G20/OECD HIGH-LEVEL PRINCIPLES ON SME FINANCING

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PREAMBLE

1. Small and medium-sized enterprises (SMEs)[1], including micro-enterprises, are important engines of innovation, growth, job creation and social cohesion in high income and emerging economies as well as low-income developing countries (LIDCs)[2]. However, SMEs and entrepreneurs can only reach their full potential if they obtain the finance necessary to start, sustain and grow their business.

2. A lack of appropriate forms of finance is a long-standing hurdle for SMEs, with varying severity of financing constraints across countries. In developing countries, credit to the private sector as a share of GDP is well below the average in high-income countries, SME loans represent a smaller proportion of business credit and the lack of a well-developed financial infrastructure[3] poses challenges. Financing is also a major constraint in advanced economies, where financing gaps for SMEs and entrepreneurs were exacerbated by the 2008-09 financial and economic crisis. Here, regulatory reforms[4] are expected to have various impacts on the availability of credit to SMEs.

3. SMEs are typically at a disadvantage with respect to large firms when accessing finance, owing to opacity, under-collateralisation, high transaction costs and lack of financial skills. Financing needs and constraints vary widely across the business population. Firm size, age and phase of development have an important bearing on the type of financing needed and access to diverse financing sources. SMEs generally face higher interest rates, tighter borrowing terms and are more likely to be credit-rationed than large firms. Capital gaps also exist for innovative and growth-oriented firms, as well as for medium-size enterprises that seek to invest and expand. Informal SMEs in particular may be unserved or underserved by financial institutions. Furthermore, financial sources tend to dry up more rapidly for small firms than for large companies during economic downturns. The shortage of finance experienced by SMEs makes the economic and social impacts of economic crises more severe and long-lasting. While many SMEs face problems obtaining bank finance[5], access to non-bank financing is often even more constrained. Most sources of finance beyond straight bank debt[6] are at the reach of only a small share of SMEs, especially in

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1 It should be noted that SMEs are defined differently across countries and regions, reflecting specificities in the economic, social and regulatory environment. Also, different definitions are adopted for different policy purposes, such as based on profitability for taxation purposes or on number of employees for employment legislation.

2 In high income economies, SMEs undertake the majority of private economic activity, accounting for more than 60% of employment and 50% of GDP. In emerging economies, SMEs contribute on average to more than 50% of employment and 40% of GDP. In LIDCs, SMEs contribute significantly to broadening employment opportunities, social inclusion and poverty reduction.

3 Financial infrastructure refers to the framework and institutions for financial sector transactions, and includes elements such as payment systems, credit information bureaus and collateral registries.

4 Such reforms may take place at the national level or the international level, for example in the case of the Basel framework.

5 Banks are here defined as licensed financial institutions, including chartered banks and credit unions. whose primary role is to receive monetary deposits from individuals and organizations, and to supply credit and other financial services to households and businesses.

6 Straight bank debt includes bank loans, overdrafts, credit lines and the use of credit cards. The defining characteristic of straight debt instruments is that they represent an unconditional claim on the borrower, who must pay a specified amount of interest to creditors at fixed intervals, regardless of the financial condition of the company or the return on the investment. The interest rate may be fixed or adjusted periodically according to a reference rate. Straight debt does

economies where private capital markets are underdeveloped and SMEs lack the scale, knowledge and skills to approach alternative sources of finance. While bank financing will continue to be crucial for the SME sector across all economies, there is a pressing need to develop a more diversified set of options for SME financing, in order to reduce their vulnerability to changes in credit market conditions, strengthen their capital structure, seize growth opportunities and boost long-term investment. This will also contribute to the resilience of the financial sector and the real economy and to fostering new sources of growth.

4. In the context of its programme of work, the OECD has produced several reports, including policy recommendations, related to these issues. The reports were discussed and declassified by the relevant OECD bodies, and shared with the G20[7]. In order to provide a general framework for government action on SME finance, at their meeting in April 2015, the G20 Finance Ministers and Central Banks Governors asked the OECD, together with other relevant international organisations, to develop voluntary high-level principles on SME financing[8]. These principles provide broad guidelines for the development of cross-cutting policy strategies, efforts to benchmark policies and the assessment of current initiatives on SME financing at the local, national and international levels. The principles also aim to encourage dialogue, exchange of experiences and coordination, including regulatory coordination, among stakeholders in SME finance, including policy makers, financial institutions, research institutions and SME management on how to enhance SME access to finance and increase their contribution to resilient and inclusive growth. Further work may involve the identification of effective approaches in G20, OECD and other countries which could facilitate the implementation of the Principles[9].

5. The present document contains the final version of the principles, which reflect both this G20 request and the ongoing work of the OECD and other international organisations. It benefits from contributions from the OECD Working Party on SMEs and Entrepreneurship, the OECD Committee on Financial Markets, and the G20/OECD Task Force on Institutional Investors and Long-term Financing, and the G20 Infrastructure and Investment Working Group. It also benefits from discussions held in the context of the B20 and the Business and Industry Advisory Committee to the OECD (BIAC). An earlier version of this document was submitted as a draft progress report to the 20-21 August meeting of the G20 Investment and Infrastructure Working Group. It was revised in line with comments received and transmitted to the 4-5 September meeting of the G20 Finance Ministers and Central Banks Governors, who welcomed the progress report in their communiqué. In addition, APEC Finance Ministers welcomed the progress on the development of these principles at their meeting on 11 September. The document was submitted to the G20 Global Partnership for Financial Inclusion (GPFI) at its meeting on 12 September. Another round of consultation, including a stakeholder consultation, took place during the second half of September.

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not include any features other than payment of interest and repayment of principal, i.e. it cannot be converted into another asset, and bank claims have high priority in cases of bankruptcy ('senior debt').

7 See *New Approaches to SME and Entrepreneurship Financing: Broadening the range of instruments* and *SME Debt Financing Beyond Bank Lending: the Role of Securitization, Bonds and Private Placements* transmitted to G20 Finance Ministers and Central Bank Governors in February 2015; *Financing SMEs and Entrepreneurs 2015. An OECD Scoreboard* transmitted to G20 Finance Ministers and Central Bank Governors in April 2015; and *Opportunities and Constraints of Market-Based Financing for SMEs* transmitted to G20 Finance Ministers and Central Bank Governors in September 2015.

8 It should be noted that the G20 Infrastructure and Investment Working Group (IIWG) and the G20 Global Partnership for Financial Inclusion SME Finance Sub-Group have developed a Joint Action Plan on SME Financing which aims to facilitate dialogue between these groups; extend, as appropriate, successful G20 endorsed reforms and policy measures in G20 and non G20 countries in order to increase the availability of finance for SMEs; and advance the agenda for SME finance across different G20 work streams with a focus on Low Income Developing Countries (LIDCs).

9 Some of the notes to the Principles offer selected examples of some of these approaches, which will be developed in further detail.

6. The final draft of the Principles was submitted for agreement on 15 October 2015 to the OECD Working Party on SMEs and Entrepreneurship, the OECD Committee on Industry, Innovation and Entrepreneurship, the OECD Committee on Financial Markets, and the G20/OECD Task Force on Institutional Investors and Long-term Financing, as well as to the G20 Infrastructure and Investment Working Group (IIWG) for any final comments. Taking these comments into account, the final report is now transmitted, as planned, to G20 Leaders.

Contacts: Ms. Miriam Koreen, Deputy Director, OECD Centre for Entrepreneurship, SMEs and Local Development [Tel: +33 1 45 24 81 41 | Email: Miriam.KOREEN@oecd.org]; or Mr. André Laboul, Deputy Director, OECD Directorate for Financial and Enterprise Affairs [Tel: +33 1 45 24 91 27 | Email: Andre.LABOUL@oecd.org].

G20/OECD High-level Principles on SME Financing

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7. *These high level principles are addressed to G20 and OECD members and other interested economies, to support their efforts to enhance access to a diverse range of financing instruments by SMEs, including micro-enterprises, and entrepreneurs. The principles are voluntary and non-binding, and build on existing international financial principles and guidelines*.

8. *Cross-cutting policy strategies to enhance SME access to finance are needed to provide a coherent framework for government actions in this area, within the broader policy ecosystem for SMEs. Such strategies are instrumental to define specific policy objectives; design, coordinate and implement policy measures; and to provide a framework for monitoring and evaluation.*[1]

9. *The principles that follow may serve the development of such strategies. They can apply to diverse circumstances and different economic, social and regulatory environments. More detailed policy guidance is under development to support governments in operationalising the high-level principles*.

1. Identify SME financing needs and gaps and improve the evidence base

10. As a first step in developing a strategy to enhance SME access to finance, governments should assess the extent to which SMEs' financing needs are met and where gaps exist, in cooperation with relevant stakeholders, including central banks and financial supervisory authorities, financial and research institutions and SME representatives. This requires a strong evidence base and a better understanding of SME financing needs and challenges by public authorities and financial suppliers.[2] Efforts should be placed on improving statistical information on SME financing, particularly in developing economies, where a lack of reliable evidence constrains policy design, implementation and assessment. This calls for cooperation at the national and international levels (including through an expansion of the OECD Scoreboard on Financing SMEs and Entrepreneurs) to increase transparency regarding definitions, improve the comparability of data and indicators, within and across countries[3], facilitate international benchmarking[4] and regulatory coordination, and shed light on outstanding financing gaps and issues.

2. Strengthen SME access to traditional bank financing.

11. As a main source of external finance for most small businesses, efforts to improve banks' capacity to lend to SMEs should be pursued. Measures may include credit guarantees, securitization[5], credit insurance and adequate provisioning for loan losses. Risk mitigation measures should be strengthened, making use of new technologies and mechanisms for underwriting risk[6][7]. Effective and predictable insolvency regimes should ensure creditor rights while supporting healthy companies and offering a second chance for honest entrepreneurs. Likewise, SMEs should be afforded credit on reasonable terms and with appropriate consumer protection measures in place. Policy makers should consider enabling SMEs to use a broader set of assets beyond fixed collateral, such as movable assets, to secure loans. The feasibility of expanding the use of intangibles as collateral should be carefully considered, to ease access to lending particularly by knowledge-based companies, while taking into account potential risks. The use of credit information should also be enabled to improve risk management for lenders and access for borrowers.

3. Enable SMEs to access diverse non-traditional financing instruments and channels

12. Recognising the complementary nature of the role of banks and other financing channels, access to a sufficiently broad range of SME financing instruments is desirable in order to obtain the form and volume of financing best suited to SMEs specific needs and the stage of the firm life-cycle. Multiple and competing sources of finance for SMEs should be supported, and efforts should be made to increase

entrepreneurs' awareness of the available financing options through targeted outreach initiatives. The development of alternative financial instruments for SMEs should also aim to attract a wider range of investors, including institutional investors[8], and to enhance their understanding of SME markets. Asset-based finance[9] could be fostered to enable young and small firms to access working capital on rapid and flexible terms, as well as supply chain and trade finance to support their integration in global value chains. Alternative forms of debt[10] could be cultivated to enable SMEs to invest, expand and restructure. Adequate policy attention should go to the development of hybrid tools[11] and equity instruments[12] to strengthen SMEs' capital structure and boost investment in innovative start-ups and high-growth SMEs[13]. Special consideration should be given to venture and private equity financing, including capital for seed, early and later stage investments, as well as to trade finance instruments.

4. Promote financial inclusion for SMEs and ease access to formal financial services, including for informal firms

13. Policy should aim to maximise the number of SMEs which have access to and use mainstream financial services and products at a reasonable cost. Financial inclusion is an important tool to reduce informality[14], and national financial inclusion strategies should include reviewing the legal and regulatory framework of the financial sector; defining a public intervention strategy and identifying appropriate delivery instruments; and ensuring the existence of tools for groups excluded from the formal banking sector.[15] Microfinance schemes should be given adequate attention, particularly in developing countries, as a means to enhance entrepreneurs' access to small amounts of funding at an affordable cost.

5. Design regulation that supports a range of financing instruments for SMEs, while ensuring financial stability and investor protection

14. Policy makers and regulatory authorities should ensure that regulation is designed and implemented that facilitates SMEs' access to a broad range of financing instruments without compromising financial stability and investor protection, and enables a return on investment. Regulatory certainty is needed to ensure a predictable and stable operating environment for firms and investors. The combined effects of different regulations should also be considered. Regulations should be proportionate to the risks of different financing instruments. Efforts should be made to avoid undue administrative burdens (including through digitalisation), cut red tape and facilitate bankruptcy resolutions. Particularly in the equity space, flexibility provided to SMEs should be compatible with investor protection, integrity of market participants, corporate governance and transparency. Good corporate governance in SMEs should be encouraged, to enhance their access to equity markets. Legal, tax and regulatory frameworks (including tax policies which provide incentives to encourage both debt and equity financing) should contribute to foster diverse sources of finance.[16] International regulatory coordination can serve to promote cross-border financing for SMEs.[17]

6. Improve transparency in SME finance markets

15. Information asymmetries in finance markets should be minimised to increase market transparency, encourage greater investor participation and reduce financing costs for SMEs. Information infrastructures for credit risk assessment[18] should aim to support an accurate evaluation of the risk in SME financing. To the extent possible and appropriate, credit risk information should be standardised and made accessible to relevant market participants and policy makers to foster both debt and non-debt SME financing instruments. Accessibility of this information at the international level should be supported to foster SMEs' cross-border activities and participation in global value chains.

7. Enhance SME financial skills and strategic vision

16. To enable SMEs to develop a long-term strategic approach to finance and improve business prospects, public policies should champion SMEs' enhanced financial literacy[19]; their awareness and understanding of the broad range of available financial instruments; and changes in legislation and programmes for SMEs.[20][21] SME managers should be encouraged to devote due attention to finance issues, acquire skills (including digital skills) for accounting and financial and risk planning, improve communication with investors and respond to disclosure requirements.[22] Efforts should also aim to improve the quality of start-ups' business plans and SME investment projects, especially for the riskier segment of the market.[23] Programmes should be tailored to the needs and financial literacy levels of different constituencies and target groups, including groups that are underserved by financial markets, such as women, young entrepreneurs, minorities, and entrepreneurs in the informal sector, and to different stages in the SME business cycle.

8. Adopt principles of risk sharing for publicly supported SME finance instruments

17. Public programmes for SME finance should help catalyse and leverage the provision of private resources, especially in risk capital markets. Under certain conditions[24], public schemes can be effective in kick-starting the offer of financing tools for SMEs. Nevertheless, leveraging private resources and competencies may be essential to enhance the resilience[25] of SME financing in the face of rapid economic and regulatory change. Policies should aim at encouraging the participation of private investors and developing appropriate risk-sharing and mitigating mechanisms with private partners which ensure proper functioning of public measures, including the allocation of government resources to their most efficient use. Policies should also be designed to avoid "moral hazard", i.e. excessive risk-taking against the public interest, and potential crowding-out effects.[26] Multilateral development banks (MDBs), national development banks (NDBs) and other public funds should be encouraged to promote SME financing, directly and indirectly.

9. Encourage timely payments in commercial transactions and public procurement

18. Timely payments in Business to Business (B2B) and Government to Business (G2B) transactions could be encouraged to enhance the cash flow of small business suppliers. Policy makers and regulators should ensure that SMEs, which are particularly vulnerable to late payments or non-payment[27], are offered clear and appropriate payment terms. Norms could be designed, implemented and enforced to discourage late payments in commercial transactions, including for cross-border trade.[28]

10. Design public programmes for SME finance which ensure additionality, cost effectiveness and user-friendliness

19. The design of public programmes to enhance SME access to finance should ensure financial and economic additionality[29], along with cost effectiveness. Policy coherence[30] across levels of government and between government and non-government bodies dealing with SME finance should be pursued, based on reliable evidence. The target population, eligibility criteria, credit risk management and fees structure should be considered carefully and defined clearly when designing programmes, which should be easy to understand for SMEs. The administrative burden and compliance costs of new and existing policies, should be proportionate to the service provided, the impact on beneficiary firms and the broader economy, as well as to the nature and size of the targeted businesses.

11. Monitor and evaluate public programmes to enhance SME finance

20. Monitoring and evaluation of policies to ease SMEs' access to finance should be promoted. Ex ante and ex post evaluation should be performed regularly based on clearly defined, rigorous and

measurable policy objectives and impacts and in co-operation with financial institutions, SME representatives and other stakeholders. Evaluation findings should feed back into the process of policy making, in particular when measures fail to meet their stated objectives or are found to have undesirable impacts. Regional, national and international policy dialogue and exchange of experiences on how to monitor and evaluate public programmes to enhance SME finance should be encouraged.

[1] Strategies may be developed at various geographical and sectoral levels.

[2] Evidence on SME financing, including micro data and micro analysis is needed for informed policy discussion; the evaluation of policies; monitoring the implications of financial reforms on SMEs' access to finance and for a better understanding by financial suppliers' of SME financing needs. Evidence on financing needs and gaps by firm size and stage in the firm life cycle is especially important to tailor policy strategies. In this regard, regular quantitative demand-side surveys can represent an important source of information, but their harmonisation at the national, regional and international level should be encouraged to improve the quality of information and cross-country comparability.

[3] At the international level, comparison of data on SME finance is significantly hampered by differences in definitions and methodology.

[4] Strengthening the ability to document differences in SME access to finance across countries can shed light on policy experiences and facilitate the exchange and adaptation of good policy practices.

[5] High-quality, transparent and standardised securitization of SME loans is one means to strengthen banks' balance sheets and foster their lending to SMEs.

[6] To gather more accurate information about businesses, banks may also make use of external experts, particularly for technology-based business models.

[7] The use of credit scoring models may also serve to facilitate bank lending to MSMEs by reducing costs and increasing service levels.

[8] See also the G20/OECD High level Principles of long term investment financing by institutional investors and their related effective approaches.

[9] Asset based finance includes, for example, asset-based lending, factoring, purchase order finance, warehouse receipts, and leasing.

[10] Alternative forms of debt include corporate bonds, private placements, direct lending by non-bank institutions, and peer-to-peer lending.

[11] Hybrid instruments include subordinated loans and bonds, silent participations, participating loans, profit participation rights, convertible bonds, bonds with warrants, and mezzanine finance

[12] Equity instruments comprise venture capital, business angel investing, other private equity instruments, specialised platforms for public listing of SMEs and equity-based crowdfunding

[13] The existence of appropriate channels for exit can help increase the attractiveness of these instruments for investors.

[14] Informal enterprises are defined on a country specific basis as the set of unincorporated enterprises owned by households which produce at least some products for the market but which either have less than a specified number of employees and/or are not registered under national legislation referring, for example, to tax or social security obligations, or regulatory acts.

[15] To promote financial inclusion, the introduction of technological platforms which enable the delivery of a broad variety of financial products and services, drive down the costs of financial access and reach previously untapped markets could be considered.

[16] This may be of particular importance to attract private investors to early stage investments.

[17] In addition, international exchange of experiences on regulation for new sources of finance can be particularly beneficial.

[18] Credit bureaus or registries or data warehouses with loan-level granularity may be part of the information infrastructures for credit risk assessment.

[19] Financial literacy is defined as a combination of awareness, knowledge, skill, attitude and behaviour necessary to make sound financial decisions and ultimately achieve financial wellbeing by the OECD/International Network on Financial Education (INFE) and G20.

[20] The OECD/INFE on financial education for micro, small and medium enterprises has developed work in this area which can provide additional guidance. See also the OECD/INFE High Level Principles on National Strategies for Financial Education endorsed by G20 Leaders in 2012.

[21] SME awareness about alternative lending options should also be improved, to enable them to obtain the most favourable credit terms and conditions.

[22] Efforts should be made to improve awareness and understanding by SMEs of the information required by creditors and other investors in order to consider their demand for finance. This should include feedback from financial institutions on how to improve the quality of applications for external financing. Entrepreneurs' financial literacy and skills can be improved either through the education system, as part of a more general effort to teach entrepreneurship skills, or through specific programmes and advocacy, including in cooperation with the private and not-for-profit sector. Approaches such as training, mentoring and coaching can help SMEs understand how different instruments serve different financing needs at specific stages of the life cycle; the advantages and risks implied; the complementarities and possibility to leverage different sources of finance; and how to approach different types of investors and meet their information requirements.

[23] Investment readiness programmes can support start-ups and SMEs in understanding investors' specific needs, gathering information and developing business plans so as to address these needs appropriately. Furthermore, accompanying support to financing, such as mentoring and coaching, including by investors, can improve the survival and growth of new and small firms.

[24] Public policy may be essential to maintain offer of finance to SMEs under certain conditions, such as economic crises or natural disasters. Due to information asymmetries, public policy may also be important to kick-start or boost offer of financial products and services to specific types of SMEs and entrepreneurs, which are typically underserved by financial markets, including young and growth-oriented enterprises.

[25] Resilience is the capacity of individuals, communities and systems to resist, adapt, and grow in the face of stress and shocks. Resilience involves being prepared for uncertainty, but also developing the capacity to cope with change and emerge stronger than before.

[26] Mechanisms for the development of effective public-private partnerships in SME financing may include co-investment schemes, private-public equity funds, the delivery of public support through private sector intermediaries and the provision of credit guarantees where risks are shared by the public and private sector.

[27] Late payments typically force SMEs to seek external finance in order to cover cash flow gap and/or to cut back investment and hiring plans.

[28] Possible policy actions to encourage timely payments in commercial transactions include the restriction of the contractual freedom to pay invoices, the automatic entitlement to compensation for late payments, the possibility for SMEs to challenge unfair terms and practices, and the simplification of debt recovery procedures, including for transnational transactions.

[29] Financial additionality means that public support reaches viable enterprises which would not otherwise have had access to finance or would have accessed finance at tighter conditions (e.g. higher financing cost, shorter debt maturity). Economic additionality implies that the intervention produces a net positive impact on the economy.

[30] Policy coherence is defined as the systematic promotion of mutually reinforcing policy actions across government departments and agencies creating synergies towards achieving the agreed objectives. Within national governments, policy coherence issues arise between different types of public policies, between different levels of government, and between different stakeholders.