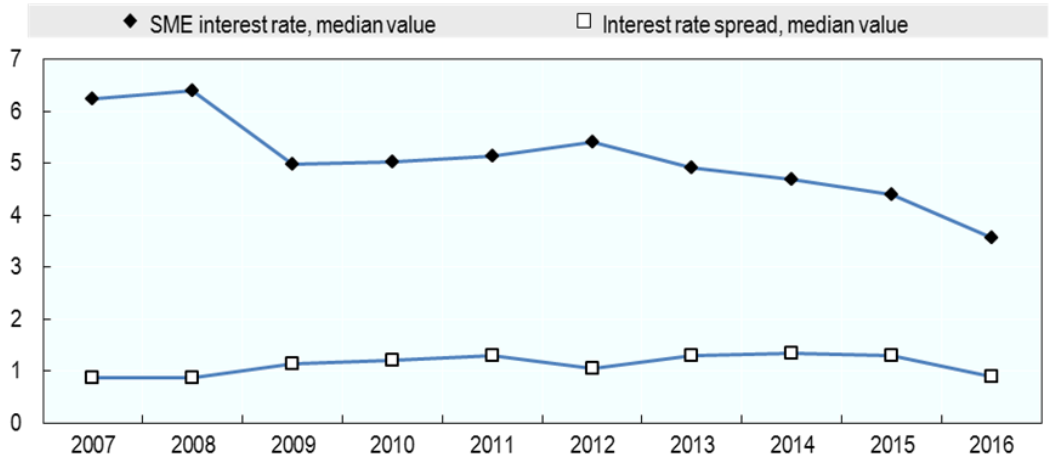
Financing in the appropriate forms is important to enable small businesses to start up, develop and grow

Access to finance is a critical prerequisite for the development of dynamic and productive SMEs in the context of an increasingly globalised and digital world. However, longstanding challenges in access to finance limit SME growth in many countries.

Although SMEs' access to bank lending largely recovered after the financial crisis, market failures and structural challenges remain, including information asymmetries, high transaction costs in servicing SMEs, and lack of financial skills and knowledge among small business owners. In addition, the financial crisis illustrated the vulnerability of many SMEs to changes in the credit cycle and more rigorous prudential rules have led banks to modify their business model and adopt more stringent credit selection criteria. As a result, and even though interest rates have declined considerably across a large number of countries, and survey data illustrate more accommodating credit conditions, the spread in the average interest rates charged to SMEs and to large firms has widened compared to the pre-crisis period (Figure 9).

Figure 9. The gap in credit costs between SMEs and large enterprises has widened

Average interest rate charged to SMEs and average spread between interest rates charged to SMEs and large enterprises, median values



Source: OECD (forthcoming).

Implementing the G20/OECD High Level Principles on SME Financing can enable SMEs to access finance in the appropriate forms and volumes

Debt finance presents heightened barriers for firms with a higher risk-return profile, such as new, innovative and growth-oriented enterprises, whose business model may rely on

intangibles and whose profit patterns are often difficult to forecast (OECD, 2015c). Alternative financing instruments, including asset-based finance, alternative forms of debt, hybrid tools and equity instruments, offer opportunities to mitigate the SME financing gap and to serve the diverse needs of the SME population. In this regard, policies that help broaden the range of financing instruments available to SMEs and entrepreneurs can increase SMEs' resilience to changing conditions in credit markets and improve their contribution to economic growth. Indeed, evidence shows that, industries that are more dependent on external finance grow relatively faster in countries with more developed financial markets and finance improves post-entry performance of firms, even when controlling for the size of entrants (Bravo-Biosca et al., 2016; Rajan and Zingales, 1998).

The OECD Scoreboard on Financing SMEs and entrepreneurs shows that, in recent years, an increasing range of financing options has become available to small businesses and governments have been stepping up efforts to foster a diversified financial offer for SMEs, including new policy initiatives, scaling up existing measures and policy experimentation. In addition, the advent of Fintech (combining technology and innovative business models in financial services) has gained considerable momentum and could have sizeable effects on SME financing, offering unprecedented solutions to deal with the main barriers that SMEs face in financial markets: information asymmetries and collateral shortage (OECD, 2016d).

The G20/OECD High-Level Principles on SME Financing advocate a holistic approach to addressing SME financing gaps, recognising that the availability and access to alternative sources of finance are held back by a number of demand-side (e.g. lack of financial skills, disadvantageous tax treatment) and supply-side barriers (e.g. opacity of the SME market; G20/OECD, 2015). As a consequence, financial instruments for SMEs often operate in thin, illiquid markets, with a low number of market participants, which, in turn drives down demand from SMEs and discourages potential suppliers of finance (OECD, 2016d; Nassr and Wehinger, 2015).

Entrepreneurship competencies and management and workforce skills also drive business innovation and growth

Evidence suggests that changes in entrepreneurial behaviour have significant consequences on levels of growth and innovation (OECD, 2010a). Successful entrepreneurship and business growth require an expanded skillset to channel the complexities of today's economies: from commercial (e.g. marketing and serving of new offers), to project management (e.g. logistics, organisations of events), financial (e.g. capital and cash flow management) and strategic thinking skills (e.g. building internal leadership, coordinating sets of actions to fulfil new strategic objectives). This might be particularly challenging for smaller firms and entrepreneurs, and policies that enable SMEs to develop, attract and retain qualified skills, both within and across borders, as well as to upgrade managerial capacities and practices, are therefore essential to boost growth (OECD, 2013b).

In particular, evidence points to a strong link between better managerial skills and formal management practices (e.g. HRM, standards and certifications, accounting) on the one hand and productivity growth on the other (OECD, 2017c). Workforce skills are also important, especially in small businesses where a larger proportion of workers than in large companies are involved in the implementation of business innovation on the 'shop

floor'. In this respect, there is evidence that SMEs that provide employees with opportunities to develop problem-solving skills are more likely than others to succeed in developing new products or processes (OECD, 2015b).

A perceived lack of capabilities remains one of the most frequently cited barriers for people to start a business and is in particular a challenge for youth (18-30 years old). OECD work on youth entrepreneurship shows that across all OECD countries, more than half of youth surveyed in the period 2012-16, reported a lack of entrepreneurship knowledge and skills (OECD/EU, 2017).

Globally, efforts to build entrepreneurship competencies through education have increased greatly over time. Schools, vocational and higher education institutions are increasingly enriching their study programmes with dedicated entrepreneurship education courses, and problem-based teaching and assessment methods have proven particularly successful.

Public policy should consider a progressive approach to entrepreneurship education over the student's lifetime, as well as specialised entrepreneurship education training and support for teachers, and strengthened business start-up support in vocational and higher education institutions, including linkages between education institutions and existing business support organisations.

Monitoring and evaluation of SME policies are needed to deliver strong outcomes

There is substantial direct public expenditure on SME and entrepreneurship programmes. In addition, many other policy measures which target SMEs have important indirect public finance implications through foregone tax revenue. Monitoring and evaluation is therefore essential to assess the economic efficiency of SME and entrepreneurship policies, and inform their design by identifying those programmes and policy features which lead to desirable outcomes.

Key challenges include increasing the application of rigorous evaluation techniques; better specifying policy objectives, targets and indicators; making better use of data, including existing national administrative data sets for purposes such as tax and social security; and seizing the potential of Big Data. It is also important to make better use of evaluation in the policy cycle; evaluate systematically across the portfolio of SME and entrepreneurship interventions; and assess the impacts on SMEs and entrepreneurship of policies in areas where business development is not the primary objective.

Continued efforts by governments are needed to strengthen evaluation culture in the field of SME and entrepreneurship, building on recent policy developments in the SME and entrepreneurship policy environment and advances in monitoring and evaluation data availability and techniques. The OECD Framework for the Evaluation of SME and Entrepreneurship Programmes and Policies (OECD, 2007) provides a guiding tool for monitoring and evaluation.

A holistic, cross-cutting perspective on SMEs is needed to seize the potential for SME growth in a rapidly evolving context

The SME policy space is complex. It comprises framework conditions; broad policies that impact SMEs; and specific targeted policies. These areas often cut across the boundaries

of ministries and government agencies, as well as across levels of government. Moreover, since SMEs are often embedded in local eco-systems, it is important to consider factors affecting framework conditions at the local level, and how policies developed at national level are tailored to local conditions, as well as how they coordinate with policies that are shaped at the regional or territorial level (OECD, 2016e).

While many governments increasingly recognise the need for a comprehensive perspective when developing SMEs policies and have taken steps in this direction, the synergies, trade-offs and complementarities within and across policy areas, as well as the implications for different types of SMEs, are often not well considered, due also to limited evidence and insufficient understanding of the interdependency of policies.

A better understanding is needed of the combined effects of structural reforms on the SME business environment, as well as on the role and impact of policies targeted to SMEs. Efforts in this direction should consider the potential synergies and trade-offs across diverse policy areas, including distortionary effects that may be introduced by some policy actions; recognise the heterogeneity of the SME population; and acknowledge the multidimensional contributions SMEs make to the economy and society. They should also recognise that countries have different priorities for different populations of firms, depending on the specific national contexts and circumstances.

Over the past two decades, the OECD has been at the forefront of international SME policy dialogue and efforts to provide an evidence base for more effective SME policies in both OECD and non-member countries. Governments can leverage its unique expertise in developing, collecting and understanding business statistics across Members and non-Members, and build on the strong foundation of policy analysis developed across OECD Committees, in areas such as SME finance, innovation, taxation, regulation, digitalisation, employment, skills, trade, internationalisation and GVCs, environment, and others. The OECD can also make use of its extensive networks, including with stakeholders from the private sector and financial institutions and its recent experience in developing cross-cutting policy strategies in other areas to serve governments in their efforts to enable SMEs and entrepreneurs to contribute more fully to productivity and inclusive growth.

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