



SMEs in Mexico

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Foreword

This report was prepared at the request of the Mexican authorities. It reviews Mexico's SME policy and programmes introduced since 2000, focusing on the 13 programmes introduced by the Ministry of Economy which form the core of the "integral economic policy for the development of SMEs". It is the second of a series, following the review of SME Issues and Policies in Turkey concluded in 2004.

Based on this report, Mexico's SME policy and programmes were discussed by the OECD Working Party on SMEs and Entrepreneurship at its 29th session in Athens, Greece, on 5 & 6 November 2006. The Working Party welcomed the progress made by Mexico in implementing a comprehensive set of policy measures aimed at making the SME sector more efficient and approved the publication of the report.

This publication represents a team effort. Leadership and management of the Secretariat Taskforce in charge of this report were provided by Marcos Bonturi of the Private Office of the Secretary-General and Marie-Florence Estimé, of the Centre for Entrepreneurship, SMEs and Local Development. The main author of the report was Axel Mittelstädt, to whom we owe special thanks.

A Steering Group of OECD countries, composed of Canada, Finland, France, Greece and New Zealand, provided guidance on the evaluation of the overall coherence and strategy of Mexico's SME policy.

Bénédicte Larre and David Haugh of the Economics Department wrote Chapter II. Guillermo Rozenwurcel, and David Storey contributed to Chapters IV and V. Rebecca Scheel provided crucial assistance in ensuring the smooth functioning of the Taskforce and in compiling the various elements of the report. Damian Garnys provided invaluable help in the formatting and publication process.

The contribution of each of these participants is gratefully acknowledged.

The report is issued under the responsibility of the Secretary-General of the OECD. Views expressed do not necessarily reflect the official views of the Organisation or of the governments of its member countries.

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Basic Statistics of Mexico

LAND

▪ Area (sq. km):	1 964 375	▪ Inhabitants in major metropolitan areas (millions, 2000)	
▪ Agriculture area (sq. km) (1990):	394 000	Mexico City:	18.1
▪ Population: (July 2006 est.)	107 449 525	Guadalajara:	3.7
▪ Age Structure: (2006 est.)		Monterrey:	3.3
0-14 years:	30.6 %	▪ Inhabitants per sq. km (2000):	49.6
5-64 years:	63.6 %	▪ Employment ¹ (2004):	41 272 000
65 years and over:	5.8 %	¹ People economically active according to results of the Quarterly National Employment Survey.	
▪ Annual population growth (1990-2000):	1.85 %		

PRODUCTION

▪ Structure of production, 2004 (percent of total, 1993 prices)		▪ GDP in 2004 (USD billion, current prices and current PPPs)	1 046.6
Agriculture	5.5	▪ GDP per capita in 2004 (USD, current prices and current PPPs)	9 807.0
Industry	26.1	▪ Gross fixed capital formation in 2004 (percent of GDP, 1993 prices)	19.8%
Of which:			
Manufacturing	19.1		
Services	68.4		

GOVERNMENT

Public sector indicators (percent of GDP, 2004)		Composition of Parliament (September 2006)	
Total expenditure	23.5		
Total revenue	23.2		
Net debt (Dec. 04)	23.2		
		<i>Senate</i>	<i>Chamber of Deputies</i>
		PAN	52
		PRD	29
		PRI	33
		Other	14
		Total	128
		PAN	206
		PRD	127
		PRI	107
		Other	60
		Total	500

FOREIGN TRADE

▪ Exports of merchandise (percent of GDP, 2004)	27.8 %	▪ Imports of merchandise (percent of GDP, 2004)	29.1
▪ Main export products (percent of total, 2004)		▪ Main imports (percent of total, 2004)	
Manufactured	85.3 %	Intermediate goods	75.6
Petroleum	11.3 %	Capital goods	11.5
Agriculture	3.4 %	Consumer goods	12.9

CURRENCY

▪ Monetary unit: Peso		▪ Currency unit per USD, average of daily figures:	
		2004	11.281
		2005	10.890

List of Abbreviations

BANCOMEXT	National Export Bank
BANSEFI	The Popular Sector's Central Bank
BBVA-BANCOMER	<i>Banco Bilbao Vizcaya Argentaria - Bancomer</i>
CANACINTRA	Federation of Manufacturing Industries
CAP	Centres of productive articulation (<i>Centros de Articulación Productiva</i>)
CB	Secured Notes (<i>certificados bursátiles</i>)
CINTRA	Airline Holding Company
CNBV	National Banking Commission
COFEMER	Federal Regulatory Improvement Commission
COMPEX	Joint Commission for Export Promotion
COMPITE	National Committee for Productivity and Technological Innovation
CONACYTE	National Council for Science and Technology
CONTACTO PYME	Public Programme offering support services to SMEs
EDP	Entrepreneurial Development Plan
FACOE	Programme for Export Support
FAMPYME	Fund giving organisational help to Medium-sized Enterprises
FIDECAP	Fund to establish networks and chains
FIFOMI	Commission for the Promotion of Mining Production
FINAFIN	Finance Programme for Micro Enterprises
FIRA	<i>Fideicomisos Instituidos en Relación con la Agricultura</i> (Financial intermediaries for the agricultural sector)
FOAFI	Financial Support Fund for Medium-sized Enterprises
FOMUR	Finance Programme for Women-run Micro Enterprises
FONDO PARAGUAS	Guarantee Programme within National Guarantee System

FONAES	National Support Fund for Solidarity Enterprises (<i>Empresas de Solidaridad</i>)
FONDO PYME	SME Fund
FOPRODE	Development Fund for productive and infrastructural projects
FUNDES	Foundation for Sustainable Development
HSBC	Private banking institution
IIC	Inter-American Investment Corporation
IMSS	Private-Sector Social Security Institute
INFONAVIT	Housing Fund
MOES	Export Modules
NAFIN	Mexico's largest State Development Bank (<i>Nacional Financiera</i>)
NDP	National Development Programme
PE	Programme for Entrepreneurs
PECYT	Special Programme of Science and Technology
PNUD	<i>Programa de Desarrollo de Proveedores</i> (Development programme for suppliers)
PROADA	Training Programme for Handicraft Sector
PROMODE	Training Programme for Retail Sector
PSCL	Popular Savings and Credit Law
PYMEXPORTA	Export Promotion Centre
RENAP	<i>Red Nacional de Articulación Productiva</i> (National network for productive articulation)
RIA	Regulatory Impact Analysis
RFTS	Federal Register of <i>Trámites</i> (administrative procedures) and Services
SARE	Rapid Opening System for Enterprises
SIEM	Mexican Business Information System
SISTEC	System for Technological Information Service
SNC	Development Bank (<i>Nacional Financiera</i>)
SNOE	National System of Export Guidance
SOFOLIS	Non-Bank Intermediaries
UNICRECE	Integration of Financial Intermediaries for SMEs
UPCI	Unit of International Trade Practice

Executive Summary

The policy setting

Over the past six years, Mexico's Federal Government has introduced comprehensive policy measures aimed at making the SME sector more efficient. SMEs account for the near-totality of Mexican firms in the *formal* economy and most of them are *micro firms*, which are encumbered by a lack of finance and skills. Only a few SMEs have been able to successfully compete at home and abroad.

Authorities have chosen a flexible policy approach to reduce barriers to entrepreneurial activity. Imparting a wide range of central policy impulses, the Federal SME Fund has put strong emphasis upon *collective process innovation and efficiency*, favouring decentralisation and network building. States, local authorities and intermediate organisations have contributed to policy design and implementation.

The SME Fund (*Fondo PYME*) has created and expanded a series of programmes accompanying SMEs at all stages of development. Based upon temporary public-private partnerships, they comprise innovation laboratories, incubators, development centres, business accelerators and export centres.

First results and need for further action

Gauging the effects of Mexico's new SME policy at this point in time is difficult, as policy lead times are long. Nonetheless, a few encouraging signs have already emerged. The number of SMEs receiving policy support has surged. Improved access to finance is evident in lower risk premiums and lower transaction costs, smoothing the entry of SMEs into the *formal* economy. Finally, administrative lead times for firm creation have decreased substantially, while survival rates have improved.

While the scale of policy impulses has been impressive, there is room for improvement. The SME policy framework can be refined with efforts needed to improve co-ordination and exploit synergies among SME-related expenditures by different federal agencies, states and local governments. Moreover, the take-up of programmes has been uneven across regions and between different firms. This calls for strengthened efforts to enhance the capacity of states and local authorities to implement federal policy initiatives and for expanded tailor-made initiatives in favour of *micro firms*.

The financial resources of the SME Fund, though stepped up over time, have remained small and are still inadequate given the *scale* of the SME sector's weaknesses. New resources should be primarily used for both spreading existing programmes and creating an efficient evaluation culture, which is essential for using scarce resources more effectively. Finally, micro economic framework conditions need to be improved as there is a clear link between them and SME policy requirements. Despite some improvement due to *SARE* (Rapid Opening System for Enterprises), the climate in which SMEs operate is still distinctly less favourable than in other OECD countries. Accompanied by better credits conditions, stronger implementation of fiscal and regulatory simplification measures should speed up micro-firms' entry into the formal economy.

I. Main Features of the Small and Medium-sized Enterprise (SME) Sector

Size and Structure of the SME Sector

Small and medium-sized enterprises (SMEs) play a vital role in Mexico's economy. They account for an estimated 99 percent of all enterprises, generating more than one half of GDP (52 percent in 2006) and nearly three fourths of total employment (72 percent in 2006).

There are nearly 4 million SMEs in Mexico, each firm employing on average seven to eight persons (see Box 1.1.). Compared to small and medium-sized enterprises, the number of large firms is tiny (6 700), accounting for only 0.2 percent of economic units and 29 percent of total employment. The average large firm employs around 700 persons.

Box 1.1. Defining Mexican SMEs

Micro enterprise:	between 0 and 10 employees in manufacturing, retail and services;
Small enterprise:	between 11 and 50 employees in manufacturing and services, and up to 30 employees in retail;
Medium-sized enterprise:	between 51 and 250 employees in manufacturing, 31 and 100 employees in retail, and 51 and 100 employees in services.

Most SMEs (95%) are micro-firms, implying a degree of predominance which exceeds that observed in most other OECD countries. Table 1.1 shows an international comparison of the number of enterprises and employment by size class in the manufacturing sector.

Table 1.1.a. Percentage of enterprises by size class in the manufacturing sector (2003)

	1-9	10-49	50-249	250+
Mexico	90.86	6.01	2.20	0.93
Czech Republic	90.17	7.13	2.14	0.57
Hungary	86.24	10.18	2.82	0.75
France	82.84	13.17	3.15	0.84
Italy	82.63	15.13	1.97	0.27
Portugal	79.77	16.28	3.50	0.44
Spain	78.03	18.68	2.83	0.46
Netherlands	74.49	19.08	5.29	1.13
Austria	72.54	20.63	5.31	1.52
Denmark	71.67	20.92	6.00	1.42
United Kingdom	71.27	21.45	5.91	1.37
Germany	60.21	29.69	8.03	2.07
United States	58.17	33.67	5.13	3.02

Table 1.1.b. Percentage of employees by size class in the manufacturing sector (2003)

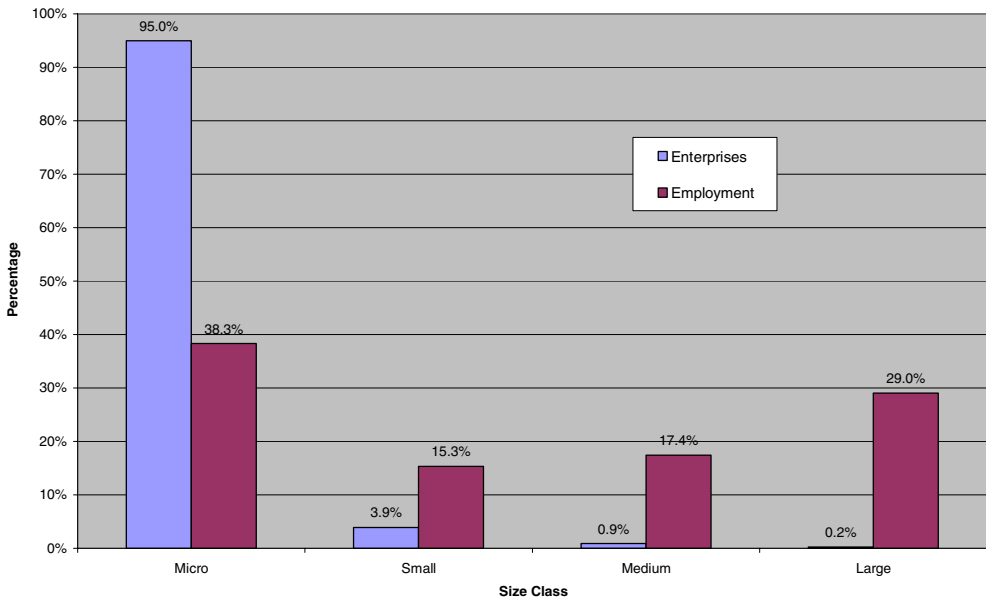
	1-9	10-49	50-249	250+
Portugal	18.69	29.37	30.34	21.60
Mexico	18.15	10.28	19.29	52.27
Spain	14.77	33.20	24.51	27.52
Italy	14.61	34.07	24.76	26.56
Japan	12.63	28.29	29.97	29.11
Korea	11.35	34.81	24.95	28.89
Hungary	10.39	17.98	25.28	46.35
France	10.16	19.30	22.55	47.99
Netherlands	10.11	22.67	29.75	37.47
United Kingdom	8.76	19.21	26.71	45.32
Austria	7.82	19.01	27.91	45.27
Denmark	5.98	19.19	26.93	47.90
Czech Republic	5.45	17.54	28.52	48.48
Germany	5.17	15.59	23.82	55.42
United States	4.23	20.74	17.09	57.94

Note: For the United Kingdom and the United States data comes from 2002. Size class discrepancies: United States: 20-99, 100-499, +500; Mexico: 0-10, 11-50, 51-250; Korea: 50-199, 200+. Size classes for all countries but Mexico have been merged from 10-19 and 20-49.

Source: *OECD Database Business by Size Class*. Data for Mexico is from INEGI.

Micro firms in Mexico employ around 8 million persons (38.3 percent of total employment), or little more than two persons on average. In 2003, micro firms employing up to two persons accounted for two thirds of Mexico's total enterprise population. While the number of small enterprises (139 000) and medium-sized companies (32 000) are fractions of the SME population, they account for one third of total employment and a relatively large share in overall output (Figure 1.1.).

Figure 1.1. Distribution of employment and enterprises by firm size (2003)



Note: Micro=0-10 employees; Small=11-50 employees in manufacturing and services and up to 30 employees in retail; Medium=51-250 employees in manufacturing, 31-100 employees in retail and 51-100 employees in services.

Source: CANACINTRA and INEGI.

The data points to a fragmented production structure and a highly polarised profile of employment and productivity levels. The typical micro firm is tiny even by Mexico's own definition. Many micro firms are unable to generate profits, reflecting over manning and related negative levels of total factor productivity. Their contribution to overall output is weak. In contrast, the typical small and medium-sized company is 'large', employing a number of persons close to the upper end of the respective SME employment definition. Their average level of labour productivity is comparatively high.

Micro firms are mostly family run and family owned, their output being oriented towards local markets. About nine tenths of these firms are located in retail, services and agriculture. Only a small share of micro firms (about 300 000 enterprises) are located in manufacturing (Table 1.2.).

Table 1.2. SMEs by sector (2005)

Sector	Total Number	Percentage of Enterprises			
		Micro	Small	Medium	Large
Manufacturing Sector	328 718	90.9	6.0	2.2	0.9
Food	123 308	95.3	3.4	1.0	0.4
Textile	47 400	86.9	8.5	3.4	1.3
Wood	17 729	95.7	3.4	0.8	0.1
Paper	17 165	88.0	8.5	2.8	0.8
Chemical	7 706	49.7	28.7	16.6	5.0
Non metallic minerals	25 037	93.4	5.0	1.2	0.4
Basic metallic	1 250	61.8	21.5	12.1	4.6
Equipment and machinery	77 373	89.9	6.4	2.4	1.4
Other industries	11 732	89.1	7.2	2.5	1.2
Retail Trade	1 580 587	97.0	2.1	0.6	0.2
Services	1 013 743	94.7	4.3	0.5	0.5

Source: CANACINTRA and INEGI.

The Informal Economy

As in many countries, official statistics understate the importance of SMEs and, especially, that of micro firms. A significant portion of Mexico's working force is active in the *informal* economy. Although no official estimates are available, many observers believe that there are more than 3 million informal firms with roughly 9 million employees (about one fourth of the recorded economically active population). The statistical office, INEGI, has started to produce a strictly defined measure of the informal sector, which considers employment (and output) of "non-structured" sectors, such as street vendors or micro enterprises. Employment in the informal sector defined as such was estimated at 10.5 million people in 2002, representing about a quarter of total employment.¹

Regional Disparities

Mexico is characterised by important regional differences in its level of economic and social development. Indicators of per capita income, poverty, health, and education vary widely. Physical and human capital are also unevenly distributed across regions.² This disparity is reflected in turn in the economic structure, with the poorer Southern states being marked by the predominance of more traditional farming systems, less advanced industries, and generally much lower levels of productivity. Moreover, the benefits of Mexico's increasing integration into the global economy have been unevenly felt, with some states better placed to reap the fruits of better access to international markets³.

Regional disparities of economic development are reflected in the geographical distribution of SME categories. For each of the three major economic sectors (manufacturing, retail, services), the regional pattern shows a particularly dominant presence of micro firms in the South and the South-eastern regions. By contrast, large and medium-sized firms display a relatively strong presence in the more prosperous Northern regions.⁴

Fundamental Weaknesses of the SME Sector

Insufficient Know-how and Low Level of Technology

As in most other countries, Mexico's smaller firms often produce exclusively for local markets. Their products generally suffer from outmoded design, outdated tools of production, low quality and inadequate marketing. Micro firms do not participate in 'association networks' and suffer from low levels of human capital, inadequate use of technology and limited access to finance. In contrast, there is a small segment of internationally competitive SMEs (mainly located in the metropolitan areas of Mexico City or Monterrey) endowed with modern equipment and a strong culture of innovation.

The extent of Mexico's technological gap is clearly illustrated in Table 1.3, which shows large gaps in the diffusion of information and communication technology (ICTs).⁵ The advance of globalisation has greatly increased adjustment requirements for Mexican SMEs. There is a pressing need to improve human capital and the use of ICTs for innovative activity.

Table 1.3. Diffusion of information and communication technology (ICT)¹

	Mexico	Poland	Turkey	EU-15	US	Japan	Korea	OECD
Standard Access Lines	15.9	29.6	26.7	43.5	59.5	40.4	57.7	43.6
Access Channels	18.9	32.9	27.0	58.9	62.3	55.0	58.4	52.0
Mobile Subscribers	29.3	45.5	39.4	84.8	54.5	67.9	70.1	64.2
Internet Subscribers to fixed networks	2.7	4.3	1.6	24.0	33.0	25.6	24.8	22.4
Broadband Access ²	0.4	0.8	0.1	5.9	9.7	10.7	24.2	7.2

Note: 1. Per 100 inhabitants in 2003.

2. "Other" broadband technologies include satellite broadband internet, fibre-to-the-home Internet access, Ethernet LANs, and fixed wireless subscribers (at downstream speeds greater than 256 kbps).

Source: OECD Communications Outlook, 2005.

The technological gap is partially linked to the weakness in product and process innovation, reflecting insufficient R&D efforts, particularly in the private sector. In 2003, Mexico recorded by far the lowest share of R&D expenditure out of GDP among OECD countries (0.4 percent of GDP as against 2.3 percent for the OECD area as a whole). Private R&D spending was particularly subdued, accounting for only 35 percent of the total R&D, compared to the OECD average of 65 percent. Financing, including venture capital, for innovation and R&D has been in short supply, delaying the diffusion of new technologies.⁶

Innovation surveys conducted in the mid-1990s showed a low overall rate of product and process innovation for Mexico compared to Argentina, Brazil and Uruguay. This was mainly due to a lack of process innovation for all categories of SMEs and large enterprises.⁷

Limited Access to Financing

Lack of financing at reasonable cost constitutes another major impediment to SME activities.⁸ SME financing in Mexico is marked by sharp asymmetries⁹ with larger companies in tradable sectors having access to bank credit, while SMEs rely mainly on costly suppliers' credit with

adverse effects on investment and innovation activities. In 2005, suppliers' credit accounted for two thirds of finance for small enterprises (Table 1.4). Overall, Mexico's direct bank credit to enterprises only started to record positive growth in the latter part of 2004, after a protracted period of decline and stagnation. Bank lending to the private sector (which includes mortgage and consumer credit) as a percentage of GDP is among the lowest in the OECD area.

Table 1.4. Sources of SME finance in Mexico (2005)
(in percentage)

Source of Finance	Companies			
	Small	Medium	Large	AAA
Suppliers' credit	66.7	57.2	52.3	44.8
Commercial Banks	13.7	19.8	21.1	34.5
Foreign Banks	0.9	2.9	3.1	6.9
Development Banks	1.7	1.2	3.1	0.0
Other Sources ^o	17.0	18.9	20.4	13.8
Total	100.0	100.0	100.0	100.0

Note: 1. Includes head office and other companies of corporate groups.

Source: CANACINTRA and Banxico, 2005.

While progress has been made over the past few years, most SMEs continue to face acute difficulties in obtaining bank credit and equity finance. Overall, the supply of bank credit to the business sector and SMEs, in particular, has been mainly limited due to the longstanding lack of adequate rules for recovering guarantees and to the remaining uncertainties about the application of the new legal framework following the 2003 reform.¹⁰ Shortcomings in the application of the bankruptcy and credit guarantee law and in credit assessment affect smaller firms more acutely than larger firms, creating important asymmetries.

Summing Up

While SMEs dominate Mexico's business population, as in other OECD countries, their development remains hampered by fundamental weaknesses: unusually weak endowment of tangible and intangible capital and limited access to finance.¹¹ This points to market failures and has important consequences for income distribution, social cohesion and employment creation. Therefore, strong policy action, based upon a targeted, flexible and differentiated approach, seems to be warranted. But SME support policy

needs also to take into account the overall framework conditions in which firms operate, including inadequate infrastructure and low human capital, budget constraints, and the pressing need for public social spending (basic education, health care, poverty alleviation). These framework conditions will be discussed in Chapter II.

Notes

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II. Strengthening the Entrepreneurial Business Environment

Introduction

SME performance and development are affected by economic events and policy at the national level and by framework conditions in which all businesses operate. This chapter is divided into two main sections. The first section provides an overview of Mexico's economic performance over the past 20 years. While much progress has been made to achieve macroeconomic stability, including low inflation and close to balance budget outcomes, key conditions for business, the rate of growth of GDP per capita remains weak and does not allow rapid catching-up in standards of living (Figure 2.1.). The second section discusses some of the framework conditions that are of major importance for doing business in Mexico. In many areas, structural reforms would help create conditions for the development of healthy businesses, including SMEs.¹ At the same time, these reforms would improve productivity and raise the growth potential of the Mexican economy.

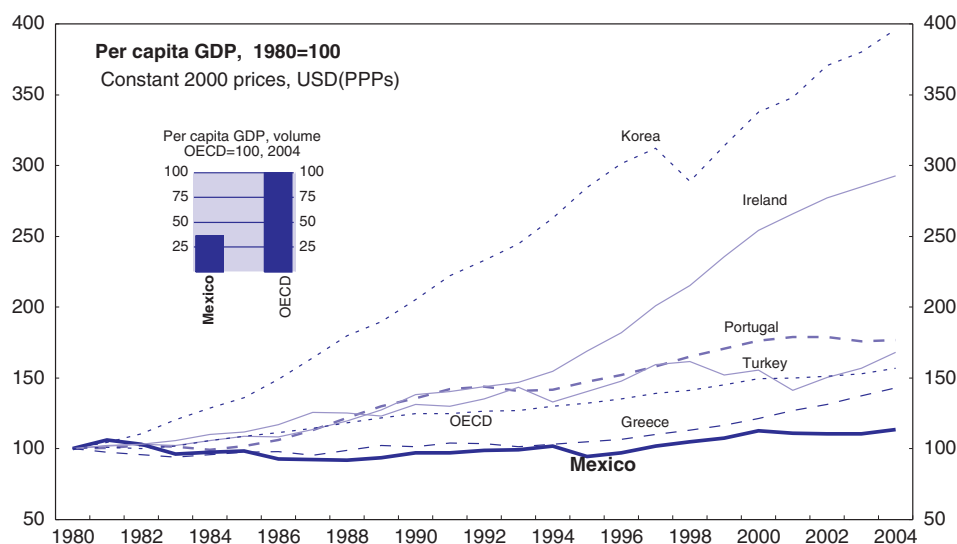
Macroeconomic Performance

The process of economic liberalisation started in the 1980s, with Mexico becoming a member of the General Agreement on Trade and Tariffs (GATT) in 1986. A process of product market liberalisation also began, with the lifting of price controls and some deregulation in transport and communications. Financial market restrictions were alleviated beginning in 1988, with the elimination of credit quotas to high priority sectors, the lifting of interest rate ceilings and the limited reduction in ownership restrictions in the banking sector.

A key step was achieved with the NAFTA treaty (1994), which dramatically increased the size of markets available for the free entry of Mexican exports and increased Mexico's exposure to import competition

from the United States and Canada, enhancing the efficiency of Mexican firms. With the opening of the economy, the combined amount of exports and imports increased as a share of GDP from 39% in 1990 to 61% in 2005.

Figure 2.1. Mexico's growth performance in comparison



Note: 1. The average growth rate of GDP per capita is calculated in constant 2000 prices, USD (PPPs), over the period 1996-2004. The level of GDP per capita is for 2004.

Source: OECD, Main Economic Indicators database; OECD, National Accounts database.

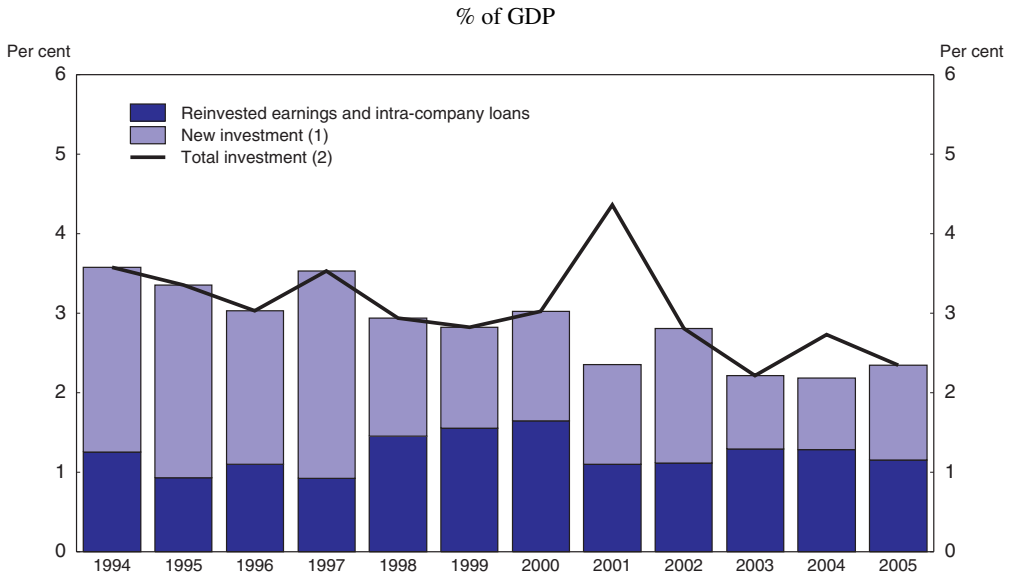
Mexico has regained stability and sustained growth

During the past 25 years, the Mexican economy suffered two major crises, the debt crisis in 1982 and the currency crisis in 1995 (Annex 1). In contrast to the long period of stagnation that followed the 1982 debt crisis, the economy quickly returned to growth following the 1995 crisis, with GDP expanding by 5% in 1996. A rebound in investment by export-oriented firms, as well as public sector projects, helped to drive this turnaround. The recovery benefited mostly larger firms, which had access to foreign financing and were able to quickly re-orient their production to foreign markets.

Economic growth remained vigorous for five years, from 1996 to 2000, averaging over 5% per annum. Openness manifested itself in an increase in the share of exports and significant inflows of FDI. The gross inflow of FDI averaged around 3% of GDP per annum from 1996-2000, representing a significant source of investment capital (Figure 2.2.).

In the labour market, approximately three million new jobs were created in the formal sector from 1996 to 2000 and the open unemployment rate decreased to 2.1%. However, the rapid growth of the working-age population meant that informal employment also continued to absorb new entrants into the labour market, with its share remaining broadly constant at around 25% of total employment.

Figure 2.2. Gross foreign direct investment in Mexico



Note: 1. Excludes the sale of Banamex in 2001 and the sale of BBVA-Bancomer in 2004.
 2. Includes the sale of Banamex in 2001 and the sale of BBVA-Bancomer in 2004.

Source: Ministry of Economy, Directorate-General for Foreign Investment.

The 1995 crisis still caused a significant set back to Mexican living standards. The level of GDP per capita returned to its 1994 level only in 1998 and private consumption per capita surpassed its 1994 level only in

2000. In the aftermath of the peso crisis, there was a significant fall in real wages. While the post-crisis fall in wages helped to improve competitiveness, increase exports and reduce inflation, it also translated in a large decrease in the purchasing power of Mexican households.

Fiscal policy has kept the financial balance close to zero...

Following drastic fiscal tightening in 1995, the financial balance was maintained between zero and 1.2% (Figure 2.3.). In 1998, when the price of oil fell below original budget assumptions, government revenue - 1/3 of which is oil-related - came under pressure. The government responded swiftly, cutting expenditure, particularly investment, in order to keep the budget on target. In 1999 and 2000, when the price of oil rose again significantly, the windfalls were used to lower the public sector debt and to contribute to a newly created oil stabilisation fund.

Figure 2.3. Public sector budget aggregates

% of GDP

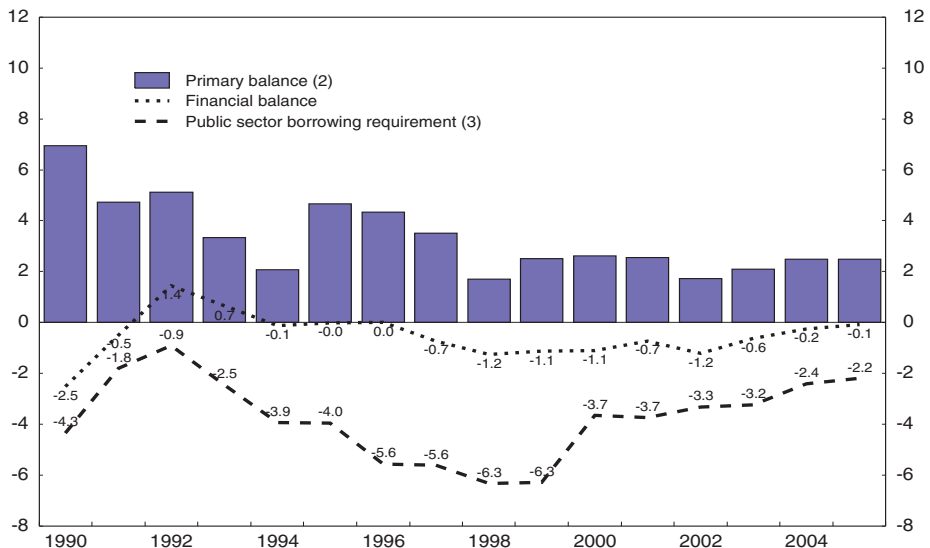
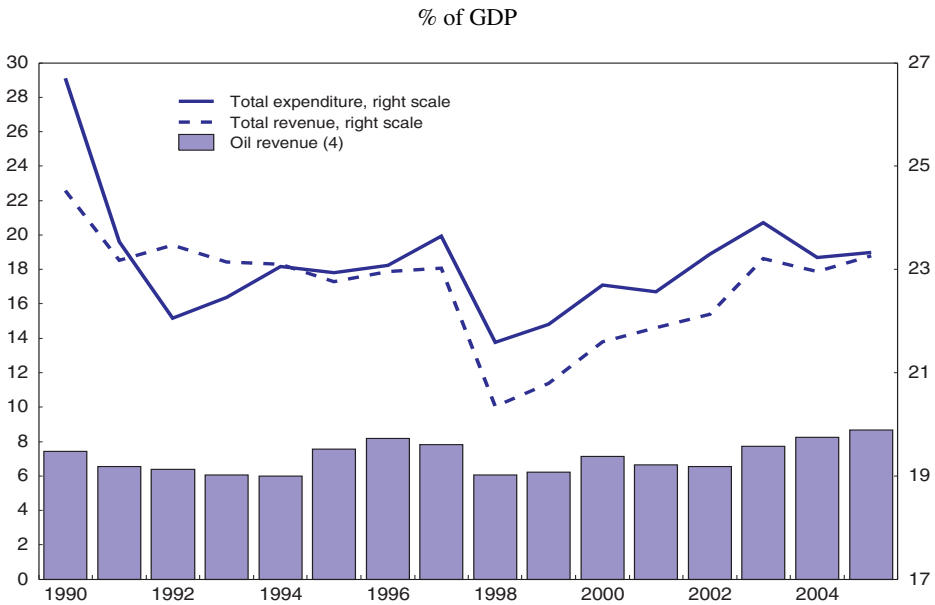


Figure 2.3. Public sector budget aggregates (cont.)

- Note: 1. The public sector comprises federal government and public enterprises under budgetary control.
2. The primary balance is the financial balance less net interest payments (such as PEMEX). Financial intermediation by development banks is not included.
3. Public sector borrowing requirement (PSBR) includes net costs of "PIDIREGAS", inflation adjustment to indexed bonds, imputed interest on bank-restructuring and debtor-support programmes and financial requirements to development banks. Non-recurrent revenues (privatisation) are not included. Further adjustment to include the net non-recurrent capital costs of the financial sector support programmes would increase the PSBR. 3. Includes oil extraction royalties, VAT and excise taxes on oil products.

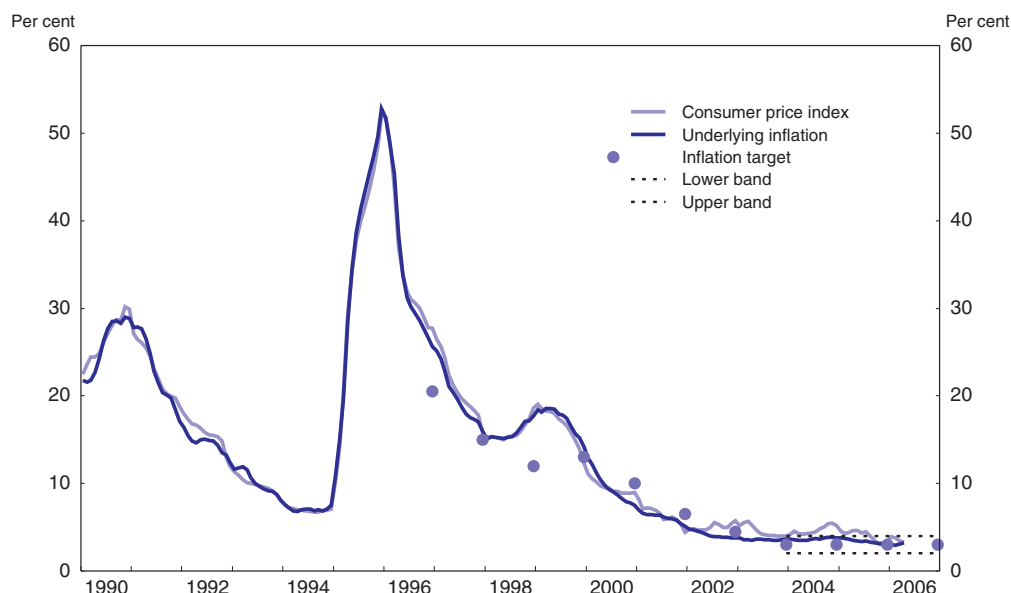
Source: Ministry of Finance; Banco de México; OECD, Economic Outlook database 79.

Despite budget discipline, the crisis did impact the broader public finance position. The government's commitments to support the financial sector came at a high fiscal cost, around 20% of GDP. These programmes, along with public-private partnership commitments in the electricity and the oil sector (PIDIREGAS), contributed to a public sector borrowing requirement (PSBR) that was around 6% of GDP from 1996-1999 and to an increase in public debt.

...and monetary policy was successful in reducing inflation...

In the aftermath of the 1995 crisis, the central bank switched from its previous focus on the exchange rate towards an inflation targeting regime. CPI inflation, after initially jumping to over 50% following the large depreciation in the peso, was gradually reduced over this period to 9.5% in 2000. This was helped by nominal exchange rate stability from the beginning of 1996 and moderate wage developments. Inflation expectations also declined steadily. Consequently, the Bank of Mexico increased its credibility as it continued to achieve its objective of reducing inflation (Figure 2.4.).

Figure 2.4. Inflation performance
Percentage change over 12 months



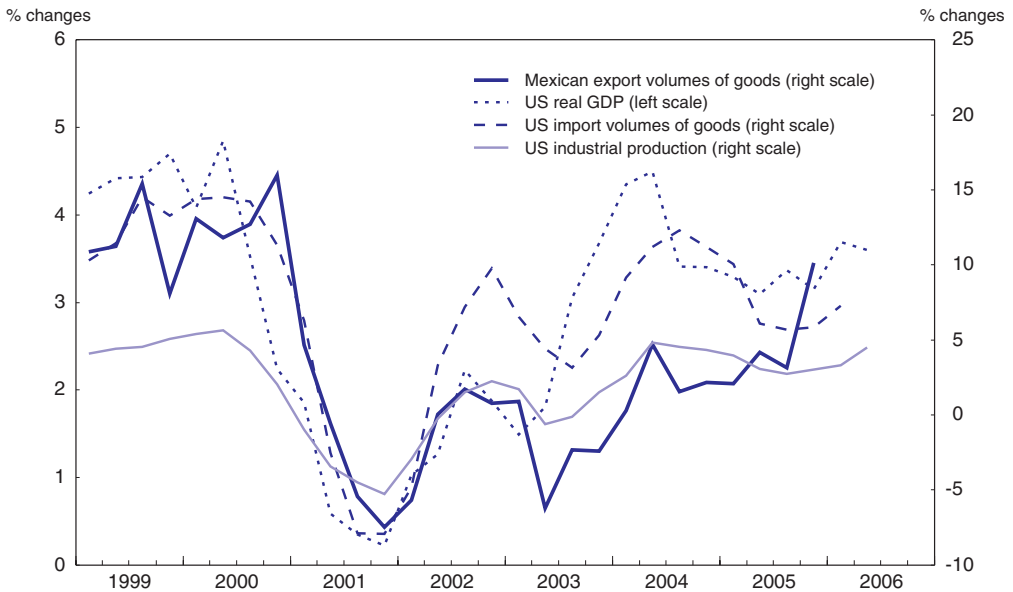
Source: Banco de Mexico.

The Mexican economy has become more closely linked to the US economy

In 2001, the Mexican economy began to slow significantly in response to a sharp slowdown in the United States. In contrast to the 1995 episode, this recession remained mild. While the previous two crises in 1982 and 1995 were “homemade”, the 2001 recession was caused by a negative shock

originating abroad and reflecting the closer integration of the Mexican economy with the US economy as a result of NAFTA (Figure 2.5.). Given the long-term strength and stability of the US economy, as evidenced by long and stable expansions and relatively few and short recessions, this increasing synchronisation with the US economy will have a positive influence on Mexico.

Figure 2.5. Export activity in the United States and Mexico
Year-on-year change



Source: OECD.

In 2004 and 2005, the economy returned to stronger export and investment growth; and consumption also picked up. The broad-based expansion is expected to continue, with GDP growth around 4% in both 2006 and 2007 and with employment in the formal sector expanding. Regulatory reform in the banking sector and the increase in foreign ownership have resulted in an increasingly solid banking system. Bank lending also increased due to the stronger economy. CPI inflation declined to 4% in 2005. According to OECD projections, this is set to remain on target in the period ahead (3% plus or minus one percent); and the current account deficit should remain close to 1% of GDP. Continued increases in oil prices as from 2003 have contributed to increasing revenue and a narrowing of the public sector financial deficit to -0.3% of GDP. There has

also been a consolidation in the broader public sector borrowing requirement, which includes support programmes for the financial sector and investment schemes undertaken with private sector financing (PIDIREGAS).

Nevertheless, the average growth rate of around 4% per year is barely enough to keep per capita living standards increasing at the same rate as the OECD average. Given the low level of average income in Mexico – about one third of the US income level (in purchasing parity) in 2004 – a faster catch-up would be desirable.

Improving the Business Environment in which SMEs Operate²

The Structure of the Economy

The structure of the Mexican economy has changed significantly over the last 15 years. Services have continued to grow while manufacturing and agriculture decreased in relative importance. Labour productivity is generally low and increasing at a slow rate, except in the manufacturing sector. Furthermore, income distribution remains significantly skewed in Mexico, and a large share of the poorest population is employed in rural areas. This suggests that there is large scope for productivity improvements, in particular in the agriculture sector, which has the potential to improve the incomes of the poorest members of Mexican society. A similar, though less acute, situation characterises the poor urban population, generally self employed or employed in small-scale activities (domestic services, street vendors, and micro-enterprises, such as repair shops, cleaning services, etc.). These activities are typically informal with low productivity levels and weak or no productivity gains over time.

The low level of labour productivity per hour worked, about a third of that in the United States, is the main explanation for the income gap in relation to higher income OECD countries. Overall productivity growth has been mediocre, despite the reform programmes of the past two decades. The evidence suggests that productivity growth is depressed, in particular, by: *i*) low levels of human capital, with low educational attainment even for younger workers and scarce adult training; *ii*) the slow pace of structural reforms in a number of areas, including in some key network industries.

The following sections discuss the various areas where reforms would improve the overall economic context in which SMEs operate, including the banking sector, infrastructure, human capital, labour market and the investment climate and competition policy.

The banking sector is sound but credit to business has been slow to recover³

A well-developed financial system, which efficiently channels resources towards the most rewarding activities and stimulates investment, is important to support stronger economic growth. After coming close to collapse in the 1995 banking and currency crisis, the banking sector required massive government support, including bank recapitalisations, take-over of some banks and debtor support programmes. In 1998, FDI restrictions in Mexico's largest banks were lifted. In 2001, a raft of reforms including the banking and securities markets and savings and loans laws were enacted to improve supervision, corporate governance, accountability and transparency, and increase foreign ownership. In 2003, the bank guarantee law was reformed to improve the enforceability of contracts. Following these wide ranging reforms, Mexico's banking sector is progressively sounder and now shows a profitability comparable to other OECD countries, and bank supervision and regulatory frameworks are much closer to best practice.

High levels of foreign investment have improved the efficiency of the system.

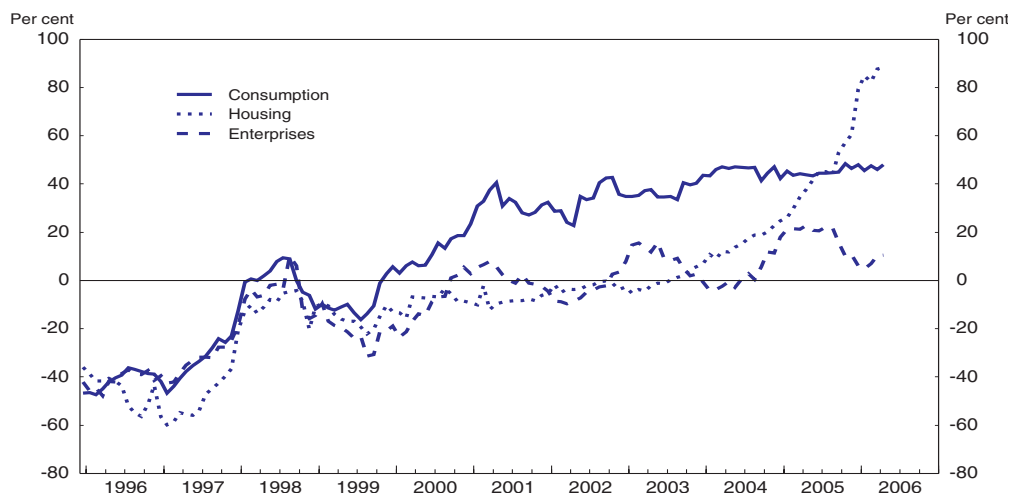
The removal of the remaining restrictions in the banking sector in 1998 led to a rapid increase in foreign ownership of Mexican banks, with the total commercial banking assets owned by foreign firms rising from 7% in 1995 to 25% in 1998. By mid-2001, the three largest commercial banks, representing about half of total bank assets, were foreign owned with investments by the United States' Citibank and Spain's BBVA and Santander. In total, foreign ownership accounted for 85% of commercial bank assets. With this high level of foreign ownership, Mexico's banking sector has excellent access to human capital, including foreign management expertise, and leading international technology and practices. This should ensure continued improvements in productivity and ongoing soundness of key parts of the overall system.

Following the 1995 crisis, it took several years for bank lending to the private sector to resume

After the crisis in 1995, bank profitability recovered and non-performing loans declined. However, growth in domestic credit to the private sector was slow to recover. Small and medium-sized enterprises faced the greatest difficulties in accessing bank financing given their higher risk and lack of access to foreign borrowing that large firms have at their disposal. Bank

credit to the private sector exhibited negative real annual growth throughout the late 1990s, except for a brief period in 1998, and into the early 2000s. While consumer credit started to increase in real terms as from 2000, housing credit recovered more recently and the growth of credit to enterprises is not yet stable (Figure 2.6.).

Figure 2.6. Trends in domestic credit to the private sector
Year-on-year percentage change in real terms



Note: 1. Direct credit by commercial banks.

Source: Bank of Mexico.

There are also wide disparities across the enterprise sector. Larger companies and those involved in export-oriented activities can more easily access foreign banks or issue debt, while SMEs have been more affected by the lack of bank credit. Consequently, SMEs tend to be self-financed or relying on suppliers' credit.

There is also a state-owned development bank sector that needs to be rationalised

Development banks have traditionally had an important role in financial intermediation. After the 1995 crisis, they curtailed lending even more sharply than commercial banks. By early 2001, their share of total bank assets had fallen to only a third of the total banking system assets and the share continued to fall. They have become more concentrated in providing

funds to commercial banks (second-tier) lending, which limits capital market distortions. By 2001, their share of direct non-bank private lending had fallen to less than 10%.

Nevertheless, despite repeated capitalisations, the development banks have continued to make losses over the business cycle, indicating distortion-inducing subsidisation. This has contributed to the constraint of the development of private banking. Lending efficiency was further hampered by overlaps between various state-owned financial intermediaries. Therefore, there is a need to rationalise operations of development banks and trust funds.

Microfinance (also called “popular banking”) can play a role in providing small loans to those who do not have access to traditional banking (e.g. the self-employed, shopkeepers). The institutional and organisational framework of this sub-sector was set up in 2001 with the creation of BANSEFI. Also in 2001, the programme for microfinancing (Finafim) was introduced with the participation of the Ministry of Economy and the development NAFIN (to be discussed Chapter III).

Among the factors constraining credit supply are the problems lending institutions face in enforcing contracts that involve collateral. While there have been improvements, more will need to be done. In 2003, legislation relating to bank guarantees (collateral) was amended to improve the mechanisms for recovery of collateral by lending institutions in the case of debt repayment default. It is designed to prevent debtors from engaging in practices that delay or obstruct the creditor’s repossession, for example by selling the collateral. The new framework is improved, but in practice it has not led to the full enforceability of contracts as debtors often make abusive use of proceedings to block enforcement. These proceedings delay decisions and, even if the creditor is successful, the collateral may have depreciated significantly in the mean time.

Providing more certainty in guarantees to creditors would help debtors by increasing opportunities for contracting credit at competitive prices and reducing the scope of informal credit at exorbitant prices. In 2005, further changes were made to the legal framework for secured transactions (*miscellanea de garantias*), in particular, to give certainty in guarantees to creditors and facilitate the recovery of non-performing loans. It is still unclear whether further changes to the legislation are needed to increase the enforceability of credit contracts. Initiatives to improve small saver access to secure savings instruments and liberalise investment rules for government pension funds would also help to improve credit growth by increasing the supply of funds available for lending to the private sector. Adequate

information sharing between lenders can play a role to attenuate adverse selection and moral hazard.

Many OECD countries have taken measures to improve SME access to *venture capital* and other types of private financing. In some countries, "business angel" networks bring together small companies and investors. Some OECD governments play a more direct role in helping SMEs, by guaranteeing or providing venture capital. Specific public support schemes are aimed at correcting market failures.⁴

Education and Training

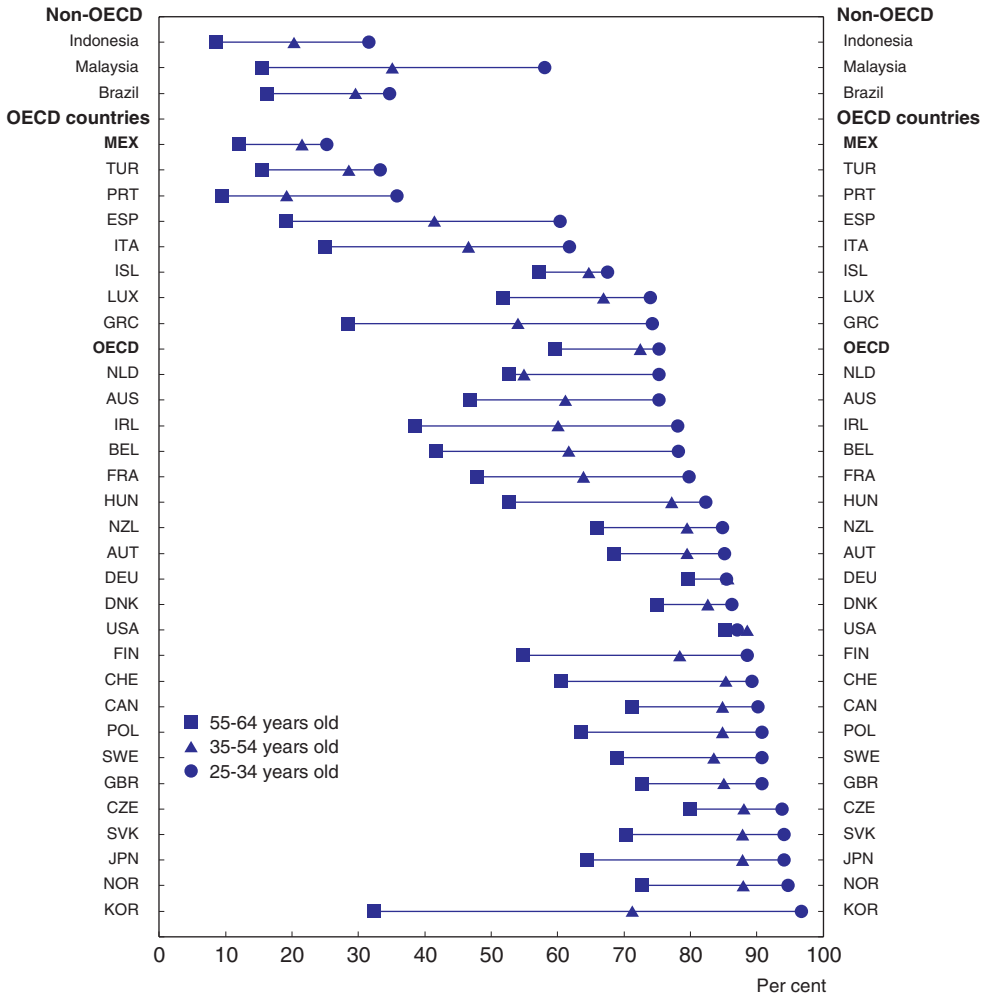
*Improving the performance of the educational system is a priority*⁵

Very rapid population growth means that a high proportion of the Mexican population is currently of school age, with close to 30 million students, or nearly one third of the population, enrolled from preschool to upper secondary education in 2001. This means Mexico faces a greater challenge in meeting the educational needs of its population than other OECD member countries, but can also potentially reap greater rewards from improving its educational system.

Human capital in Mexico is the lowest in the OECD and the educational system does not perform well enough to reduce this lag at an acceptable pace. Over the past decades, Mexico has made immense progress in increasing school enrolment, and there has been a deliberate increase in public spending towards education. However, while the volume of educational services has increased, there are doubts about whether the additional funding is actually delivering the expected improvements. Both the coverage and quality of educational services remain far behind OECD best practices even though, on paper, average teacher-pupil ratios are appropriate. Mexican children still spend comparatively few years in formal education, and do not benefit from it as much as they should. Consequently, poor educational attainment, and thus poverty, is reproduced from one generation to the next (Figure 2.7.). Many children, especially the poor ones, still leave school before completing compulsory education and drop-outs have poor literacy and numerical skills.

Figure 2.7. Educational attainment of the working-age population

Population with at least an upper-secondary qualification, 2003 (1)



Note: 1. Percent of each age group. 2002 for Czech Republic, Iceland, Italy and Netherlands.

Source: OECD, Labour Market Statistics Database.

Educational resources need to be better allocated, and a higher proportion of spending should be directed to non-wage items. Teachers' pay absorbs a high proportion of total educational spending by international comparison, while spending on infrastructure and teaching aids is low.

While low in absolute terms, teachers' wages relative to GDP per capita are among the highest in the OECD. This is usual in lower and middle income countries, but in Mexico, the ratio is among the highest in Latin America. A larger proportion of future spending needs to be directed towards non-wage items.

Value for money could be improved. Actions are needed to: *i)* further improve the selection and training of teachers; *ii)* introduce teaching standards that foster comprehension skills and communication; *iii)* better match curricula with student and labour market needs; and *iv)* find alternatives to the systematic use of class repetition, which is an inefficient way to correct lags in learning. Mexico has yet to introduce policies to enhance efficiency, to create credible sanction/reward mechanisms for teachers and principals, and to give more responsibilities to schools so that they can better adapt to local conditions and needs.

The authorities at the federal government and state level are aware of the weaknesses of the educational system, and some reforms have been launched to improve its performance and accountability. However, these efforts are spread across many programmes that have sometimes conflicting priorities. In some states, interesting experiments are taking place to improve quality and efficiency, reflecting successful negotiations with the local sections of the teachers' union. The next step should be to evaluate these experiences and to find ways to generalise the most successful ones to other states. To facilitate implementation, the required reforms should be launched as a package: mixing measures with an immediate and visible impact with deeper reforms to enhance efficiency and quality that will have more diffuse benefits, but which are more likely to raise opposition. Well-informed parents could also contribute to these efforts by putting pressure on authorities and teachers for a higher quality education for their children.

Addressing weaknesses in the transition from school to work

In addition to the shortcomings of the general educational system, the transition between school and work also presents some weaknesses. The performance of technical, technological and vocational education varies across the various systems of professional schooling: the national technical professional school (Conalep), the upper secondary technological centres (CBTIS) and the upper secondary technical agricultural centres (CBTAS).⁶ Reforms were launched in 2004 to match better the curricula of these institutions with the educational needs of the productive sector and the needs of students who do not find jobs matching their skills once they have finished school. In general, OECD experience shows that close interactions between professional schools and the business sector are appropriate.

Further efforts aimed at improving the attractiveness and quality of technical and vocational education will be needed. And apprenticeship, which is almost nonexistent in Mexico, should also be developed.

Enhancing adult training

Due to the large share of the population with low educational achievements and the low competence level of the workforce, adult training is key in providing opportunities to acquire new qualifications for current workers. International experience shows that there is generally a significant positive impact of training on wages, especially so for workers with low qualifications. However, Mexico, like several other countries in the OECD, has a low training culture: only a small share of employees, often the most qualified workers and employees of larger firms, are involved in adult training. On the other hand, the least-educated employees are the most in need of training programmes and post-school education. Although they have been able to find jobs, they risk being less adaptable and may restrain future growth in a changing environment.

The lack of innovative processes in firms may reflect to some extent “old style” management. This problem, which affects the business sector broadly, is perhaps more acute in SMEs since they cannot afford to pay the salaries required to hire highly qualified managers. To address the lack of qualified managers in SMEs, OECD countries have acted differently, relying to various degrees on private initiatives or public support.⁷

Labour Market Issues

Informal activities are widespread and have been expanding in recent years (Chapter I), partly reflecting poverty and the lack of basic skills in a large share of the population. In the absence of unemployment insurance, it acts as a buffer in economic downturns or when the farm sector is hit by a shock. However, other factors also come into play. First, non-wage labour costs, in particular social security contribution rates, are relatively high for employees at very low salary levels.⁸ As a result, the “cost of formality” for those workers is higher. If benefits provided by the IMSS as a counterpart are valued less than the contributions, and the non-insured population also benefit from minimum services, workers have little incentive to join the formal sector. Second, employment protection legislation is relatively restrictive, especially for temporary contracts.

In many countries, temporary contracts are used to provide flexibility to the labour market, when employers and employees are reluctant to engage in permanent contracting. However, the informal labour market provides

flexibility in Mexico, where the absence of a probationary period compounds the reluctance of employers to hire on permanent contracts. Easing regulation on temporary contracts would facilitate hiring in the formal sector. Third, administrative requirements for setting up a business remain complex, despite ongoing progress to simplify the processes, exemplified by the SARE (see below). Fourth, there are weaknesses in tax controls and labour inspections, which typically focus on large taxpayers. More stringent controls will not suffice, but it should be part of the solution.

A reform of labour market legislation was proposed in 2002, which included some measures that would have made hiring more attractive for employers in the formal sector: *i*) the introduction of probation periods; *ii*) first steps in easing regulations on permanent contracts by giving some flexibility on working hours; *iii*) simplification of administrative requirements for SMEs; *iv*) measures to promote workers' training, making working under a formal contract more attractive to employees. However, this 2002 reform was not approved.

It would it be appropriate to put the labour market reform back on the policy agenda. A comprehensive reform should include additional elements conducive to increasing formal employment - for instance easing overly strict regulation on atypical forms of employment (short-term contracts or part-time work).

Infrastructure needs to be improved

Regulatory obstacles to private investment and FDI persist in some sectors...

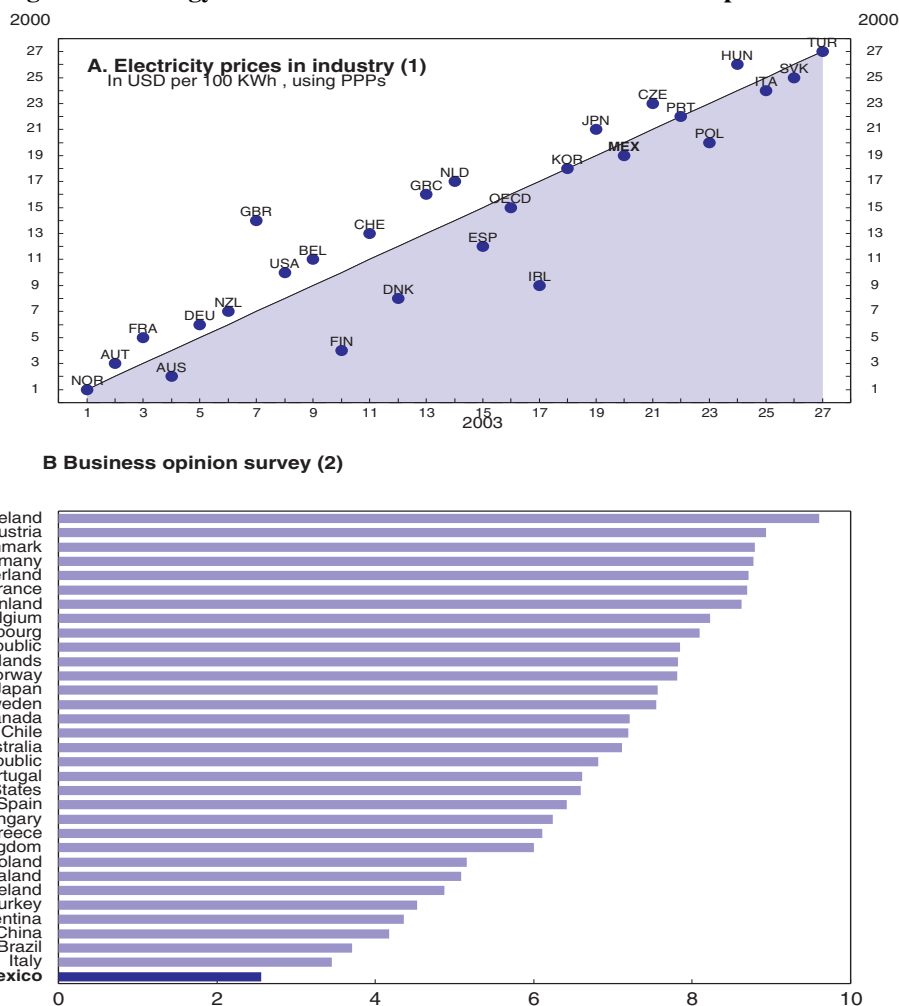
Although demand for electricity has been met and the frequency of power cuts has declined, prices for industry users in 2003 were relatively high relative to other OECD countries and continue to be so (Figure 2.8.).

To meet expected demand, the electricity sector will require large scale investment for expanding and modernising the transmission and distribution network. Removing legal obstacles to private investment in the electricity sector would help to ensure that businesses and households have access to a low-cost and reliable energy source.

The on-going privatisation project in the airline industry limits foreign ownership to 25%, which is at the low end of OECD countries and is well below the level required to ensure national control. This implies that the Mexican airline sector is missing opportunities to benefit from spill-over

effects usually associated with FDI. Although there was some interest shown by foreign investors in 2005, no sale has occurred yet.

Figure 2.8. Energy infrastructure indicators: International comparison



Note: 1. Ranking for 29 OECD countries excluding Canada, Iceland and Sweden. Countries in the shaded area have below average progress. Although comparable data are not yet available, several OECD countries have recorded substantial declines in electricity prices since 2003, the latest decline in Mexico occurring in January 2005 for both industry and household use.

2. "Is the energy infrastructure is adequate and efficient?" Value 10 indicates the most positive perception.

Source: IEA, Energy Prices & Taxes database; IMD World competitiveness Yearbook 2004.

... and effective competition is lacking in others

There are also sectors that are, in principle, open to competition, but where the application of the law is impaired so that there is no effective competition. If Mexico is to maximise the potential gains from having an open economy, including its participation in NAFTA, it needs to improve transport and communication infrastructure. Transportation costs (railroad freight transportation, inter-modal transportation, ports) greatly affect the business environment and, in particular, SMEs. For instance, gains achieved through port reform in terms of loading and unloading time have been undone through the counter productive long waiting times for trucks and trains.

In rail freight transportation, the restructuring and privatisation process in the late 1990s has made the sector more productive, but inefficiencies are still restricting the use of rail transport. Because of the initial costly structure discrepancies and the lack of clear, objective regulations, the private concession holders have been involved in serious disputes. Some have undertaken anti-competitive practices, *i.e.* setting excessive and discriminatory rates, limiting access conditions and refusing to provide interconnection and right of way. The Ministry of Communication and Transport has been unable to resolve the disputes between the private railroad companies and stop anti-competitive practices. The companies under investigation by the Federal Competition Commission (CFC) are using judicial procedures (*amparos*⁹) to avoid the resolution of the dispute. Enforcement of the competition law will not suffice to solve the problem. The regulatory framework should be reviewed across the board in order to resolve the weaknesses in the original regulations.

An important problem in road infrastructure is the lack of coordination between the states and the Ministry of Communication and Transport. Inadequate coordination and lack of division of responsibility between the different levels of government creates problems in the planning of the networks and contributes to the poor maintenance of existing roads. Mexican ports, which were privatised in the late 1990s, suffer from efficiency problems and are relatively expensive by international comparison. Poor coordination in customs, sanitary controls and other formalities are important factors contributing to the high costs of handling and storage.

Despite large declines in telephone charges in past few years, Mexico remains one of the OECD countries with the highest charges. Although the number of users has been increasing rapidly, the density of services (for the combined fixed and mobile telephony) is one of the lowest in the OECD. Similarly to the other infrastructure sectors, many of the difficulties slowing

the development of effective competition in the telecommunications sector stem from the abusive use of *amparos* to block the implementation of decisions by regulators and the CFC.

Competition Policy

Set up in the early 1990s, the competition authority has been playing an increasing role in promoting competition-oriented markets. But the general public is still not aware of the benefits of competition. Also, competition criteria are not sufficiently taken into account in designing public policy. After an extensive period of analysis and consultation with the private sector, amendments to the Competition Law were approved by Congress in April 2006.

The reform addresses three main weaknesses in the former law. First, it corrects legislative gaps and shortcomings, clarifying the CFC procedures and streamlining merger notification. Second, it strengthens the Commission's powers (*e.g.* a leniency programme became enshrined in law and fines were increased to lead to a stronger deterrent effect). Third, it strengthens the compulsory nature of the CFC's opinions on government action in regulated sectors and grants the Commission the power to investigate restraints to local trade. The reform of the legal framework, by clarifying the Commission's procedures, gives added legal legitimacy to its investigations and its opinions (whereas, in the past, some opinions were challenged and deemed unconstitutional).

Notes

1. OECD (2005), (2004), (2003), (2002), OECD Economic Surveys: Mexico, OECD Publications, Paris.
2. This section is based on OECD Economic Survey of Mexico, 2005 and previous issues.
3. For further details, see Bonturi (2002), “The Challenges in the Mexican Financial Sector”, OECD Economics Department Working Paper, No. 339, August.
4. Government financial support for SMEs is reviewed in the following chapter on SME specific policies.
5. For further details, see Guichard (2005), “The Education Challenge in Mexico: Delivering Good Quality Education to all”, OECD Economics Department Working Paper, No. 447, September.
6. In general the term vocational schooling corresponds to lower secondary education, while technological classes are in upper secondary levels.
7. For instance, in France, some SME managers have formed an association setting up small groups for cooperation and exchanging experiences in all the domains of competences relevant to directing a firm. In Portugal, public support is given more importance, with the introduction of a public programme to develop management training in enterprises of 50 or less employees
8. Employers' contributions are higher for employees earning less than the "average production worker", who are also those with lower-than-average productivity.
9. These are cumbersome appeal proceedings that are widely abused in Mexico. Typically, excessive use of "amparo" proceedings has blocked competition law enforcement and undermined the effectiveness of regulations, with detrimental impact in the telecommunication and railroad sectors for instance. See Annex 3.A3 in 2005 OECD, Economic Survey of Mexico.

III. SME Policy and Programmes

Mexico's labour productivity has risen more slowly over the ten years prior to 2004 than in any other OECD country, notwithstanding relative economic stability. This is a paradoxical outcome for a country with low per capita income and correspondingly large catching-up opportunities. As a result, the level of labour productivity has remained at the lower end of the OECD spectrum.¹

One of the reasons for this disappointing outcome is limited productivity gains in the SME sector. The disparity is extremely large between the competitive and export-oriented, 6 700 large enterprises and the often unprofitable and inefficient, 4 million SMEs. Across the spectrum of SMEs, employment and productivity are positively correlated with each other, implying vast disparities of productive efficiency within the SME population. Indeed, educational attainment, organisational know-how, credit availability and capital equipment are unevenly distributed among SMEs.

In all countries, the diversity of the SME population presents special challenges for SME policy makers. In Mexico, however, this is further exacerbated by regional disparities and by unfavourable framework conditions, most of which affect the economy at large and fall outside the area of direct SME policy responsibility. These include inefficiencies in the banking sector and the education system, rigidities in labour markets, inadequate physical infrastructure, and cumbersome tax and regulatory systems.

The Policy Context Surrounding the SME Sector

Before 2000, no coherent and comprehensive policy framework existed to support SMEs. Although some programmes targeted SMEs (Box 3.1.), overall SME policies suffered from inadequate coverage, lack of evaluation and insufficient co-ordination.

In recognition of the severe structural deficiencies in its SME sector, Mexico designed in 2000 a new framework policy aimed at achieving an integrated and competitive SME sector along with a balanced regional

development. The 2000 Entrepreneurial Development Plan (EDP), created within the National Development Programme (NDP) and covering the 2001-06 period, has served as a central axis of the government's new economic policy. The new focus on a coordinated strategy to help SMEs partly builds upon earlier measures.

Box 3.1. Selected programmes in favour of SMEs prior to 2000

Prior to 2000, measures to help SMEs with a view to increasing the productivity and competitiveness of the productive system included:

- For occupational training, the Quality and Modernisation Programme for SMEs (CIMO), done in collaboration with the Ministry of Education and the Ministry of Labour and Social Welfare, which has been aimed at providing technical support and financial assistance.
- A specific programme for technological development in SMEs, drawn up jointly by the Education Ministry and the National Council for Science and Technology (CONACyT), with the purpose of helping SMEs to access new technologies. The private sector is involved in the provision of training services.
- A broad ranging programme for industrial policy and foreign trade (PROPICE, 1996-2000), under the responsibility of the Ministry for Economy (previously Ministry for Commerce and industrial Development), especially targeting measures to improve the quality of Mexican production and encourage the development of enterprise clusters with greater micro enterprise and SME participation. The objective was to promote the competitiveness of Mexican industry on international markets by diversifying to products with a greater technology content.
- The National Committee for Productivity and Technological Innovation (COMPITE) started up in 1997 to provide targeted counselling for micro-firms and SMEs, with a view to helping them to apply more efficient manufacturing methods and thus improve their productivity.
- The Mexican Entrepreneurial Information System (SIEM), a website providing information and online advice for SMEs, similar to those that exist in most OECD countries. Its role has been to circulate information on the formalities involved in setting up a company and on government aid schemes, and to provide companies with self diagnostics tools.

Source: Economic Survey of Mexico, 2002.

Being comprehensive and flexible, the new *Federal* policy approach favours the removal of impediments to entrepreneurial activity in general rather than selective intervention, the preferred policy tool of the past. The new policy framework essentially rests upon building consensus and spurring collaboration among the main stakeholders, including educational and research institutions, business and industry associations and local governments. Due to the progressive implementation of new and innovative programmes, the number of SMEs receiving support from SME programmes has risen steadily, reaching an estimated 254 000 firms in 2006 (about 6 percent of the total SME population) compared to 13 000 in 2000.

The EDP calls for stakeholders to co-operate and develop joint strategies for the business sector, including SME-specific policies. With this aim in mind, the federal government has put in place mechanisms to improve participatory processes and vertical and horizontal policy coordination. In the process, administrative powers have been decentralised, opening up space for state and local governments as well as to other intermediaries to tailor the design and implementation of SME-policy projects.

The EDP initially laid out six strategies for SME promotion (‘strategic support lines’): *Easing access to finance; promoting innovation and technological development; improving managerial and employee skills; providing a favourable legal and regulatory environment; developing industry in terms of specific regions and sectors; and strengthening the presence of SMEs in domestic and external markets.*

In accordance with this mandate, the newly created Under Ministry for Small and Medium Enterprises (2001) developed new SME policy instruments, including three support funds (*FAMPYME*, *FIDECAP*, *FOAFI*) and two programmes (*FACOE* and the *Programa Marcha hacia el Sur*). The support funds were subsequently consolidated to become the SME Fund (*FONDO PYME*). Annex 2 presents the calendar of major SME policy events since 2000.

The SME Fund, run by the Under Ministry for SMEs, serves as the federal government’s main tool to shape and implement SME policy. By 2005, 13 programmes had been implemented, grouped around four major ‘action routes’: *innovation and firm creation; access to finance; production networks; and access to foreign markets* (Box 3.2.). These 13 programmes are the core of the “integral economic policy for the development of SMEs”, a key component of the Mexican government strategy towards an innovation-based growth model that implies, to a large extent, increasing SMEs’ productivity through technology and innovation.

Box 3.2. The strategic support programmes for SMEs (2005)

Creation and strengthening of firms' innovation and technological development

1. The Programme for Innovation and Technology
2. The National System of Business Incubators
3. The Business Development Centres Network
4. The Programme for Training and Strengthening SME Capabilities

Financing access

5. The National SME Guarantee Programme
6. The National Financial Extension Programme
7. The Capital for Development Schemes

Regional and sectoral productive articulation

8. The National Network of Productive Articulation
9. The National Programme of Suppliers Development
10. The Programme for Strategic Productive Projects

Access to foreign markets

11. The *Impulsoras* Programme for Exportable Offer
12. The Programme for Commercial Missions
13. The PYME*Exporta* Centres' Network

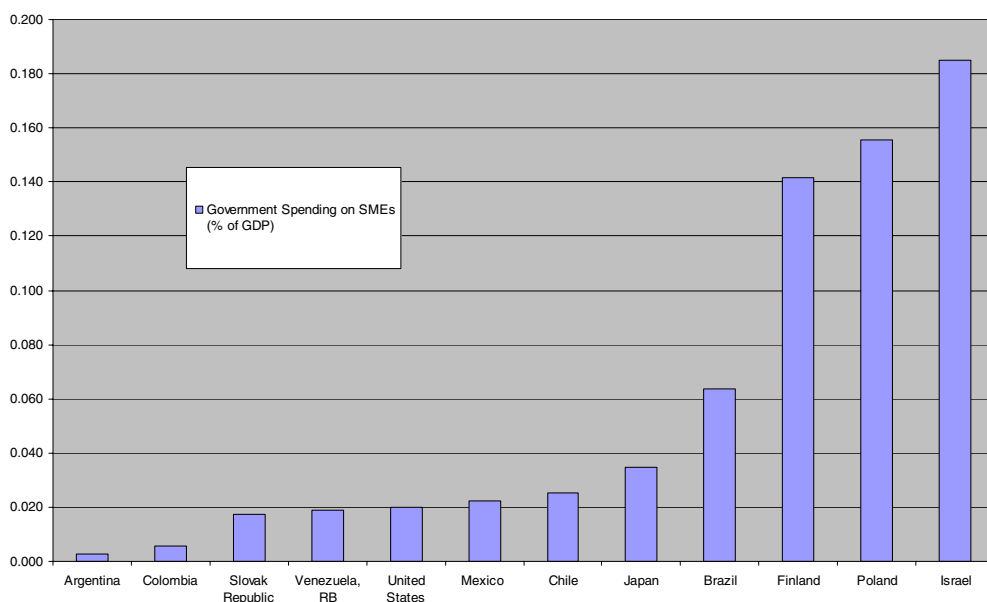
The initial budget for the SME Fund in 2004 of USD 106 million was subsequently raised to USD 167 million in 2005 and an estimated USD 200 million in 2006. The federal government thus spends no more than four US dollars, on average, for each unit of its SME population, a small amount by international comparison (see Figure 3.1.). This is to a large extent due to a tight budget constraints and competing needs for public spending (on basic education, health care, and poverty alleviation) in a country with a low tax/GDP ratio.

While the number of projects supported by the SME Fund appears to be relatively low (947 projects by October 2006), the reach of its activities is leveraged through the participation of intermediaries. In fact, the SME Fund is matched by other funds from state governments or 'intermediary

organisations'. The Fund supplies no direct funds to SMEs, dealing exclusively with sub-national governments and associated intermediary organisations, which often bring additional resources to specific projects.

In 2006, the SME Fund financed several types of programmes. Those related to financing, including seed capital and guarantees, absorbed 29 percent of total funding. About one half of total resources were used for sectoral and regional productive programmes, one fifth was allocated to company start-ups, technological development and innovation (including incubators and training), 5 percent was dedicated to access to foreign markets, and the remainder (one percent) for events and promotion.

Figure 3.1. Central government spending on SME programmes as a percent of GDP (2005)¹



Note: 1. The data are not strictly comparable cross countries.

Source: OECD Working Party on SMEs & Entrepreneurship (WPSME) for OECD countries and Angelli and Moudrey (2006) for non-OECD countries.

Initial Policy Emphasis upon Access to Finance

The thrust of policy action has initially focused on lessening the severe financial constraints encountered by the myriad of micro firms and larger SMEs. Micro finance was viewed as a key route to providing firms with

credit funds that normally have no access to traditional banking (e.g. self-employed and shopkeepers). Highlights of these measures are:

- 2001** Adoption of the Popular Savings and Credit law (*Ley de ahorro y credito popular*), the establishment of the National Guarantee System (*Systema Nacional de Financiamiento a PYMES*), and the introduction of securitised notes (*Certificados Bursátiles*);
- 2002** Creation of *BANSEFI*, the popular sector's central bank extending micro credits and *FOAFI*, the financial support fund for SMEs;
- 2003** Reform of the legal framework governing the extension of collateral and expeditious judicial processes;
- 2004** Creation of the SME-Fund (*FONDO PYME*) and the National Financial Extension Programme (*Red Nacional de Extensionismo Financiero*), a financial assistance network;
- 2005** Preparatory steps to establish a new securities market, attracting equity funds for medium-sized enterprises;
- 2006** New stock market law.

This policy approach has been underpinned by administrative and institutional action exemplified by the creation of the Under Ministry for Small and Medium Enterprises within the Ministry of Economy (2001), the reactivation of the National Council for Micro, Small and Medium-sized Enterprises (2001) and the establishment of the SME Observatory (2004). Other major policy initiatives included the 2002 Law for the Competitiveness and Development of SMEs (*Ley para el desarrollo de la competitividad de la micro, pequeña y mediana empresa*) aimed at fostering SME creation, sustaining SME growth, and increasing SME participation in domestic and foreign markets through productive global value chains. In line with these aims, the government also put into operation the *SARE* (Enterprise Rapid Opening System) in 2002.

Subsequent Policy Emphasis on Innovation

The creation of both the SME Fund (2004), integrating four support funds created in 2001-02, and the 'Fund of Funds' (2006) for long-term equity funds and venture capital (2006) coincided with a shift in focus in Mexico's SME policy. The new *innovation-based* policy approach strives to

speed up progress to achieve higher levels of SME productivity, value added and competitiveness.² Three principal avenues used to spur innovative activity were entrepreneurship encouragement, collective efficiency promotion and the application of a systemic model for economic growth.

Building on concepts and recommendations in the Oslo Manual (OECD, 1999) and current innovation theory, the first strategy - *entrepreneurship encouragement* - distinguishes between five forms of innovation (market, product, process organisational, and business)³. It also seeks to identify the impact of innovation by distinguishing between *incremental* (marginal gains derived from improvements to an existing offer), *radical* (transitory monopoly of gains through accelerated obsolescence of an existing offer) and *technological innovation* (sustained income growth by displacement of a dominant technology offer).

Combining the five forms of innovation and the three categories of innovation impact yields a matrix, which serves as a framework for promoting, processing, reviewing and financing the innovation projects for different categories of SMEs. Clearly, the vast number of Mexico's micro firms requires a different policy response than the comparatively limited number of larger SMEs.

The second strategy, *collective efficiency promotion*, views social capital as a vital innovation asset, improving SME access to financial resources, infrastructure and knowledge services. Accordingly, the federal government has promoted the creation and strengthening of various institutions adopting the collective efficiency approach. This approach emphasizes the use of externalities and joint action by public institutions, trade unions, entrepreneurial organisations, groups of firms and universities, and other social and economic agents in the domain of local business programmes.

Under the collective efficiency approach, institutions seek to accelerate and broaden information flows, diffusing best practices, innovation tools and technology. The collective efficiency strategy is based upon the notion that firms can influence the local business culture, giving rise to trade relations and easing risks of innovation failures. Knowledge-intensive business services (interlinkers) create and strengthen a supportive environment for business activities through connecting firms with access to venture capital, skilled labour force, other experienced entrepreneurs, suppliers, customers, universities, communications infrastructure, and technical assistance.

The third strategy, *systemic model for growth*, recognises the productive and geographical diversity of Mexico's SMEs and promotes the application of a competitive SME policy. Different regions have different needs. Some of them may come up with innovative ways of spurring SMEs' competitiveness, with positive spillover effects for other regions.⁴ Diversity may thus give rise to knowledge transfers.

Four Groups of Strategic Support Lines

Under the new innovation-based SME policy, the 13 programmes have been integrated into a framework of four groups: innovation and firm creation; access to finance; production networks; and access to foreign markets. This framework is designed to be flexible, creating space for various funding lines (diversification). Potential combinations of programmes allow, in theory, for SMEs to be supported during all phases of SME life, beginning with the incubation of business ideas and innovation followed by productivity upgrading and value chain integration. Entrepreneurship and innovation can thus be encouraged in ways that respect the highly heterogeneous nature of Mexico's SME population.

Creation and Strengthening of Firms' Innovation and Technological Development

Under the new innovation-oriented policies, primary emphasis is placed upon firm creation and stronger performance of existing companies. To this end, the federal government has designed a set of four innovation-oriented programmes. Two of them (the Programme for Innovation and Technological Development and the National System of Business Incubators) seek to directly stimulate innovative activities via innovation laboratories, business incubators and business accelerators. The other two programmes (the Business Development Centres Network and the Programme for Training and Strengthening SME capabilities) strive to augment SMEs' capacities to absorb new technology.

The Programme for Innovation and Technological Development

The *first* pillar of innovation-oriented SME policy is the Programme for Innovation and Technological Development. Designed after the establishment of the SME Fund in 2004, this novel programme directly supports innovative and R&D activities by reinforcing SMEs' ability to absorb and access new technology and specialised knowledge. About 125 enterprises (of a total of 592 which applied) have benefited from this

programme in 2004-06. Prior to the creation of the SME Fund, there were 134 different support schemes for SMEs, with none of them directly focusing on R&D and innovation activities.

The newly created support lines for innovation in the Programme for Innovation and Technological Development strive to create links between SMEs and principal centres of applied research and technological development. These lines of actions mainly concern mature and fast-growing SMEs. Sustained expansion of such firms often requires linkages with national and international networks. To this end, it proposes two main sub-programmes, the creation and expansion of business accelerators (*Aceleradores de Negocios*) and innovation laboratories (*Laboratorios de Innovación en Nichos Especializados*). Other sub-programmes include incentives for inventors, *inter alia* supporting R&D, building of prototypes, and registering intellectual property. Under another sub-programme, enterprises benefit from financial support for product, process, organisational and market innovation.

Business accelerators are all those organisations, institutions and specialised enterprises that are capable of identifying, assisting and financing technically-oriented SMEs during their expansion phase. In this capacity, business accelerators help such firms strengthen innovative efforts, conquer new markets at home and abroad, attract business angels' investment capital and become part of international value chains.

Assisted by the Programme for Innovation and Technological Development, an infrastructure of business accelerators has gradually emerged since 2004 consisting of six national units, three privately run accelerators, two units run by institutions of higher education, and four international accelerators.⁵

Innovation laboratories are run by institutions of higher education and centres of applied research. These institutions act as service providers to firms, not only assisting them in R&D, but also providing specialised technical support to help SMEs innovate products and processes. In 2005, the Programme for Innovation and Technological Development led to the creation of a network of laboratories specialised in the design, prototyping and testing of micro electronic mechanisms-MEMS (*e.g.* States of Puebla, Chihuahua and Mexico City). It also promoted the transfer of technology from large to smaller firms in the automobile industry and underpinned the formation of clusters for robots and automation. Overall, investment in innovation laboratories totalled about USD 8 million in 2005-06, nearly two thirds of which were financed by the SME Fund.

The National System of Business Incubators

The average life time of a Mexican SMEs is short, with at least 50 percent of newly created enterprises going out of business after two years. Partially inspired by the success of foreign incubator programmes, the federal government launched in 2003 a programme aimed at creating, intensifying and promoting a national network of business incubators. This system represents the *second* pillar of innovation-oriented policies. Prior to 2003, no policy initiative had been taken to systematically help entrepreneurs to create their firm. The generation of business incubators thus became an integral part of Mexico's new entrepreneurship and SME policy.

The incubator programme provides a wide range of support services, including feasibility studies of market opportunities as well as administrative services providing offices, skilled labour and information about access to finance and new technology. There are three categories of business incubators. The *traditional* variant assists the birth of firms in traditional sectors with well-known material and immaterial input requirements. The usual incubation period for this category is about three months and at most six months.

The second variant, *intermediate* technology incubator, assists the birth of firms requiring knowledge inputs from specialised institutions, large firms and strategic innovation networks. The usual incubation for this category is about twelve months and at most 18 months.

The third variant of *high technology* incubator assists the birth of firms in the domain of information technology, biotechnology, microelectronics, wireless technologies, robots and automation, nanotechnology and new, high-quality materials (*e.g.* ceramics). The usual incubation period for this category is about 24 months.

The incubator programme distinguishes between four types of assistance: the identification of the business model; equipment (offices, computers, training, but excluding transportation); infrastructure (excluding construction); and consultations during all stages of firm creation. Incubators, which are often sponsored by universities, are expected to become self-financing after a start-up period of three years.

Since its inception to October 2006 (over the 34 months period), the incubator programme created 254 business incubators, the greater part of which specialises in the use of intermediate technology (Table 3.1.). The incubators, in turn, induced the creation of 10 042 firms in the same period, more than half of which use intermediate technology. High-technology firms account for only 1.5 percent of the incubator-induced new business population.

Table 3.1. Business incubators and enterprises

		2004	2005	2006 ^a
Incubators	Total (cumulative)	95	196	254
<i>of which</i>	Traditional firms	25	63	85
	Intermediate technology	64	124	152
	High technology	6	9	17
Enterprises	Total	2 113	3 144	4 785
<i>of which</i>	Traditional Firms	588	1 418	2 171
	Intermediate technology	1 482	1 691	2 486
	High technology	43	35	128

Note: (a) Until October 2006.

Source: Under Ministry for Small and Medium Enterprises, Ministry of Economy.

To ensure the continuity of the incubator programme (independent of governments), the National Council of Business Incubators (*Consejo Nacional de Incubadoras de Empresas*) was established. This council is autonomous and acts as a ‘window’ for obtaining information about business incubators.

The Business Development Centres Network

The *third* pillar of innovation-oriented policies is the Business Development Centres (BDC) Network. Under this programme, the federal government has taken measures aimed at rendering the operations of business development centres (*Centros de Desarrollo Empresaria, CDEs*) more efficient. CDEs are locally established units providing a wide range of basic and more sophisticated support services for SMEs.

CDEs generally provide ‘business solutions’ but no entrepreneurial training. Loan requests are drawn up upon the assessment of a firm’s needs. CDEs represent one of the major SME policy tools that directly act upon impediments to higher levels of SME competitiveness. Services rendered by public CDEs are free of charge, whereas private CDEs charge a moderate fee.

Sponsored by the chambers of commerce and industry, CDEs have been developed since 2001 as part of the EDP and currently number 155. About 55 percent of these centres are located in the central region around Mexico

City, 30 percent in the northern region and 15 percent in the south-eastern region

The Centres are based in state and local governments, as well as entrepreneurial associations, chambers of commerce and educational institutions jointly participating in their creation. The local dimension has naturally given rise to a great variety of CDEs, displaying large differences in the nature of support services, in the provision of such services as well as in their own administrative functioning.

Since 2004, the *CDEs* are subject to systematic monitoring by the SME Fund administrators. In line with recommendations made by experts from the European Union, the SME Fund has taken initiatives to issue terms of reference for what constitutes a ‘standard’ CDE and what constitutes ‘standard or ‘required’ operations. These efforts of harmonisation seek to raise the efficiency of individual Centres as providers of support services. In addition, they also seek to create conditions apt to create an effective *network of CDEs*. Such a network is likely to trigger mutual learning processes based upon information exchange.

In pursuit of this aim, the SME Fund has encouraged the formation of pilot groups exchanging views about how to run themselves more efficiently as well as about how to employ e-learning and the internet as a platform for spreading SME training programmes. In May 2006, one pilot group with 25 Centres has begun the process of defining the terms of reference for a ‘standard’ *CDE*, while another one with 16 Centres has been exploring possibilities for creating e-learning platforms. A standardised management system has been drawn up and Centres are required to put it into place within four months, should they want to obtain operational authorisation from the Ministry of Economy.

Under this approach, the most dynamic *CDEs* can be identified, perhaps growing at a later stage into a strong nucleus of the *CDE* network. Early results confirm the usefulness of this approach; network links having grown stronger with the exchange of best practice experience. Members of pilot groups enjoy the automatic renewal of validation by the Ministry of Economy. Overall, the quality of *CDE* services is expected to rise significantly with better networking links between *CDEs* and local authorities.

The current programme run by the SME Fund distinguishes between two categories of Centres: conventional *CDEs*, which essentially provide basic support services to micro and small firms, and *CDE’s Plus*, which contribute to the creation of favourable framework conditions for innovative (high value-added) investment projects.

The Programme for Training and Strengthening SME Capabilities

The *fourth* cornerstone of newly grouped programmes (2005) that directly spur innovation and technological development is the Programme for Training and Strengthening SME capabilities. Its main purpose is the creation and upgrading of entrepreneurial human capital allowing a wider and deeper absorption of new technologies in all areas of entrepreneurial activities. These areas include managerial and administrative skills as well as marketing strategies. The programme primarily facilitates access to training for owners and managers, especially of micro firms.

Main actors implementing the programme at federal, state and local levels include the Ministry of Economy, state governments, training centres, chambers of commerce, and other institutional programmes and educational institutions. Through this programme, consultants provide systematic and methodological training to SMEs. Well-focused workshops and interviews with workers and managers, however brief, seems to have led to significant productivity improvements.

Limited entrepreneurial training was initially provided by *FAMPYMYE*, a support fund established in 2001 and subsequently integrated into the SME Fund. From 2004 onwards, new activities of the SME Fund broadened access to entrepreneurial training by making entrepreneurs aware of different possibilities to participate in networks, chains and entrepreneurial associations. In 2005, the range of available training programmes was widened further with the systematic inclusion of innovation as a principal aim of human capital upgrading. Training options came thus to be shaped in the light of their potential impact on different forms of innovations.

At the same time, the SME Fund also encouraged firms to participate in interactive processes of information and knowledge exchanges, thereby augmenting the collective efficiency of different SME groups. This kind of knowledge diffusion is expected to strongly improve the knowledge base of firms. As noted above, the new SME policy approaches views collective efficiency as a vital innovation asset.

In 2004-05, the Programme for Training and Strengthening SME Capabilities absorbed nearly 13 percent of financial resources of the SME Fund. The number of funded training programmes totalled 114 in 2004 and 95 in 2005. The Programme offers three categories of training: *conventional* training for administrative, commercial, financial and productive activities; *specialised* training for product and process innovations; and training the ‘coaches’.

The new organisation of training options for SMEs also strengthened ‘older’ training programmes for micro firms such as *PROMODE (Programa*

de Capacitacion y Modernizacion del Comercio Detallista) and *PROADA*. Since its inception in 1998, *PROMODE* has helped nearly one million persons to open retail shops (micro firms in commerce) or improve their functioning. The target for 2006 is to provide training support for 160 000 micro firms in the retail sector. Established in 1997, *PROADA*, in turn, offers training courses for groups of craftsmen, helping them in the design of new products as well as in the application of new methods of production and marketing.

Access to Finance

Under the Entrepreneurial Development Plan (EDP) for 2001-06, better access to finance has been a key lever for strengthening SME development, growth, technological upgrading and competitiveness. Accordingly, the Ministry of Economy, in coordination with sub-national governments and commercial banks, created a grid of support lines supplying guarantees for SME credits at reduced cost. Financial institutions and sub-national governments were called upon to create, modify and consolidate financial instruments capable of opening and widening SME access to finance. This policy evolved further with the adoption of an *innovation-based* policy approach which pursues three avenues towards better access to finance: The National SME Guarantee Programme, the National Financial Extension Programme and the Capital for Development Schemes.

The National Guarantee System

The initial building stones of this policy were the creation in 2003 of the National Guarantee System (*Sistema Nacional de Garantia, SNG*) and the establishment in 2002 of *FOAFI*, the Fund for SME Finance (*Fondo de Apoyo para el Acceso al financiamiento*). In parallel, the Federal Funds FIDECAP and FAMPYME were established in 2001-02 underpinning guarantee schemes at state level, often co-sponsored by the federal government. Subsequently, the National Guarantee System evolved into the National Financing System (2004) (*Sistema Nacional de Financiamiento de Micro Pequeñas y Medianas Empresas*), while *FOAFI*, along with three other funds, was incorporated into the newly created SME Fund (2005).

Pursuing the aim of enlarging the supply of affordable financial resources for all categories of SMEs, initially a two-pronged strategy was adopted. It created and promoted new financial instruments in the form of guarantee funds (*credit supply approach*), while, at the same time, upgrading the managerial and organisational capacities of SMEs (*credit*

demand approach). The capacity building programme became later known as the National Financial Extension Programme (see below).

This strategy also involved the strengthening of institutional links between the Ministry of Economy, sub-national governments and financial institutions, improving the efficiency of programmes and increasing leverage. The number of financial products offered by the Ministry of Economy rose sharply, while the portfolio of funding lines became much broader.

Within the National Guarantee System, the two most important guarantee programmes are the *FONDO PARAGUAS*, run by *NAFIN*, and the *GARANTIA SME programme*, run by the *FUNDES* foundation. The greater part of guaranteed credits are of a short-term nature, nine tenth of SMEs' credit demand serving the purpose of financing working capital.⁶

NAFIN, along with commercial banks, intensified financial intermediation efforts, simplifying procedures for guarantee payments, and thus making a larger number of SMEs eligible for bank credit. Notary and registration costs declined as a consequence. Credit transaction costs also declined with the use of parametric models and the better access to credit bureaus.

Under a novel programme, federal funds cover first losses on financial institutions' SME loan portfolio. A bidding process for guarantee funds was started in 2005, creating competition between financial intermediaries bent on obtaining guarantees for SME loans. The bidding links the amount of funds obtained to the leverage index and the interest rate (the higher the index and the lower the interest rate, the higher the funds obtained). This bidding procedure led to much higher SME credit/fund ratios (62 in 2006). In the previous institutional setting, with direct provision of guarantees, the leverage of SME Fund resources was much smaller, at about 2 pesos of credit for each peso of funding.

Following the 2001 Savings and Popular Credit Law, credit unions have been established to participate in guarantee programmes. The creation of *UNICRECE* (2003) played a key role in integrating financial intermediaries and reinforcing credit flows to SMEs at lower cost. Legislation relating to bank guarantees was also amended in 2003, improving mechanisms for recovery of collateral by lending institutions. Though improved, the new framework did not fully ensure the enforceability of contracts, as legal proceedings remained costly and long. To facilitate the recovery of non-performing loans, the legal framework for secured transactions (*miscellanea de garantias*) was changed further in 2005.

The National Financial Extension Programme

The National Financial Extension Programme (*Red Nacional de Extensionismo Financiero*), the second cornerstone of policies aimed at increasing SME access to finance, was established in 2004. Conceived as a financial assessment net, it helps SMEs enter into credit relationships through the upgrading of their organisational and managerial faculties.

This federal programme covers two major phases of creditor-debtor transactions, the preparatory phase (prior to the actual extension of credits) and the first year of actual credit utilisation (credit surveillance). During the first phase, credit advisors assess the financing needs of SMEs, select the most suitable loan products and assist entrepreneurs in their credit negotiations. Through their nationwide network of branches, commercial banks help SMEs in the process of screening and improving credit applications. The National Financial Extension Programme seems to have contributed to lowering banks' risk perceptions, creating a supply of pre-approved SME credits. Costs of credit approval have declined as a consequence.

The National Financial Extension Programme expanded rapidly, reaching full nationwide coverage in 2006 (all 32 States are now participating in the programme). Six hundred professional credit advisors, authorised by the Ministry of Economy, helped process SME credit applications and monitor the subsequent use of credit funds; over 8 000 SMEs benefited from cost-free credit advice and surveillance in 2006 (0.3 percent of the SME population).

The Capital for Development Schemes

The third set of financial measures seeks to increase the supply of venture capital. Two sub-programmes primarily serve this purpose: the Seed Capital Programme (*Programa Capital Semilla PYME*), and the Fund of Productive and Infrastructural Development Projects (*FOPRODE*). Authorities also sponsor the creation of SMEs' investment clubs and other instruments to channel private venture capital to SMEs.

Under the *Seed Capital Programme*, financial intermediaries and incubators release capital funds for the creation of micro firms and small enterprises. The supply of venture capital ranges from USD 10 000 to USD 200 000, depending upon the nature of planned firm creation (traditional, intermediate and high-technology firms). This sub-programme targets potential entrepreneurs with little or no experience in entrepreneurial and financial activities. The seed capital programme started operations at the end of 2005 with a total amount of USD 10 million from the SME Fund.

The *Seed Capital Programme* injects capital under twin formulas of partnership capital and quasi-capital. Under the partnership formula, entrepreneurs remain owners of their newly created company. Seed capital is released for a period of up to four years, the business incubator being the business associate. Financial resources are disbursed to the business incubator centres, allowing them to enter into a contractual, strategic partnership with the entrepreneur. At the end of the contract period, profits and losses are shared in line with initial capital contributions.⁷ Success of these programmes largely depends upon business incubators and intermediate organisations providing adequate follow-up to the release of capital funds.

Under a variant of this programme, quasi-capital is provided in the form of a loan at a subsidised annual interest rate of 6 percent, the initial grace period of six, twelve or eighteen months depending on the nature of the planned enterprise (traditional, intermediate or high technology). This scheme can be operated by business incubator centres or financial intermediaries (non-bank banks). Requirements for own funds are 20 percent for firms in traditional sectors and 15 percent for firms in non-traditional sectors. Since the inception of the programme at the end of 2005, 302 SMEs and entrepreneurs have benefited from this programme.

The second sub-programme (*FOPRODE*) is a pilot project programme (2004) providing funds between USD 25 000 and USD 100 000 over a period of three to four years at a subsidised interest rate of 6 percent with a grace period of one year. *FOPRODE* mainly supports prospective innovative entrepreneurs with no proven entrepreneurial background, no credit file, no credit guarantees and no collateral. In 2005, *FOPRODE* assisted 200 firms with financial resources of USD 10 million. In 2006, the SME Fund resources available for this programme were doubled, rising to USD 20 million, with about 200 SMEs being likely to benefit from this scheme.

The *FOPRODE* programme is operated and managed by an intermediate organisation with national coverage, allowing local governments to participate. Local financial institutions are able to identify and evaluate projects as well as to formalise credit contracts, manage and recover credit portfolios. Investment proposals are received and assessed via an electronic window operating through internet.

Venture capital is also supplied by so called *SMEs' Investors Club*, which authorities help to convene. Such clubs are 'civil organisations' composed of investors intent on realising high rates of return on capital through investment in innovative SMEs. For individual members, investment clubs reduce operation costs and risks, and augment their

investment capacity. For entrepreneurs, investment clubs release private venture capital which is otherwise unavailable.

The recently created *PYME Option* (2006) is a unique type of investment guarantee designed to encourage the creation of investment clubs and venture capital funds geared towards investing in SMEs at early stages. Beneficiaries are SMEs engaged in innovative, high value added or export oriented activities, or clearly oriented towards integration in industrial chains. This programme offers investors flexible procedures to cover the risk in case of business failure. The amount of capital covered has a ceiling of USD 500 000 and a limit of 70 percent of investment projects, a duration coverage ranging from three to five years.

Regional and Sectoral Productive Articulation (networking)

Expanded and deepened networking (horizontal and vertical linkages) is an effective tool of upgrading SME activities. The underlying notion is that all levels of government and intermediate organisations share a joint responsibility for strengthening the performance of local SMEs. From this flows the need to establish an efficient web of connections between all stakeholders, including new links between states, municipalities and intermediate organisations (public-private partnership formulas). The vertical networking activities use both ‘top-down’ and ‘bottom-up’ approaches.

Three ‘network’ programmes serve this purpose: the *Network of Productive Articulation*; the *National Programme of Suppliers’ Development*; and the *Programme for Strategic Productive Projects*. Together, these programmes can generate ‘collective process innovations’, which help speed up the diffusion of innovation and new technologies. They also have the potential of fostering co-operation among different levels of government and of opening the way for tailor-made SME policy initiatives at local level, thus making SME policy more efficient.

The National Network of Productive Articulation

The first element of networking is the National Network of Productive Articulation. Established in 2001, this strategic line of SME support seeks to spur entrepreneurial and innovative activities by way of establishing horizontal and vertical links between all categories of SMEs (micro, small and medium-sized firms), government levels, institutions, intermediate organisations and networking centres.

The National Network of Productive Articulation is backed up by several stakeholders, using various sub-strategies and instruments. Between 2001 and 2003, the networking activities were mainly undertaken by the Fund for Integrating Production Chains (*Fondo de Fomento a la Integración de Cadenas Productivas, FIDECAP*). From 2004, the SME Fund, has been releasing financial resources for networking purposes at regional and sectoral level. These funds have acted as a trigger for extending and improving linkages between government levels, intermediate organisation and SMEs.

Four major instruments stimulate networking activities:

- Market studies, infra structural analysis and regional and sectoral impact analysis (*competitive intelligence*); 485 projects have been co-financed between 2003 and 2006.
- Creation and strengthening of ‘integrators’ which are enterprises with investment projects aimed at improving the infrastructure of industrial, commercial and services branches. The number of ‘integrators’ reached 558 in 2005, releasing positive spillover effects for nearly 14 000 SMEs according to authorities.
- Centres for Productive Articulation (*CAPs*), which are micro or small business units acting as a hub for rendering high value-added services to special branches of industry, commerce and services. There were 81 CAPs at the end of 2005.
- Sectoral networking based upon investment projects of representative organisations. In the domain of sectoral networking, financial assistance from the federal and state governments was mainly used for creating business associations and fora.

Initiatives for creating CAPs are mainly private. They may be taken by groups of entrepreneurs, private investors and intermediate organisations intent on strengthening the position of their industrial branch at home. CAPs may serve to create databases of potential customers for producers of well-defined products, allowing them to swiftly adapt production to changing consumer needs (market study approach). CAPs may also scrutinise investment projects of affiliated SMEs and upgrade entrepreneurial training (investment analysis). Finally, CAPs may act as sales outlets for special products (*e.g.* handicraft), thereby generating networks of micro producers.

Projects of CAP creation are thoroughly screened by authorities. If approved, they are based on different formulas of public-private partnership. Partnerships are essentially temporary, financial independence being the

medium-term goal. Under the terms of the partnership, authorities and/or intermediate associations provide financial assistance and closely monitor the activities of a CAP.

The National Programme of Suppliers' Development

The second vehicle of horizontal and vertical network building is the National Programme of Suppliers' Development (*SDP*). It is a programme created and supported by the United Nations Development Programme (UNDP), the Mexican National Association of Manufacturers (*Canacintra*) and the Mexican Ministry of Economy. Created in the mid-1990s, the National Programme of Suppliers' Development has helped form, on a voluntary basis, strategic alliances and permanent commitments between large firms and SME suppliers.

Supply chains are progressively built up from the initial stage of supply-chain promotion to the final stage of implantation. The network building or network improvement begins with the selection of ten suppliers or distributors and one big firm. For these pilot projects, the gestation period covers a period of eight to nine months. The subsequent consolidation phase and eventual network expansion may take up to three years.

Participation in the *SDP* requires identification of contact persons (leaders) in SMEs desiring to join the network. It also requires the signing of Collaboration Agreement with UNDP, which ensures productive interactions between suppliers, *SDP* 'leaders' and UNDP consultants. In 2005, there were 104 *SDP*-sponsored networks in Mexico, predominantly located in the northern and central regions of the country. Institutional network-building, involving several stakeholders seems to have enhanced the effectiveness of the *SDP*. The flexibility of institutional networking also allows adaptation to regional and local needs.

SDP programmes have been implemented in various branches of manufacturing, commerce and services sectors (big export firms, car producers, hotels, restaurants and hospitals). Creating supplier-client links requires a consultation methodology based upon international standards (ISO 9000:2000). Under *SDP* programmes, consultants receive standardised training, preparing them to give structured support to network candidates. For the networking of high-technology firms, a different methodology is followed. CAPs play a key role in training consultants and providing consultation services for potential and actual network members.

Opportunities for networking include the annual week for SMEs (a national event) and business fora organised throughout the year. These meetings are partly financed by the SME Fund. Close to 18 000 micro firms

have thus been able to establish first contacts with bigger firms and institutions in the 2004-06 period. The SME Fund has also supported the training of *SDP* consultants by matching private sources.

Programme for Strategic Productive Projects

The third axis of network building is the Programme for Strategic Productive Projects. In the authorities' view, attracting foreign investments and spreading them more evenly across the five Mexican regions or 32 states requires large investments in domestic (tangible and intangible) infrastructure. The underlying premise here has been that a coherent infrastructure represents a platform for attracting foreign direct investment, which subsequently allows a great number of micro firms to become part of local suppliers. The causality thus runs from building a local infrastructure with the help of local producers to attracting foreign clients becoming a nucleus of local producer chains.

The Programme for Strategic Productive Projects correspondingly favours innovative, strategic investment projects, such as industrial parks, productive chains, eco-tourism and commercial centres. Thanks to a special consultation system, five meso regions with high degrees of actual and potential cluster formation have been identified. Ancillary services of training and consultancy support the preparation and execution of investment projects in these regions. The Programme is also backed up by the National Network of Productive Articulation.

The Programme for Strategic Productive Projects distinguishes between two types of investment: productive projects and strategic projects with potentially strong impacts. Under the operating rules of the SME Fund, priority areas are the aeronautics, aerospace, agro-industrial, automotive, chemical, electric-electronic, leather, software and textile industries, as well as retailing.

Investment projects are usually designed by private investors under various forms of public-private partnerships and presented to the SME Fund for approval. In the period 2001-06, nearly 590 productive investment projects were carried out, providing help to nearly 135 000 micro firms. Government estimates put the number of jobs preserved or created at 34 000. Regarding the strategic projects with strong impacts, the SME Fund approved 18 such projects in 2004-06 worth USD 3.2 million and co-financed nearly one third of this sum (USD 1 million). About 860 micro firms benefited from these projects, creating 14 000 new jobs. At the same time, the SME Fund supported and co-financed 104 infrastructural projects, which were carried out in 28 Mexican states in 2001-05.

Access to Foreign Markets

The fourth group of SME-programmes is concerned with opening up access to international markets. Three programmes pursue this aim: The *Impulsoras* Programme for Exportable Offer; the Programme for Commercial Missions; and the *PYMExporta* Network. There are about 36 500 exporting SMEs in Mexico (one percent of the total SME population), accounting for 11 percent of total exports. Micro firms account for 26 percent of this subtotal, small firms for 45 percent and medium-sized firms for 29 percent. The predominant part of SME exports is directed towards the United States which absorbs 83 percent of Mexico's total exports and 95 percent of SME exports.

The “Impulsoras” Programme for Exportable Offer

The “*Impulsoras*” Programme for Exportable Offer strives to internationalise SME activities by way of helping SME exporters to diversify products and export markets. It also assists firms that want to start export activities. Help given under this programme is temporary and mainly consists of providing tailor-made consultancy and informing potential exporters about requirements for technical specifications, regulations, quality and pricing possibilities in foreign markets, predominantly the United States, Canada and Central America. In some cases, foreign-based consultants act as sales representatives and identify sales outlets for Mexican goods, e.g. introducing Mexican goods in chain stores abroad.

The programme has been drawn up, at the federal level, by the Under Ministry for Small and Medium Enterprises and the Ministry of Foreign Affairs in collaboration with states, two major public banks (*BANCOMEXT* and *NAFIN*), and entrepreneurial chambers and associations at the national and regional levels. Like other programmes described above, it performs a ‘trigger’ function, prompting states and local authorities as well as employers’ organisations into providing help for activating SMEs’ export potential. About two thirds of (federal) assistance is absorbed by SMEs with export experience, with the remaining third aiding those companies that want to start export activities. In 2005, over 6 000 firms participated in the programme, of which 1 200 started to export.

Programme for Commercial Missions

The second export promotion programme uses market studies as a means of identifying potential export markets. Commercial missions are subsequently organised either abroad or at home to arouse foreigners’ interest in Mexican goods and services. The export experience of large firms

is shared with potential SME exporters. The programme co-financed by the SME Fund provides systematic training and assistance for Mexican ‘salesmen’ on how to establish first contacts with potential foreign buyers.

The PYMExporta Centres’ Network

The third pillar of SME export promotion is the *PYMExporta Centres’ Network*, a sub-programme of the Impulsoras Programme for Exportable Offer. Under this programme, assistance is given to current and potential exporters by the Centres which help develop detailed export projects, taking into account the regulatory and specification requirements of foreign markets as well as the assistance criteria laid down by the SME Fund. The target group is SMEs that are or want to become exporters by either selling their products and services directly abroad or by selling them to large exporting firms. There are 22 Centres in Mexico and four abroad (United States, Japan, Spain and the European Union).

Pursuing this aim, the Centres’ Network uses standardised methodology for identifying, developing and consolidating export projects, taking firms through all stages from the beginning to the finalisation of export projects, including joint ventures. This also includes assistance for applying for financial and investment support from the SME Fund and other entities related to state governments and local authorities. The centres normally accompany nascent exporting firms over a period of two years.

Notes

- 1 OECD 2006, Economic Policy Reforms, Going for Growth.
- 2 Gonzalez Hernandez, Alejandro (2006), An Integral Economic Policy for the Development of Small and Medium-sized Enterprises in Mexico, Supporting Document, Mexico City.
- 3 Market innovation is defined as the development and introduction of new or improved ways to access markets, or the creation of new ones to supply goods and services. Product innovation is the development and introduction of new or improved goods or services. Process innovation is the development and use of new or improved methods and factors of production. Organisational innovation is the development and carrying out of new or improved efficiency and productivity plans inside an organisation. Business innovation is the development and investing on new or improved business models and plans.
- 4 . OECD (2004), Global Knowledge Flows and Economic Development, OECD Publication, Paris.
- 5 TechBA at Silicon Valley (California, USA), TechBA at Austin (Texas, USA) , TechBA in Montreal (Quebec, Canada) and TechBA in Madrid (Spain).
- 6 . OECD (2002), OECD Small and Medium Enterprise Outlook, OECD Publication, Paris.
- 7 The entrepreneur is also entitled to end the partnership before the contract expires. In this case, the refund of financial resources to the business incubator centre is augmented by an extra payment equal to 20, 30 or 40 percent of the capital contribution, depending upon the nature of the new firm (traditional, intermediate or high technology).

IV. Programme Evaluation

This chapter reviews the four major categories of SME policy (action routes): Creation and strengthening of firms' innovation and technological development; Access to finance; Regional and sectoral productive articulation; and Access to foreign markets. The 13 programmes (Table 4.1), the main elements of policy categories, are examined individually and collectively as it is important to determine whether all the programmes combined constitute a coherent whole best suited to meet the stated objectives of Mexico's SME policy. Best practices and SME and entrepreneurship policies pursued elsewhere provide benchmarks and references for evaluation. A summary of programme-specific recommendations is presented at the end of the Chapter, in Box 4.7.

Creation and Strengthening of Firms' Innovation and Technological Development

A new institutional infrastructure

Under the new innovation-oriented policies, the authorities have rightly placed strong emphasis upon building a coherent institutional infrastructure (collective efficiencies), with a view to stimulating the creation of new firms and strengthening existing ones. Partly inspired by international best practices, a coherent sequence of four institutional support units has been established, accompanying firms from the time of 'conception' to full maturity.

Business incubators (run by universities and research organisations) serve prospective firms in their pre-birth stage. The subsequent creation and expansion of firms can be underpinned by locally established business development centres (*BDCs*) (mainly linked to chambers of commerce and industry), business accelerators, innovation laboratories and training facilities for owners and managers of micro firms and SMEs. The organisational form of these support entities is flexible, often taking the form of public-private partnerships. Overall, the string of support units is closely compatible with an innovation-based policy.

Table 4.1. Programmes: Main targets & budget (USD)

Programmes	Description	2005	2006	Percentage of total budget in 2006
1. The Programme for Innovation and Technology	Introducing and diffusing innovative technologies. Raising SMEs' absorptive capacity of new knowledge.	15 117 565	15 254 303	7.78
2. The National System of Business Incubators	Creating a national network of incubators, linking academic and entrepreneurial activities.	5 819 676	6 003 670	3.06
3. The Business Development Centres Network	Enhancing the efficiency of micro firms.	2 293 601	2 366 068	1.21
4. Programme for training and strengthening SME capabilities	Improving human capital and fostering entrepreneurial culture. Diffusing efficient entrepreneurial strategies.	14 877 136	11 606 997	5.92
5. The National SME Guarantee Programme	Creating more favourable conditions in credit markets.	40 220 386	27 553 270	14.06
6. The National Financial Extension Programme	Reducing formal barriers to SME bank credit.	1 069 789	2 269 318	1.16
7. The Capital for Development Schemes	Enlarging the supply of equity capital for business start ups.	21 120 294	27 553 270	14.06
8. The National Network of Productive Articulation	Establishing and expanding regional & sectoral networks on the basis of variable public/private partnerships, so as to strengthen competitiveness.	39 706 152	58 210 874	29.70
9. The National Programme of Suppliers Development	Creating links between big firms and micro firms.	4 141 414	10 479 427	5.35
10. Programme for Strategic Productive Projects	Investment in tangible and intangible infrastructure.	19 825 528	26 184 791	13.36
11. The Impulsoras Programme for Exportable Offer	Fostering the internationalisation of SME activities.	4 306 017	3 814 555	1.95
12. Programme for Commercial Missions	Fostering the internationalisation of SME activities.	542 935	1 184 857	0.60
13. The PYMExporta Centres' Network	Fostering the internationalisation of SME activities.	1 341 352	3 535 683	1.80
Total Government Spending on SME Programmes		170 381 844	196 017 083	100.00

Note: 2006 Exchange rate is the simple average of the first two quarters in 2006.

Source: SME FUND (FONDO PYME).

Under a flexible and decentralised policy approach, a full range of optional policy support is offered covering specific needs of different categories of SMEs and related investment projects (traditional, intermediate technology and high technology). Implemented in co-operation with the Federal Regulatory Improvement Commission (*COFEMER*), the Enterprise Rapid Opening System (SARE) developed in 2002 helped reduce the complexity of administrative procedures and significantly reducing lead times. As such, it facilitated the creation of enterprises and made policy initiatives more effective.

The benefits flowing from the above institutional infrastructure have greatly risen with the establishment of horizontal networks.¹ Such networks induce mutual learning processes, augmenting the quality of services rendered by individual support units (“teachers teaching themselves”). Other welcome policy initiatives include the diffusion of standards for *BDC* operations and services.

Indicators of positive policy impact

The development of business incubators is a crucial component of any innovative enterprise policy. Various experiences from OECD countries show that incubators assist both in the creation and development of SMEs, and are also particularly important for innovative businesses.² The evidence from Italy³ shows that science parks serve to enhance the performance of firms. Evidence from other countries⁴ also suggests that good practice requires a combination of property and process factors. These have to be delivered by a management team committed to achieving success. Illustrations of each of these are set out in Box 4.1.

Over the 27 months period to March 2006, business incubators helped generate 10 042 firms (about six percent of the SME population excluding micro firms), more than half of them applying intermediate technology. Overall, the incubator programme has lengthened the average life of newly created firms, with 70 percent of them surviving an initial period of two years compared to a national average of around 50 percent. International business accelerators have lent momentum to 80 fast-growing enterprises (largely medium-sized firms) in 2005-06. Gains in total factor productivity also seem to have been achieved through well focused workshops and interviews. The number of managers, owners and workers participating in these activities has surged to 15 000 in 2006 from 2 000 six years earlier. Interactive processes of information and knowledge exchanges among SMEs (knowledge networking) have risen as a consequence.⁵ Finally, innovation laboratories have been introduced as an “institutional innovation”

to assist SMEs lacking the ability to undertake more complex innovation activities.

Box 4.1. Good practices for business incubators

- Maintenance of the building and the surrounding environment is crucial.
- Delivery of high quality, reliable central services, such as telephone answering, mailing, conference and meeting facilities.
- Technical support that may be either physical assistance or online support.
- The workspace needs to be flexible to enable businesses to expand if they wish to do so, but also to accommodate businesses of different sizes.
- Security for the business is vital.
- The process factors terms of occupancy should be flexible, with easy ‘entry’ and ‘exit’ conditions.
- Businesses learn from one another. The learning curve being steep for young businesses, meeting opportunities should therefore be developed. Experience shows that social interaction can lead to greater trading opportunities. Workspace managers can facilitate this interaction.
- A crucial managerial decision is on tenant duration. Commercial workspaces will focus heavily on achieving high occupancy rates. Those funded from public sources may place more weight on moving tenants out after perhaps two years so as to “free up” space for new businesses seeking their first property. There is a clear trade-off between commercial returns and social objectives that has to be recognised by policy makers.
- Tenant selection has to be undertaken to avoid clashes or to focus the workspace on particular “types” of tenant, such as those in the technology sectors.
- A critical consideration is the nature of business support to be provided to tenants. Some value this support highly, whereas others would prefer less support and a compensating lower rent. Normally, this is resolved by not including support services in the rent.
- Given the above considerations it is unsurprising that the most successful workspaces are a public-private partnership.

As regards to micro firms, they have benefited from special training programmes (*PROMODE*) enabling entrepreneurial candidates to set up small businesses as well as improving the running of existing units. Around the globe, firms of all sizes seek skilled, qualified and committed workers and managers to maintain competitiveness. Managers are also increasingly

mobile, even across borders, being well-informed about employment opportunities. In these circumstances, SMEs can feel threatened, being unable to compete with larger firms in terms of salary payments. They are also more reluctant to train managers in part because of a fear of poaching. In this context, Mexico, like many countries, has implemented programmes to support management training in SMEs (see Box 4.2.).⁶

Mexico's provision of basic training services seems to have been useful in speeding up firm creation and wiping out wasteful practices in existing micro firms. The estimated number of micro firms receiving basic training support in 2006 was 160 000 (four percent of the micro firm population in the formal sector). Beyond that, business incubators are being designed to create an entrepreneurial culture in poor rural areas where micro firms abound.

Box 4.2. International experiences with training programmes for strengthening SME capabilities

- The Dutch government programme *Profijt van Mensen Kennis* seeks to make SMEs human resource management (HRM) activities more professional. Under this programme, SME owners become more aware of the importance of skilled personnel. It combines group and individual awareness programmes which include group training and individual mentoring.
- Japan has a long tradition of providing management training for SME owners. Currently, training is provided by the Institute for Small Business Management and Technology for SME owners, managers, technicians and support personnel. About 14 000 individuals are trained per year in this way. The Small Business Support Centres provide training on an even larger scale for those seeking advice on innovation and business creation.
- In New Zealand, the Enterprise Fund cover 50% of the cost-up to a maximum of NZD 20 000 – for engaging the services of a business mentor or undertaking advanced management training.
- The Employment and Economic Development Centres (EEDC) in Finland play a key role in organising management training – ensuring that it is tailored to the specific “life cycle” requirements of the firm. It also has “expert services” such as those to help with business planning and networking.
- At the federal level, the United States provides modest sums for the funding of Small Business Development Centres - especially in comparison with its support for the SBIR programme to support technology-based small firms.

Source: For the Netherlands, Japan and the United States. OECD (2002c).

Possible policy improvements

The policy measures aimed at directly spurring innovation and firm creation have been absorbed more rapidly by SMEs than by micro firms. The support units best suited for either creating new efficient micro firms or lifting their productivity are business development centres (*BDCs*) (see Box 4.3.). These centres, though, continue to be highly underrepresented in poor rural areas (especially in the poorer southeastern states) where micro firms predominate.

Box 4.3. Business development centres network

Business development centres can be public, private or quasi-public organisations. OECD countries provide examples of all three models. In Sweden, *ALMI* is a wholly public organisation, the United States favours the private sector, and in the United Kingdom, *Business Links* is a quasi-public organisation. Under the public or quasi-public model, free access to services tends to create excess demand. Policy makers have to decide how to respond to this potential imbalance.

Five Key policy choices in delivering business support and advice to SMEs (Kevin Mole, 2006)

1. Who delivers? Public, private or quasi.
2. What “type”? Generic, standard, tailored, regulated, direct, face-to-face, e-based.
3. How is it rationed? By time, sector of business, price, once-off only.
4. How is it integrated? Into other economic and social programmes.
5. How is it funded? By charges, by donations, directly from public funds.

Current federal spending on BDCs is modest (just over 1% of the SME Fund). In many OECD countries, though, the provision of subsidised information and business advice represents a major item of SME expenditure. Drawing upon the recommendations by the European Union and given the need of SMEs for good quality advice, there is a case for reviewing the scale of operations of these centres. Many SMEs appreciate the provision of tailored and relevant business advice, which is free or available at low cost. Policy efforts should seek to reinforce the presence of business development centres in poor rural areas, with strong participation from local authorities, which have better knowledge of local conditions.

Although vertical networking has improved, there is also a need for better horizontal integration among support units, setting into motion information flows between innovation laboratories, business incubators, business development centres and business accelerators. For instance, synergies can be created through information exchange ('learning from each other') between training programmes offered by COMPITE (manufacturing firms), PROMODE (retailers) and others. In this way, potential overlapping can be reduced. Further efforts are also warranted in inducing business development centres to offer 'solutions' (non-R&D based innovations) rather than just training, which is likely to be more appropriate in helping jump start firms, especially micro firms.

The growth performance of incubator-sponsored firms should be closely monitored by the National Council of Business Incubators so as to establish an empirical basis for setting an optimal tempo of phasing out assistance to such firms. The SME policy aimed at spurring firm creation, innovation and technological development could also benefit from an increased emphasis upon fostering an entrepreneurial culture through entrepreneurship education policies. Many OECD countries have taken measures with a view to enhancing young peoples' awareness of options for starting their own business. In some countries, courses raising the awareness of possibilities to create one's own business are taught in schools and, more importantly, at universities. A number of countries also foster women's entrepreneurship and that of minority groups to promote job creation, employment and social inclusion (Box 4.4.). Strengthening programmes of this kind could be part of Mexico's efforts to build an entrepreneurial society. They would also fit comfortably with stated objectives of improving the technological sophistication of Mexican SMEs.

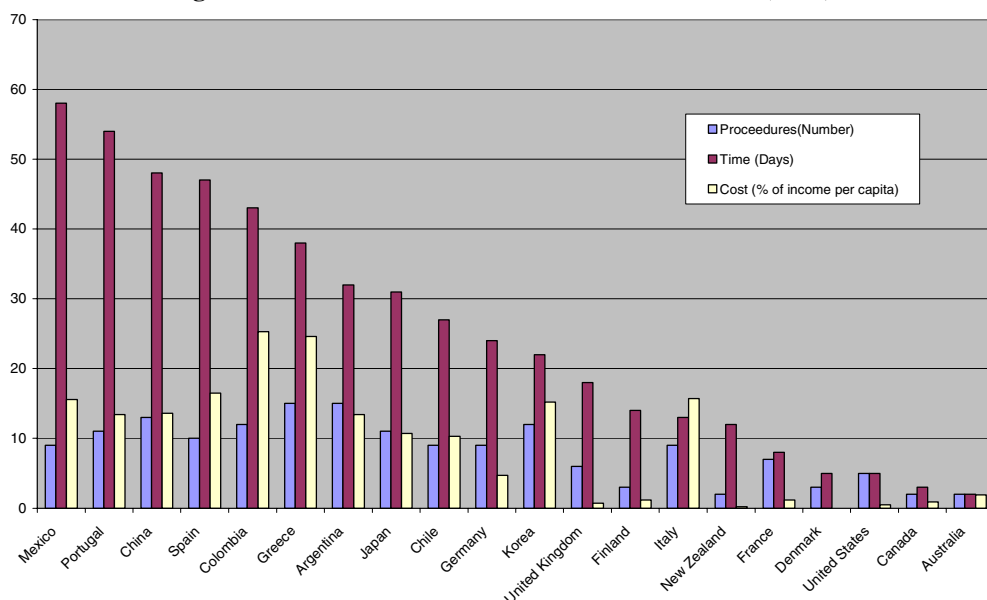
Despite the ongoing progress achieved by SARE, the administrative burden on businesses remains heavy by international comparison (Figure 4.1.)⁷. Overall, processes remain particularly complex at the local level. Even though there are some innovative experiences to improve regulations and simplify procedures at the state and municipal level (*e.g.* the states of Chiapas and Sonora), most states are slow in implementing regulatory reform. A comparison on the cost of doing business across Mexican states shows that only a few states stand out as attractive to business, while most are in a distinctively unfavourable position. It would be appropriate to enhance the visibility of such information, as this could help put pressure on the laggards to improve their performance.

Box 4.4. Entrepreneurship education in schools and universities: Some examples

Many countries attach increasing importance to the development of entrepreneurship education in schools and universities. Examples of such programmes include the National Entrepreneurship Education Programme in the Netherlands (2000) and the Enterprise Education in Schools Programme in Australia. A second option consists in having college students work for SMEs. Trainee programmes tend to encourage students to establish their own businesses at a later stage. An example is the Shell Technology Enterprise Programme (*STEP*) that was launched in the United Kingdom and that is now being used by more than twenty countries.

Many OECD countries also have programmes aimed at women and minorities to set up their own business. Examples of programmes that encourage women to start their own enterprises include the establishment of a Women's Enterprise Agency and a range of financial and soft support for women business owners in Finland. In the United States, public procurement policy requires 5% of funding to be earmarked for women-owned firms. Other programmes encourage young people to set up their own businesses, with Canada and Taiwan providing the strongest assistance in this domain. In the United Kingdom, the *Prince's Trust*, established by Prince Charles more than twenty years ago, provides advice and finance to disadvantaged young people. In the United States, the Small Business Administration (*SBA*) provides comprehensive services to Hispanics and African Americans to create their own enterprises. Finally, emigrants with business expertise should be encouraged to return to Mexico, thereby enriching the human capital of domestic managers and entrepreneurs. For example, New Zealand and Scotland have programmes favouring the return of emigrants.

Figure 4.1. Administrative burdens to firm creation (2006)



Source: World Bank (2006), Doing Business database.

Access to Finance

New financial products and credit assistance

Since the inception of the new SME policy programme in 2001, better access to finance has been a key lever for raising SMEs' overall efficiency. High real interest rates on suppliers' credits (the predominant source of finance for SMEs) and limited access to bank credits have tended to inhibit firm creation and productive investment, as required rates of return on capital are too high to make borrowing worthwhile.

Over the past few years, the federal government, in conjunction with state and local governments, commercial banks and intermediate organisations, has progressively put into place a coherent set of measures aimed at correcting market failures and lowering barriers to SME access to finance. Building and expanding institutional links between the Ministry of Economy, state and local governments, financial institutions and intermediate organisations has been a key element in this policy approach. With the policy impulse from this partnership, financial institutions have been progressively creating, modifying and consolidating financial instruments, thereby enlarging the *supply* of finance to SMEs.

A cornerstone of finance-oriented policy measures has been the National SME Guarantee Programme, providing guarantees for SME credits at reduced cost. Under a system of rapidly expanding funding lines, many guarantees are jointly extended by the Ministry of Economy, the State Development Bank (*NAFIN*) and commercial banks. As a result, financial institutions have been progressively creating, modifying and consolidating financial instruments, thereby enlarging the *supply* of loanable funds for SMEs.

The National Financial Guarantee Programme differs strongly from guarantee schemes used elsewhere (Table 4.2.). Other countries' guarantee schemes normally apply to viable firms, which have no access to collateral and which therefore have no access to loans. Governments share the risk with banks in funding such applications, the government covering between 60% and 85 % of the risk. Financial institutions, absorbing the residual risk in the event of default, charge SMEs an interest rate premium, which partly covers potential losses. Under such a system, governments can adjust either the interest premium or the percentage guaranteed. In contrast, the Mexican programme only covers first losses, seeking bids from financial institutions and then selecting those with the highest credit/guarantee fund ratio and the lowest interest rate. The system has succeeded in leveraging

Table 4.2. Summary table of international loan guarantee programmes

Programme	US	US	Netherlands	Denmark	Belgium	France	Germany
	7a loan	SBAExpress	BBMKB	Vaelsktauktion	SOWALFIN	SOFARIS	Burschaftsbanken
Guarantee	Up to 85% up to USD 150 000 Up to 75% over USD 150 000	Up to 50%	Up to 50% Up to 75% for start ups and innovative companies	66.67% up to €350 000 50% from €350 000 to €700.00	Up to 75%	Varies – generally around 50% (average of 45% for 2001) Up to 70% for start ups	Up to 80% (average between 50% - 80%)
Maximum size of loan	USD 2 million (maximum guaranteed amount is USD 1 million)	USD 250 000	Up to 50% Up to 75% for start ups and innovative companies	€700 000 (minimum size €10 000)	€2.5 million	No limit on loan size, but SOFARIS' risk is limited to €750 000 (up to €1.5 million for SME transmissions and development)	€1 million
Cost of loan	Premium of 1% for loans USD 150 000 and less 2.5% for USD 150 000 - USD 700 000. And 3.5% for loans over USD 700 000 Annual fee of 0.25% of balance of guaranteed part of loan	As per 7a	€1 million	3% pa in first two years, 1.5% thereafter	1% pa on guaranteed exposure (paid as an upfront and one-off fee)	Annual fee of 0.45% to 0.60% on the outstanding amount	Premium of 1% pa (can be 1.2% for first operation, then 0.8%)
Interest Rates	Fixed by lender, but subject to SBA limits (between 2.25% - 4.7% above prime)	As per 7a	Fixed by Government (usually equal to a low-risk rate, but the commission is passed on by lenders to borrowers)	Fixed by lender	Fixed by lender	Fixed by lender (subject to restrictions ensuring it is a market rate)	Fixed by lender
Length of loan	Maximum 7 years (up to 10 years for working capital). Maximum 25 years for real estate & equipment	Maximum 7 years	Maximum 6 years (maximum 12 years for real estate financing)	3 – 10 years	Maximum 10 years (but lenders can request longer)	Length of loan guarantee matches length of underlying loan	Up to 15 years (average 10 years)
Target firms	Vast majority of SMEs (definition of SME varies depending on sector)	As per 7a	Firms up to 100 employees Special conditions for start ups and innovative companies	SMEs in 6 focus areas	All SMEs	All SMEs in all phases of their existence – are 10 different guarantee funds managed by SOFARIS	All with focus on start ups

federal funds while keeping default rates low (0.74% of total SME loan portfolio in 2006).

Alongside the guarantee system, a financial assessment network of independent credit advisors has been established (the National Financial Extension Programme) improving the quality of SMEs' *credit demand* (loan requests). Stronger emphasis has also been placed upon increasing the supply of SME venture capital, with funds supplied by private and public sources on the basis of variable partnership formulas.

Indicators of positive policy impact

The twin policy approach (based upon guarantees and a financial assessment web) was instrumental in enlarging the *supply* of financial resources available to SMEs (including both bank and non-bank credits) over the past few years. Financial resources available to SMEs have increased sharply. The system of auctioning guarantees among commercial banks and other institutions has allowed authorities to leverage limited public resources available for guarantees. The number of financial products guaranteed by the Ministry of Economy has risen to 25 in 2006, contributing to the surge in the credit/fund ratio. In 2006, a guarantee of one peso generated as much as 62 pesos of SME credit supply in 2006 as against two in 2000.

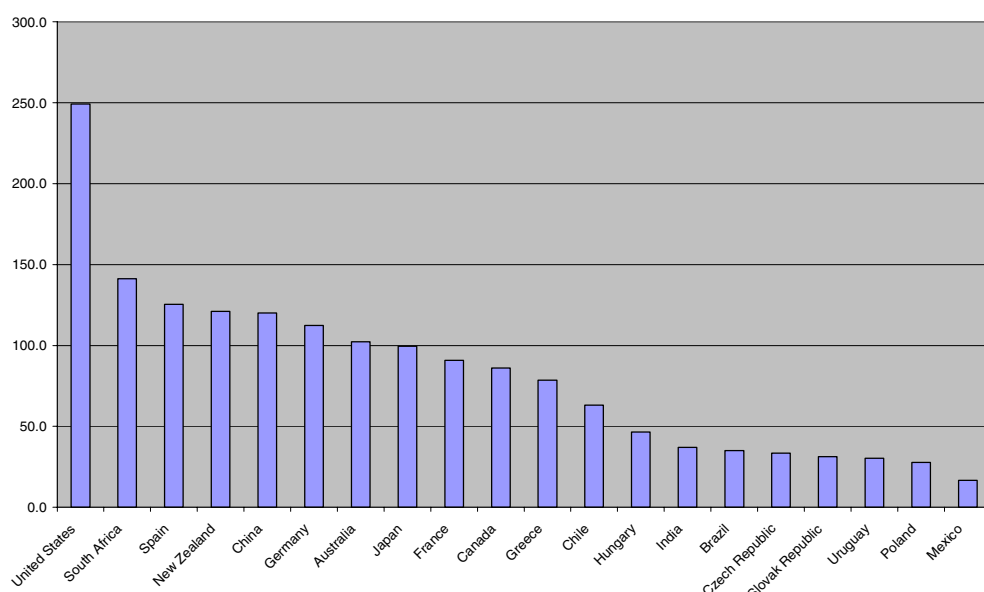
Transaction costs have fallen with the removal of collateral requirements for some categories of SME credits, the use of parametric models, improved bank records and financial assessment services rendered by the National Financial Extension Programme. At the same time, the introduction and refinement of the National Guarantee System has helped progressively reduce default rates, leading to a reduction in risk premia for SME credits. This went hand in hand with falling spreads for SME lending, a key indication of improved SME access to finance. SME loan charges declined relative to short-term interest rates, the average spread narrowing by 7-8 basis points between 2001 and 2006.

Better credit conditions (lower interest rates and no formal guarantees) have also smoothed the entry of *informal* SMEs into the *formal* economy. Cost advantages from more affordable credits in the *formal* sector may have begun to outweigh benefits from tax and regulatory non-compliance in the *informal* sector. Thanks to the Capital for Development Schemes, the supply of venture capital has been rising. This trend is likely to quicken with the new stock market law (January 2006), strengthening minority powers and easing SMEs' access to stock markets.

Possible policy improvements

Notwithstanding these outcomes, the Mexican SME sector continues to suffer from highly underdeveloped bank credit markets and related high cost of finance. Domestic credits to the private sector as a percentage of GDP remain low compared with other countries (Figure 4.2.). By mid-2006, the interest rate for short-term SME bank credits covered by guarantee schemes stood at 18-24 percent, implying real interest rates of 14-20 percent and correspondingly high required rates of return on capital.⁸

Figure 4.2. Domestic credit to private sector (% of GDP)



Note: Domestic credit to private sector refers to financial resources provided to the private sector, such as through loans, purchases of non-equity securities, and trade credits and other accounts receivable, that establish a claim for repayment. For some countries, these claims include credit to public enterprises.

Source: World Development Indicators, World Bank, 2005.

While short-term SME credit rates and short-term interest rates have converged, the gap is still large (see Table 4.3.). Together with high tax compliance costs, heavy regulations and incomplete coordination among government levels, high cost of finance are part of a hostile environment hampering innovative SME policy.

Moreover, while access to finance has improved, the bulk of increased credit volumes has gone to small and medium-sized enterprises. Micro credits totalled USD 308 million in 2005 (up from USD 283 million in 2004), which corresponds to USD 77 per each micro enterprise in the formal sector. Micro enterprises have again benefited less than proportionately from policy impulses.

Table 4.3. Short term bank lending rates for enterprises: An international comparison

	2000	2001	2002	2003	2004	2005	2006
Mexico	16.15	12.24	7.46	6.51	7.10	9.33	7.52
New Zealand	6.52	5.74	5.67	5.42	6.13	7.11	7.37
Australia	6.18	4.90	4.75	4.90	5.48	5.64	5.77
United States	6.48	3.73	1.76	1.17	1.58	3.53	5.06
United Kingdom	6.11	4.97	3.99	3.67	4.57	4.70	4.55
Canada	5.70	4.00	2.62	2.97	2.31	2.81	4.09
Norway	6.75	7.23	6.91	4.10	2.01	2.21	3.13
Denmark	4.90	4.62	3.48	2.36	2.14	2.17	2.69
Euro area	4.39	4.26	3.32	2.34	2.11	2.19	2.68
Switzerland	3.17	2.86	1.13	0.33	0.48	0.81	1.60
Japan	0.25	0.12	0.06	0.04	0.03	0.03	0.05

Note: Short term interest rates are usually either the three month interbank offer rate attaching to loans given and taken amongst banks for any excess or shortage of liquidity over several months or the rate associated with Treasury bills, Certificates of Deposit or comparable instruments, each of three month maturity.

Source: OECD, Main Economic Indicators (2006).

While Congress approved legislation on popular savings and loans in 2001, with a view to expanding and strengthening the micro finance sector, it seems crucial to expand more swiftly the role of micro finance institutions (credit and savings union) in poor and in rural areas, where more flexible modes of micro finance are needed.⁹ Better use of ICT can also help diffuse microfinance, thereby countering costly fragmentation. Special attention should be given to training staff, the driving force in the micro finance sector. Policies concerning the collection and sharing of credit history records should also be designed taking into account their impact on SME bank credit. Securing micro finance, though, is intricate, as millions of Mexico's micro firms operate in the informal sector.

The *PYME Option* programme has made an important contribution, but the availability of venture capital remains limited. Stronger action needs to be taken to improve the investment climate for potential suppliers of venture capital (*investors' hospitality*). Public venture capital programmes have the virtue of revealing lucrative investment opportunities to potential suppliers.

More importantly, new financial instruments such as trust funds and closed-end investment funds could be further developed, widening the range of financial options for SMEs. Several OECD countries have had positive experiences with public venture capital programmes (Box 4.5.). In some countries, such as the US and the UK, there has also been great interest in the creation and operation of business angel networks, which foster a venture capital culture, attracting private sector investment.

Box 4.5. Public venture capital programmes: The international experience

Several European and Asian countries have established public venture capital (VC) funds. In Germany, the *Kreditanstalt für Wiederaufbau (KfW)* and *Tbg* developed public venture programmes. Combined with the Lander (state) programmes this ensured a relatively even regional spread of funds. By contrast, in the United Kingdom funds are heavily concentrated around London.

Main lessons to be learnt from this international experience include:

- Public VC programmes only work when there is a strong interaction with the private VC market
- VC is only effective when focused upon a very narrow range of new technologies. Hence a “balanced portfolio” spread across many sectors may not succeed.
- Successful private funds are both flexible and active. They are involved with the inevitable shifts in direction and personnel associated with fast moving companies. Public funds require the same involvement.
- Public funds have to be “ruthless” in jettisoning under-performing companies. Performance has to be judged according to private funds’ criteria.
- While public VC funds need to emulate the private sector, they still have a useful role to play. Public funds can be used to demonstrate to financial institutions the presence of a potential market.
- Public funds should be more “patient” than private funds in performing the role referred to above.
- The experience of OECD countries is inconclusive as to whether public VC funds supplement or lead the provision of venture capital. Such funds are generally young, assisted firms having insufficient time to grow.

Source: OECD (2006g).

The Mexican Guarantee System could also be broadened and strengthened through mutual guarantee associations (*SGRs*). Common to countries such as Spain and Portugal, a *SGR*-system would complement the SME Fund as a second-tier fund extending counter-guarantees to *SGRs*

(*guarantees of last resort*). In Mexico, this would require changes to the regulatory framework. In addition, such associations may only operate successfully in a few sectors, where industry associations are well organised.

Finally, notwithstanding sharp increases in guarantee funds and improved loan requests, most credit institutions still view procedures for loan recovery as being cumbersome. Bankruptcy and credit guarantee laws have yet to attain full effectiveness, while judicial procedures are generally viewed as being slow, costly and not sufficiently transparent.

Regional and Sectoral Productive Articulation (networking)

New forms of linkages

The policy category *Regional and Sectoral Productive Articulation* in 2006 absorbed nearly 50 percent of the SME Fund. In essence, the success of networking activities is key to the overall success of the SME Fund. Welcome progress has been achieved in this domain by expanding and deepening links among states, municipalities and intermediate organisations (public/private partnership formulas). Vertical networking activities have relied on both ‘top-down’ and ‘bottom-up’ approaches. Moreover, main characteristics of each of the 2 500 municipalities are captured by a sophisticated indicator system, paving the way for locally inspired (tailor-made) policy initiatives. Together, the various networking programmes have fostered collective process innovations, speeding up the diffusion of various forms of individual innovations and raising overall economic efficiency. They represent a great step towards a more generalised cluster approach.

New forms of support entities have also been established spurring productive network building. Prime examples are centres of productive articulation (*CAPs*), which spring from *private* initiatives (in line with best practice) and which are based on public-private partnerships. Since 2004, these centres have upgraded numerous individual firms, preparing them for insertion into different kinds of productive networks.

CAPs normally sell their services, the main sources of current revenues being investment analysis, market studies, training of consultants and sales of products from micro producers linked up in small producer networks. Public support is appropriately designed as temporary, financial independence being the aim. CAPs current revenues should normally begin to cover current outlays after a two to three-year period. Progress in network building has also been achieved through the National Programme of Suppliers’ Development (*SDP*) using pilot projects (in line with best

practices) as a means of establishing durable links between big firms (clients) and small local suppliers. SDP programmes have been implemented in various branches of manufacturing, retail, and service sectors (large export firms, car producers, hotels, restaurants and hospitals).

Indicators of positive policy impact

Performing their “intelligence” function, CAPs have been instrumental in identifying business opportunities in less advanced regions. Their rising number (52 in 2004 increasing to 81 in 2005) points to greater collective efficiency. There are also signs of new and better connections between support units of the same type, taking the form of experience sharing and information exchange. Support unit efficiency has risen as a consequence. In addition, there are signs of emerging links between support units of different types, *e.g.* between innovation laboratories, CAPs and business accelerators, speeding up the diffusion of product and process innovation.

Networking activities have also become more efficient with the execution of privately sponsored, strategic investment projects including industrial parks, productive chains, eco-tourism and commercial centres. A coherent infrastructure has been shown to attract foreign direct investment (client firms) acting as a magnet for transforming isolated micro firms into efficient local suppliers. Nearly 135 000 micro firms have so far benefited from *strategic investment projects* of this kind, partly reflecting five important clusters focusing upon innovation and technology.¹⁰

Finally, *SDP*-induced supply chains seems to have increased efficiency and profitability, with reduced out-of-time deliveries, reduced non-conforming production, better inventory management and increased sales. Overall, authorities estimate that *SDP* participation has allowed client firms to reduce prices by 7 percent, to increase the quality of production by 11 percent and to realise a return on investment of four to one. For suppliers, the programme has induced a cut in operational costs by an estimated 3 percent. It has also smoothed their business fluctuations, making planning easier. Network candidates benefit from structured support from consultants, who receive standardised training.

Possible policy improvements

Most of the 104 SDP-sponsored networks are located in the more prosperous northern and central regions. Greater networking efforts are needed in the less prosperous regions, buttressing programmes of the United Nations and private foundations which seek to connect rural micro firms with local institutions and then with larger client firms. State and local

authorities should encourage large local employers to engage SMEs more actively in value chains. Overall, networking programmes should be strengthened through a methodological development effort, taking into account best practices used by other countries (Box 4.6.).

Box 4.6. Networking programmes: The international experience

Governments concerned with economic development have frequently encouraged large local employers to engage SMEs more actively in value chains. The development of supplier development programmes involving SMEs in other OECD countries reflects the increasing recognition that the delivery of a final product or service to the customer involves the linking of often numerous suppliers in a “value chain”. SMEs are rarely the initiator of value chains or the final deliverer of products and services.

Incentives for creating value chains can stem from adversity. In the United Kingdom, the *Accelerate* programme was implemented in the West Midlands of England suffering from a continuous decline in the motor car sector dominated by a large company (MG Rover). Many local suppliers in the region were almost dependent upon this firm.

The *Accelerate* programme encouraged local SMEs to use their wide range of skills, diversifying their customer’ portfolio’ and improving modes of production and organisation. This was achieved by the provision of subsidized consultants working closely in conjunction with firms. Over seven years, *Accelerate* assisted more than 1 000 companies and safeguarded more than 16 000 jobs.

In the OECD’s recent review of SMEs in Global Value Chains, the OECD concludes that such chains are likely to grow in importance and that governments seeking to increase the role played by SMEs should seek to raise awareness of such matters amongst SMEs, as well as facilitating SME financing, protecting intellectual property, and helping SMEs comply with international standards.

Source: OECD (2006h).

Internationalisation of SME Activities

New forms of export promotion

New forms of support units have also been used as part of efforts to raise SMEs’ exports. Mexican SMEs’ current involvement in international trade is weak, with less than one percent of all SMEs (36 500 firms) participating in export activities and accounting for only 11 percent of total Mexican exports. These numbers are low by international comparison.¹¹

A novelty in SME export promotion, especially for *micro* firms, are the *Centros Pymexporta*, intermediate organisations based upon public-private

partnerships, which provide a wide range of services for internationalising SME activities. A network of 22 *Pymexporta* centres in Mexico and four centres located abroad (co-funded by the Federal government, States and other organisations) accompany nascent SME export firms over a period of two years, using standardised methodology for identifying, developing and consolidating export projects.¹²

Indicators of positive policy impact

Mexico has successfully invested in new forms of export promotion, providing targeted and market-specific information to SMEs. The *Impulsoras* Programme for Exportable Offer performs a useful ‘trigger’ function, encouraging state and local authorities and employers’ organisations to help strengthen and activate SMEs’ export potential. In 2005, over 6 000 firms, mainly SMEs, representing 15 percent of the SME-exporters, participated in this programme.

Possible policy improvements

The spectrum of export assistance could be widened to include joint ventures, franchising and R&D links as additional tools to spur the internationalisation of SME activities. At present, export promotion programmes appear to be less present in the southern regions, where ample scope remains for helping *micro* firms export. This can be done by way of horizontal networking (*micro* exporters’ web) or by way of tying them to big exporting firms.

Federal funds earmarked for internationalising SMEs seem too low. Larger amounts should be allocated for the attendance and exhibition in overseas trade fairs, which is a cost-effective way of upgrading the quality of Mexican entrepreneurship and strengthening SMEs’ export orientation. Further efforts should be undertaken to create networks among actual and potential SME exporters to exploit possible economies of scale in international transactions. Programmes to encourage links between SMEs and multinational enterprises are also an effective way to help the former access international markets.

The large number of Mexicans living abroad offers vast export opportunities for Mexican SMEs. International trade fairs could be used as a platform for tapping the entrepreneurship spirit of Mexicans living abroad. They should be seen as both potential consumers of Mexican goods and services, and also as possible investors and entrepreneurs involved in the export-import business.

Box 4.7. Programme specific recommendations

Creation and Strengthening of Firms' Innovation and Technological Development

The Programme for Innovation and Technology

- Set stronger market-based incentives for R&D activities and innovation.
- Strengthen efforts to raise non-R&D based innovations, especially in less privileged regions.
- Reinforce links between innovation-oriented support units.

The National System of Business Incubators

- Establish science parks.
- Strengthen horizontal links between business incubators.
- Increase the number of tailor-made business incubators in less privileged regions.
- Collect more data on the growth performance of incubator-generated firms. Set the optimal phase of assistance.

The Business Development Centres Network

- Increase the number of conventional business development centres.
- Strengthen co-ordination between the SME Fund, states and local authorities to establish business development centres.
- Strengthen links between business development centres and entities in charge of providing training and consultancy services.

Programme for training and strengthening SME capabilities

- Increase the number of tailor-made training and consultancy services, especially in less privileged regions.
- Strengthen entrepreneurship policy, notably raising young people's awareness about entrepreneurial prospects.
- Improve co-operation between training programmes such as COMPITE (manufacturing firms), PROMODE (retailers) and others.

Access to Finance

The National SME Guarantee Programme

- Enlarge and strengthen the guarantee system.

Box 4.7. Programme specific recommendations (cont.)

- Broaden micro firms' access to finance.
- Enlarge the range of financial instruments.

The National Financial Extension Programme

- Increase the number of professional credit advisors.
- Extend training of special staff to assist micro firms.
- Create network of professional credit advisors.

The Capital for Development Schemes

- Reinforce interaction between public venture capital programmes and the private venture capital market.
- Set stronger market-based incentives to generate private venture capital.
- Devote larger resources to creating a venture capital industry (venture capital funds and investment clubs).

Regional and Sectoral Productive Articulation

The National Network of Productive Articulation

- Increase the number of Centres of Productive Articulation (CAPs).
- Improve information exchange between CAPs.
- Stimulate information flows between CAPs and other support units.

The National Programme of Suppliers Development

- Increase the number of SDP consultants.
- Strengthen presence of SDP-sponsored networks in low-tech innovative industries.
- Identify comparative advantages in less privileged regions.

Programme for Strategic Productive Projects

- Expand this programme.
- Use this programme to develop low-tech innovative industries.

Access to Foreign Markets

The “Impulsoras” Programme for Exportable Offer

Box 4.7. Programme specific recommendations (cont.)

- Use this programme as a springboard for partnerships, licensing, franchising, joint ventures, R&D links and direct investment overseas.
- Extend the scope of the programme, mainly in poor regions with export potential.
- Clarify and simplify the relations with the *Pymexporta* network.
- Reinforce the creation of export networks among SMEs and between SMEs and larger firms.

The Programme for Commercial Missions

- Improve information flows from commercial missions to export centres, business incubators, business development centres, CAPs and business accelerators.
- Use commercial missions to tap the entrepreneurship spirit of Mexicans living abroad.

The *Pymexporta* Centres' Network

- Expand the network to activate export potential in less prosperous regions. Strengthen information exchange between export centres, business development centres and CAPs.

Notes

- 1 There is a network of innovation laboratories (2005); a network of business incubators (2003) linking 512 business incubators in 2006; a budding network of business development centres (2001) striving to connect 148 such entities in 2006; and a network of business accelerators (2004) linking six national units, three privately run accelerators, three international accelerators and two units run by institutions of higher education in 2006.
- 2 OECD (2004), Istanbul Ministerial Declaration on Promoting Entrepreneurship and Innovative SMEs in a Global Economy, 2nd OECD Ministerial Conference on SMEs (June 2004, Istanbul).
- 3 Columbo and Delmastro (2002), “How effective are Technology Incubators? Evidence from Italy”, Research Policy .

- 4 For example see “Good practice in Business Incubation”, OECD, 1999 or “Local Authorities, Managed workspaces and Business Premises”, Local Government Association, London 2002.
- 5 . OECD (1999), Good Practice in Business Incubation, OECD Publication, Paris.
- 6 The key policy debate is the extent to which it is appropriate for taxpayers’ funds to be used for these purposes. Whilst there is little doubt that participants in such programmes report high levels of satisfaction, there remains some uncertainty about the impact that such programmes have upon firm performance. A research project carried out by the OECD Working Party on SMEs & Entrepreneurship on management training and SMEs found evidence of an impact of management training on the performance of SMEs and concluded that “when the views of trainees are sought, public programmes appear to be well received”. However econometric methods linking training participation to small firm performance produce weak findings. This suggests that the relatively low take up of formal management training is an informed decision by the small firm owner/manager. Overall, experiences in developed countries with the provision of training for SME owners and managers are mixed. There remains a serious doubt as to whether entrepreneurs can be taught.
- 7 . World Bank (2006), Doing Business in Mexico, Washington D.C. (United States).
- 8 This compares with interest rates for short-term credits outside the guarantee schemes of 60-90 percent.
- 9 Procedures for micro credit extension could be simplified by adopting flexible formula used, for example, by Novobanco (active in Africa and Latin America). This bank provides credits 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.
- 10 . OECD (2005), Business Clusters, Promoting Enterprise in Central and Eastern Europe, Paris.
- 11 . OECD (2003), Entrepreneurship and Local Economic Development, Programme and Policy Recommendations, OECD Publication, Paris
- 12 . OECD (2004), OECD Local Entrepreneurship Review Series: Case Study of the Mexican State of Sinaloa.

V. Policy Evaluation and Recommendations

Overall Policy Evaluation

The Challenge to SME Policy Makers

Over the past six years (2001-06), Mexico has introduced an impressive array of SME policy measures aimed at making the vast SME sector more efficient and competitive. The breadth and intensity of this policy effort is unprecedented, reflecting increased policy awareness of the scale of SMEs' structural weaknesses. While SMEs constitute the near totality of all Mexican enterprises in the formal economy (99 percent), most of them are *micro* firms (95 percent), suffering from an under endowment of both tangible and intangible capital, and related negative levels of total factor productivity.

The inefficiency of loss-making *micro* firms has largely overshadowed the good performance of many *small and medium-sized* firms, which successfully compete in domestic and foreign markets, aided by access to US markets, Mexico's main trading partner. Notwithstanding macroeconomic stability, aggregate labour productivity has risen more slowly over the ten years to 2004 than in any other OECD country. For a country with a low per capita income and correspondingly large catching-up opportunities, this outcome is paradoxical. Placed into the context of globalisation and mounting competition, it is highly disquieting.

Mexico's SME policy makers have thus been facing a largely fragile and heterogeneous SME population (an outgrowth of large regional disparities). This calls for a strong, evolutionary and differentiated policy approach capable of raising, over the medium term, SMEs' productivity. Currently, SMEs account for only one half of overall output, while employing nearly three quarters of workers in the formal economy (see Annex III and Annex IV).

The SME Policy Response

The SME policy programme based upon the Entrepreneurial Development Plan (*EDP*) (2001-06) largely meets these criteria. Being flexible and comprehensive in nature, the new SME policy seeks to improve SME investment conditions by removing impediments to entrepreneurial activity, rather than by intervening directly in order to pick winners.

To reach this aim with limited resources, the newly created Under Ministry for Small and Medium Enterprises (2001) has relied upon a ‘trigger approach’, imparting central policy impulses with a view to releasing widespread policy effects (‘multiplier function’). Sustained institutional ‘road building’ (the creation of both network links and new forms of support units) has progressively raised the efficiency of such policy impulses. Central elements in this approach have been the creation and expansion of a range of support units, including innovation laboratories, business incubators, business development centres, centres of productive articulation, business accelerators, and export promotion centres. Most of these new support units are run according to market criteria, medium-term financial independence being the aim.

The federal government’s ability to inject central policy impulses has been greatly enhanced by the establishment in 2004 of the SME Fund, the main financial tool for conducting SME policy. In line with best practices, the SME fund applies the principle of co-financing, requiring SMEs to contribute their own resources for innovation-related projects. Variable and temporary public-private partnerships have thus become a central element of SME policy. Concomitantly, a comprehensive set of 13 programmes have been created, allowing SMEs to be supported during all phases of SME life, beginning with the incubation of business invention and innovation and followed by productivity upgrading and value chain integration

SME support lines have been grouped around four major action routes in 2005: Creation and strengthening of firms’ innovation and technological development; Access to finance; Regional and sectoral productive articulation; and Access to foreign markets. In the process, innovation has become the central policy axis, permeating each policy category and releasing various externalities through cross fertilisation. Strong emphasis has been placed upon *collective process innovation*. In 2006, nearly one half of SME Fund resources have been deployed for networking purposes (third policy action route: regional and sectoral productive articulation).¹

Table 5.1 SME policy: Stages of SME evolution

SME Policy	Stages of SME Evolution			
	Pre-Birth	Birth	Expansion	Internationalisation
Support Units and Special Programmes	<ul style="list-style-type: none"> • Incubator 	<ul style="list-style-type: none"> • SARE • Business Development Centres • Investment Clubs • Training 	<ul style="list-style-type: none"> • Business Development Centres • Innovation Labs • Business Accelerator • Suppliers' Development Programme • Training 	<ul style="list-style-type: none"> • Business Accelerator • PYMExporta Centres • Export Impulsoras
Action Route	I	I, II	I, III	I, IV
Programme	2	3, 7, 4	1,3,8,9,4	1,11,13

Note: 1. Programmes 5 and 6 (National Guarantee Programme and Financial Extension Programme) apply to different stages of a firm's evolution

Apart from creating and expanding various support units, *collective efficiency* has been promoted through the building of 'institutional' linkages connecting, in vertical and horizontal modes, all levels of government, intermediate organisations (non-banking banks, foundations, business associations, United Nations) as well as educational and research institutions. Placed into a dynamic context, the creation of the Under Ministry for Small and Medium Enterprises in 2001, the subsequent incorporation of four previously established support funds into the SME Fund in 2004, and the shift to innovation-oriented policies in 2005 reveal an *institutional learning process* that has made Mexico's SME policy increasingly effective.

In line with best practices, administrative powers have been decentralised, contributing to improved policy coordination at all levels of government. As a result, state and local governments along with intermediate organisations have been able to participate more actively in the design and execution of novel SME policy projects. Shifting the power of design and execution of SME projects down to the level of local authorities, support units and intermediate organisations (bottom-up approach) is tantamount to recognising the diversity and heterogeneity of the SME universe. In this setting, central policy impulses have become more effective in spreading their multiplier effects. Moreover, the productive and geographical diversity of Mexico's SME population has been recognised more fully as part of the *systemic model for growth*.

Building new links has strongly benefited from a consensus-based policy approach drawing all policy participants into the domain of SME policy. Better communication and the sharing of information between various stakeholders have been identified by the OECD as being essential for making entrepreneurship policies more effective.²

Policy Recommendations

While the pace and the extent of policy impulses have been impressive, there is room for improvement. Aside from the programme-specific policy recommendations (Box 4.6.), several major policy recommendations emerge from the evaluation of Mexico's SME policy (see Box 5.3. at the end of the Chapter).

The sequence in which these major policy recommendations are presented directly flows from efficiency considerations. Better policy coordination facilitates information flows among policy stakeholders, raising the visibility of SME policy. This, in turn, may set the stage for introducing nationwide best practice procedures of policy evaluation. Once put into practice, the recommendations on evaluation will provide a rational basis for adapting the *substance* of certain policies within a framework where policy tools have been improved. Evaluation will also provide the necessary signals about the degree to which overall financial resources for SME policy may need to be increased.

Improve Policy Co-ordination

In spite of the welcome regrouping of SME programmes in 2005 around four major action routes, there is still a need for enhancing policy coordination among all SME stakeholders and reducing risks of overlapping. What is needed is a thorough methodological review taking into account international best practices and a consequent rebalancing of priorities within the SME policy package. This will help improve access to SME programmes, increase the visibility of SME policy and facilitate programme evaluation.

Authorities should strengthen efforts to review all public SME expenditure by the federal government, states, and local authorities to identify areas where a reorganisation of programmes could make SME policy more efficient. There is room for improving the co-ordination between various programmes, for example between innovation laboratories, business incubators, business development centres (*BDCs*), centres for productive articulation (*CAPs*), business accelerators and export centres. More generally, there appears to be ample scope for harmonising some programmes in action routes one (creation and strengthening of firms,

innovation and technological development) and three (regional and sectoral productive articulation).

The link between business development centres and training activities present a first step in upgrading basic managerial abilities of SMEs, setting the stage for eventual network building under the programmes of suppliers' development (*SDP*) and strategic productive projects. Providing cost-free, tailor-made advice to individual SMEs, public business development centres (*BDCs*) provide a higher value for money than conventional training programmes. Further efforts should be made to better connect export centres (*PYMEExporta* centres) with centres for productive articulation (*CAPs*). Incubators could be joined more formally with the business accelerator programme, while *BDCs* and innovation laboratories could integrate and further increase the range and diversity of knowledge in terms of business services offered to SMEs.

Overall, integration efforts should recognise and follow a natural sequence of 'service stations', which many firms use on their way from creation to growing into a mature exporting company. From the perspective of network efficiency, which seeks to connect support units of the *same* kind (e.g. network of innovation laboratories) and *different* types of support units (e.g. innovation laboratories and business incubators), such integration is also useful (see Box 5.1.).

Box 5.1. Three phases for innovation-oriented SME policy

A successful SME policy evolves through time with the maturing of both innovative processes and supporting 'institutions' (*support units*)³. Three policy phases can be usefully distinguished. The first (initial) phase is generally aimed at creating a vast segment of innovative SMEs by way of spurring R&D and innovation. The second phase seeks to spread these innovations through improved scientific-technological networks, specialised institutions and better access to finance (including venture capital). In the third and final phase, the innovative momentum accelerates under the effect of learning and the transition to the knowledge economy.

A smooth transition from the first to the second policy phase requires the building of institutional capacities apt to design and implement tailor-made SME policy. To this end, clusters and value chains need to be established and new financial instruments developed.⁴ In addition, sectors, regions and production chains need to be identified displaying *revealed advantages* in terms of innovative and competitive potential. The activities of innovative SMEs can then be internationalised in the third policy phase, using services provided by export-oriented *support units*.

Source: Dr. Guillermo Rozenwurcel, Economic Area Director, Political and Government Institute, UNSAM (Argentina).

Finally, while great efforts have been undertaken to encourage participation by different stakeholders in policy design and implementation, policy co-ordination among federal agencies, as well as among federal, state and local governments, should be further improved. To this end, an inter-institution review should be conducted yielding concrete policy proposals.

Better communicate the SME Policy Framework

A harmonised policy framework makes it easier to raise awareness and communicate federal SME policy to the SME sector as well as to policy stakeholders, including states, local authorities, municipalities, banks and intermediary organisations (non-banking banks, foundations, business organisations, universities, research institutions, international organisations and all the support units mentioned above). The annual SME week has been successful in attracting 50 000 firms by providing on-the-spot information, training and network opportunities. Mobile information centres (*SME-policy vans*) have also been useful in spreading valuable information about opportunities to access government support. Nevertheless, large numbers of SMEs remain unaware of the availability of programmes.⁵ The Under Ministry for Small and Medium Enterprises should enhance the visibility of SME programmes bringing SMEs' needs into sharper focus. This approach has been followed by other countries and by the European Union (Box 5.2.). Improved information flows stimulate policy dialogues, paving the way for consensus on all levels of SME policy making.

Box 5.2. An envoy for SMEs: The European Union experience

SMEs are the backbone of the European economy and the best potential source of jobs and growth. SME issues have been at the top of the EU agenda since the 2006 spring summit; the European Commission has promoted the integration of the “*think small first*” principle into all EU and national policies.

In addition, the European Commission has created the post of *SME Envoy* to bring SME needs into even sharper focus at the EU level. The *Envoy* solicits and assesses SME concerns and operates as a dedicated “ambassador” for small business throughout the Commission. Aiming to secure SME-friendly policy development, the *Envoy* screens the Commission's work programme for initiatives that could have a particular impact on SMEs. For instance, ten measures have been identified as needing special attention in 2006, including health and safety at work, consumer protection, evolution of labour law, and a market access strategy.

Source: http://ec.europa.eu/enterprise/smes/think_small_first_en.htm, last accessed January 2007.

A key condition for communicating efficiently the SME policy framework is *high-level political support*. A brief central policy statement signed by the President and involving all Ministries with SME responsibilities would greatly enhance the visibility of SME policy, widening access to policies, notably in poorer regions. Such a policy statement could explain, in simple terms, the essence of each individual programme, thereby attracting larger numbers of SME clients. Looking further ahead, baseline surveys could be conducted every two to three years, soliciting SMEs' assessment of different policy options.

Better communication is also needed in the interplay between SMEs and individual support units. Suppliers of network services often use a technical language deterring potential users. This calls for 'policy disseminators', making technical modes of expression transparent for new customers.

Enhance the Capacity of States and Local Authorities to Absorb Federal Policy Impulses and to take Policy Initiatives

Many indicators suggest that *collective process innovation and efficiency* have been unevenly spread across different regions and states. Much stronger policy action is needed in the micro sector of poor and rural areas where business development centres, centres of productive articulation and export centres are underrepresented. The uneven take-up of SME policy assistance across regions calls for efforts to increase the receptive capacity of states and local governments. This is especially the case of the south-eastern region, which absorbs only about 10 percent of the total SME Fund, despite efforts by federal authorities (notably through the centres of productive articulation).⁶

The range and nature of federal SME programmes should be wide and flexible enough to address potential needs of all SME categories (micro, small and medium-sized firms). SMEs operate under starkly different conditions marked by regional characteristics and different economic regimes (*formal* and *informal* economy). Further efforts in that regard would enhance the effectiveness and leveraging of federal policy impulses. Special programmes of capacity building need to be expanded. States need to issue effective guidelines for using financial resources from the SME Fund and from their own sources. These guidelines should be discussed with other states and local authorities from within and outside the state and modified in the light of policy experience with existing business development centres (BDCs), centres of productive articulation (CAPs) and export centres (*Pymexporta*). Moreover, state support for SMEs and state regulations should be examined and modified to ensure consistency with federal SME support and federal regulations.

Create an Efficient Evaluation Culture at all Levels of Government, Support Units and Intermediate Organisations

Another aspect of current SME policy in need of amelioration is the implementation of comprehensive, systematic evaluation procedures. Current evaluation processes are incomplete, presenting policy results in terms of output (number of participating firms) rather than impact. The wide range of recent SME policy has greatly increased the need for an evaluation methodology, the efficiency of medium-term policies being contingent upon a continual, proper assessment. With many SME policy changes over the past few years, the government may wish to consider undertaking a formal gap analysis. This research into SME needs would trigger the evaluation cycle through the development and approval of policy responses, implementation, independent evaluation and programme renewal.

Two policy areas merit special attention: the National Financial Guarantee Programme and the National Network of Productive Articulation. While Mexico has some experience in evaluating the impact and operation of its guarantee programme,⁷ more detailed information on other countries could be collected to allow possible further refinement of Mexican programmes. To undertake such a review, it would be necessary to identify the criteria on which other guarantee programmes are assessed (credit/fund ratio, default rates and interest premiums). Regarding the National Network of Articulation, it would be valuable to have information from SME participants about the performance-enhancing impact of networking activities.

Overall, Mexico needs an independent agency capable of assessing the impact of SME policy with the help of a certified (best practice) evaluation methodology. Systematic evaluation procedures are necessary for conducting cost-efficient policies over the medium term, making it possible to adapt them in the light of emerging policy outcomes. Evaluation procedures, being conditioned by policy targets, should be part of individual policy programmes at the time of policy formulation. The workings of such an agency would greatly ameliorate the quality of policy coordination among all government levels, making policy initiatives more efficient and less costly. To this end, it would be desirable to gather profiling information on SMEs so that development problems can be better identified. This would allow for a more efficient evaluation of policy responses. Rural/urban and other sectoral disaggregations of data would be useful.

Increase micro firms' take-up of programmes

Despite efforts by policy makers, some programmes struggle to reach large numbers of ailing micro firms. By 2006, only about 4 percent of micro firms in the formal sector benefited from SME support policies. In comparison, about 50 percent of small and medium enterprises were receiving support. In this area, stronger collective process innovation (broader and deeper networking) is a condition *sine qua non* for moving away from inefficient modes of production, putting micro firms on a sustainable development path. Without a more comprehensive approach towards buttressing micro firms, the overall aim of Mexico's SME policy (raising the efficiency of the total SME sector) will remain elusive (see Annex V and VI).

Some regions are still deprived of a minimum institutional capacity to absorb certain policy impulses from the centre, preventing micro firms from taking full advantage of existing policy options. Most micro firms are in need of non-R&D based innovations, calling for specific support services in the form of advice (problem solving) and basic training. Business development centres (*BDCs*) offering business solutions (non-R&D based innovations) are best suited to jump start micro firms or to ensure their economic viability. Their presence in poor rural areas should be massively enlarged in close collaboration with local authorities. Similarly, less privileged regions should set up more export centres (*Pymexporta*) and centres of productive articulation (*CAPs*), activating the potential of micro firms as export units. Spreading *collective process innovation* of this kind in poor areas requires intense collaboration between the state government, local authorities, intermediate organisations and the private sector. One way of touching large numbers of potential SME policy clients on a regular basis is the creation of *mobile* business development centres focusing on basic needs of different categories of micro firms (*formal* and *informal* units).

Upgrading the quality of local micro firms also contributes to attracting large investments in the form of investment parks, commercial centres, etc. Networks of micro suppliers often arise as a consequence. The kind of network building performed under the National Programme of Suppliers' Development (*SPD*) (big client firms and micro suppliers) has not been sufficiently used by less privileged regions. Network building programmes can be extended to those regions, thereby supporting similar efforts made by the United Nations and private foundations.

Micro firms are also in need of a much larger pool of affordable financial resources. The flow of micro finance can be improved with the

extension of the Financial Guarantee Scheme, allowing new financial instruments to be developed. Moreover, the number of micro credit advisors should be increased, strengthening the presence of credit unions at the local level. Existing micro finance programmes, managed by different government agencies, could be harmonised and better integrated into the SME Fund. The use of *mobile micro banks (banking vans)* can also be envisaged.

In several countries, micro entrepreneurs are motivated by poverty and non-existing social safety nets. Therefore, policies helping micro firms need to go beyond the scope of SME policies in *strictu sensu*. A more holistic approach, including a review of labour market, tax, social security and land reform policies seem to have had an important impact on the creation and growth of micro firms in some countries. Finally, some countries also promote the creation of associations representing micro firms on a regional, sectoral or craft-based basis. Such associations, which are insufficiently developed in Mexico, can serve as helpful intermediaries in the design and implementation of tailor-made policies.

Increase Resources for SME Policy

The amounts spent by the federal SME Fund are small relative to the scale of SME sector's structural problems. The structural deficiencies affecting Mexico's SME sector are of a scale calling for stronger and sustained federal (and state) government action. This can take the form of either direct SME policy measures or indirect measures taken in the domain of tax and competition policy as well as regulatory reform. Reforms of tax, regulatory and competition provisions are notoriously difficult to enact, shifting the onus of SME policy stabilisation to direct SME policy.

In the light of this, the current federal SME programme appears to be under funded. To the extent that the federal budget position permits a release of incremental resources for the SME Fund, additional funds should primarily be used for extending existing programmes and creating an efficient evaluation culture, which is essential for using scarce resources more efficiently. Looking further ahead, a policy-induced rise in overall SME efficiency may over the longer term reduce the need for direct SME policies. A growing supply of highly skilled *advisors* working in the private sector may gradually replace federal policy impulses guiding SMEs in different areas such as firm creation, product innovation, finance, business organisation and internationalisation of SME activities.

Concluding Remarks

Mexico's innovation-oriented SME policy effort has been unprecedented in both breadth and intensity. However, gauging the aggregate effects of this policy effort is still difficult. Policy lead times are long, most statistical data is inadequate, and appropriate evaluation procedures are not yet in place. Even so, a number of encouraging signs have emerged, pointing to a positive impact of new SME policies.

On the input side, the number of SMEs receiving some kind of SME policy support has surged, rising to an estimated 254 000 in 2006 (nearly six percent of the SME population) compared with 13 000 SMEs in 2000. Two-thirds of the enterprises receiving support in 2006 were micro firms. Considering the limited financial resources of the SME Fund, this outcome points to a strong catalyst function performed by SME policy. On the output side, the number of small and medium-sized enterprises, which are relatively efficient firms, has grown more strongly in 2001-06 than that of micro firms. Similarly, the average survival time of new SMEs has lengthened.

At first sight, the above evidence of policy successes may seem fragile. But placed into the context of adverse micro economic framework conditions (cumbersome tax provisions and high regulatory burden), the preliminary policy outcomes can be valued in a more positive light. Despite some improvement due to SARE (Enterprise Rapid Opening System, 2002), the simplified tax system for micro firms (2005), the new stock market law (2006) and the amendment to the competition law (2006), the overall climate in which SME policy operates is still distinctly less favourable than in other OECD countries.

Marketplace framework issues are of fundamental importance. SMEs are small players in the marketplace and must have the protection of an effective legal system to ensure they are able to compete effectively with larger, more powerful players. There is a clear link between SME policy requirements and micro economic framework conditions. Keener competition in the banking sector may reduce the need for extending the scale of the National SME Guarantee Programme. Moreover, stronger fiscal and regulatory simplification measures are liable to facilitate the entry of *informal* micro firms into the *formal* economy. Likewise, market-based incentives through the tax system may be more effective in increasing the provision of venture capital than the Capital for Development Schemes. All told, the strategic predominance of Mexico's SMEs calls for a systematic review of all different kinds of policies affecting SMEs. Such a review could be undertaken with the help of the National Council for Science of Technology (CONACYT) and other relevant agencies.

Box 5.3. Major policy recommendations

Improve Policy Co-Ordination

- Conduct a methodological review taking into account best practices.
- Review programmes in action routes one and three with a view towards harmonisation.
- Use the natural sequence of *support units* as a guide for simplifying and harmonising communication and networking among support units.
- Conduct an inter-institution review.

Better Communicate the SME Policy Framework

- Issue a succinct policy statement (*White Paper*) on SME policy, explaining in simple terms the essence of each action route.
- Conduct regular surveys of SMEs' views on different policy options.
- Simplify the technical language of different types of *support units* and introduce 'policy disseminators'.

Enhance the Capacity of States and Local Authorities to Absorb Federal Policy Impulses and to take Policy Initiatives

- Expand the scope of programmes for reinforcing capacity building in states and local governments.
- Strengthen states' capacity to issue effective guidelines for the use of SME Fund resources.
- Support states and local authorities in their efforts to draw up tailor-made programmes of institutional-capacity building for less privileged regions.
- Build further synergies between federal, state and local programmes.

Create an Efficient Evaluation Culture at all Levels of Government, Support units and Intermediate Organisations

- Develop an effective evaluation methodology.
- Undertake a formal *gap analysis*.
- Make best-practice evaluation procedures an integral part of each policy programme.
- Establish an independent evaluation agency.

Box 5.3. Major policy recommendations (cont.)

Increase Micro Firms' take-up of programmes

- Create and extend institutional networks making use of *mobile* business development centres.
- Enlarge the presence of micro credit institutions making use of *mobile* micro banks.
- Develop new tailor-made financial products to micro firms.
- Encourage micro firms to join associations, to help in the design and implementation of tailor-made policies.

Increase Resources for SME Policy

- Increase financial resources available to the SME Fund.
- Use incremental resources for spreading existing programmes and creating an effective evaluation culture.

Other Recommendations

- Improve data collection on SMEs to help policy analysis.
- Lighten the administrative burden on businesses.
- Facilitate regulatory compliance by SMEs.
- Review inheritance tax policies to ease procedures for change in SME ownership.
- Improve and broaden entrepreneurial education in schools and universities.

Notes

1. New approaches to developing small-scale industry were stimulated by the successful performance of industrial districts in Northern Italy. Various studies showed that the clustered firms tended to be more economically viable and contribute strongly to regional growth. Small firms were shown to gain significantly from these clusters (Petrobelli and Rabellotti, 2004). Only few nations, however, have taken steps to formally classify, track and compare cluster characteristics and impacts.
2. OECD (2000), The Bologna Charter on SME Policies, 1st OECD Ministerial Conference on SMEs (June 2000, Bologna) and 2nd OECD Ministerial Conference on Fostering the Growth of Innovative and Internationally Competitive SMEs (June 2004, Istanbul).
3. Teubal, M. (2001), 'The Systems Perspective to Innovation and Technology Policy (ITP): Theory and Application to Developing and Newly Industrialized Economies', The Hebrew University, Jerusalem.
4. Clusters provide an integrating perspective within national innovation systems to turn the theory of systemic innovation into a more pragmatic and practical application. The cluster approach provides an integrative knowledge and innovation management tool or framework for spurring innovation in clusters and customising all policies affecting innovation in clusters. Clusters provide policy makers with a way of dealing with increased complexities and better targeting policies by addressing particular systemic failures that hamper innovation. Den Hertog, Pim *et al* (2001), 'Creating and sustaining innovative clusters: towards a synthesis' (OECD).
5. The national SME week is complemented by regional and local SME fora.
6. This calculation excludes the portion of the SME fund allocated to nation-wide programmes.
7. On a request from the Under Ministry for Small and Medium Enterprises, FUNDES has prepared a report evaluating the national guarantee programme.

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Annex I.

The Debt Crisis of 1982 and the Currency Crisis of 1995

During the past 25 years, the Mexican economy suffered two major crises, the debt crisis in 1982 and the currency crisis in 1995.

In 1982, the fiscal deficit had reached 17% of GDP and Mexico was no longer able to service its increasing foreign liabilities. The government defaulted on its sovereign debt obligations, sparking the debt crisis and necessitating a large consolidation of the fiscal position throughout the 1980s and into the 1990s. This consolidation was interrupted by a terms-of-trade shock resulting from an oil price collapse and a major earthquake in 1985, but then continued in earnest from the mid 1980s through to 1991. In the early 1990s, the central objective of monetary policy was to stabilise the exchange rate, first by fixing the peso rate to the US dollar, then by an exchange rate commitment (a widening fluctuation band).

Mexico recorded solid growth and falling inflation until 1994

During the early 1990s, Mexico was benefiting from earlier reforms in the 1980s, and GDP growth averaged 4% per annum. The fiscal consolidation reduced the fiscal deficit from around 15% of GDP in 1986 to a surplus by 1991, mainly through a cut in the expenditure-to-GDP ratio. However, from 1992 onwards there was a loosening of the fiscal stance and the fiscal balance returned to a small deficit. The effective loosening was greater as the government permitted rapid net lending growth by publicly-owned banks, which generated a significant indirect fiscal stimulus to the economy. Nonetheless, the process of disinflation continued helped by the exchange rate commitment.

...but with a widening current account deficit, the economy became increasingly reliant on foreign capital inflows

The return to solid growth and falling inflation was accompanied by an ongoing widening of the current account deficit, reflecting a rising saving-investment gap. There was a sharp decline in private saving associated with

financial market deregulation, increased confidence following fiscal consolidation and higher asset values, while public saving increased. Investment increased driven by the liberalisation of the economy, increasing competition, and the prospects of NAFTA. The ongoing fall in private sector savings, combined with a decline in public savings from 1992 onwards and the continued increase in the investment, led to a current account deficit of around 8% by 1994.

With the widening of the current account deficit, Mexico became increasingly dependent on capital inflows from abroad. As foreign direct investment (FDI) remained broadly stable, a growing proportion of the current account deficit was financed by increases in short-term portfolio investment. The increasing size of the current account deficit and the reliance on short-term funding increased Mexico's vulnerability to a sudden change in investor sentiment. As interest rates on government debt started to rise at the end of 1993, it became difficult for the government to place short-term peso debt in the market. The proportion of US dollar-indexed bonds (*tesobonos*) issued by the Mexican government rose from 4% to 74% of total government bonds.

When sentiment changed, a currency and banking crisis ensued...

Triggered largely by political events, investor sentiment deteriorated in the course of 1994, leading to large outflows of portfolio capital and a rapid run down in foreign exchange reserves. The central bank's exchange rate commitment was no longer sustainable and the government was forced to devalue and then float the peso in December 1994. Confidence continued to deteriorate into 1995 with concerns about the health of the banking sector and the Mexican government's ability to repay *tesobonos*. By the first months of 1995 the peso had fallen to around 50% of its pre-crisis level. With the withdrawal of foreign capital, interest rates had increased to over 80%. At that point, the international community came to rescue with USD 40 billion in financial support made available by the US Treasury, US Federal Reserve, the Bank of Canada, the BIS and the IMF, some of which was used to replace *tesobono* borrowings.

The currency crisis was accompanied by a banking crisis. Following deregulation of the financial sector in the 1980s, an increasing number of commercial banks were competing for market share without adequate procedures for credit control and banking supervision. This led to an explosion of credit to the private sector, which was followed by a large rise in non-performing loans, from 2% of total loans in 1990 to around 10% in 1994. The large rise in interest rates, the depreciation of the exchange rate

(30% of commercial bank lending to the private sector was foreign-currency denominated), and the collapse in activity in 1995 severely constrained borrower's ability to repay debt and the proportion of non-performing loans continued to increase. The rise in non-performing loans and inadequate bankruptcy laws put severe pressure on banks' profitability and the banking system came under extreme pressure. The problems in the private sector were further compounded by large non-performing loans of state-owned development banks.

To prevent a systemic collapse and ease the stress on the financial system, bank assistance measures (and debtor support programmes) were taken, including temporary capital injections and a US dollar lending mechanism provided to banks through the Bank of Mexico using international support resources. Rescue measures continued over several years generating concerns about the emergence of moral hazard problems in the banking sector.

...forcing a sudden adjustment in the economy

The crisis forced a sudden readjustment of the economy, which had to fund investment almost entirely from domestic savings. As a result the current account deficit shrunk from -7% in 1994 to -0.6% in 1995 and GDP fell by 6%, as investment and private consumption contracted sharply after the withdrawal of foreign capital and the sharp rise in interest rates. At the same time, the large fall in the exchange rate combined with previous policy reforms to open the economy, including NAFTA, allowed Mexico's producers to switch their sales from domestic markets to abroad, resulting in buoyant export growth. Inflation jumped to over 50% following the depreciation of the peso. Labour market conditions significantly worsened with large falls in employment especially in the formal sector (insured employment) and a rise in the open unemployment rate from 3.6% to 6.3%. In parallel, informal labour and poverty increased.

Annex II.

Calendar of Major SME Policy Events

- 2000** Legal framework for secured transactions (*Miscelánea de garantía*)
National Development Programme (NDP) for 2001-06
Entrepreneurial Development Plan (EDP) for 2001-06 (*Programa de Desarrollo Empresarial*)
Creation of the Federal Regulatory Improvement Commission (*COFEMER*)
- 2001** Creation of Under Ministry for Small and Medium Enterprises at Ministry of Economy Popular Savings and Credit Law (*Ley de Ahorro y Crédito Popular*)
Introduction of securitised notes (*Certificados Bursátiles*)
Creation of National Guarantee System for SMEs (*Sistema Nacional de Financiamiento a PYMES*)
Programme ‘*Marcha Hacia El Sur*’
Creation of *FAMPYNE* and *FIDECAP*
Establishment of the National Council for the Competitiveness of Micro and SMEs
- 2002** Creation of *FOAFI* and *FACOE*
Creation of National Savings and Financial Services Bank (*BANSEFI*)
Programa de Extensionismo
Law for the Competitiveness and Development of SMEs (*Ley para el Desarrollo de la Competitividad de la Micro, Pequeña y Mediana Empresa*)
Enterprise Rapid Opening System (*SARE*) (*Sistema de Apertura Rápida de Empresa*)
Labour market reform proposals

- 2003** Reform of the National Guarantee System
- 2004** Creation of the SME Observatory
- One-year moratorium on new regulations for the year 2005 extended to November 2006
- Creation of ‘Centres for Fast Enterprise Creation in the northern State of Sonora
- Federal Law of Transparency and Access to government information
- Creation of SME Fund (*FONDO PYME*)
- Creation of Financial Extension System (*Red Nacional de Extensionismo Financiero*)
- 2005** Postponement of labour market reform
- Changes in legal framework for secured credit transactions (*Miscelánea de Garantías*)
- Project “Concrete Actions to Enhance Competitiveness”
- Proposal of new Securities Market Law
- Shift to innovation-based SME policy
- 2006** Regulations of the Law for the Competitiveness and Development of SMEs
- Reactivation of the National Council for the Competitiveness of the micro and SMEs
- Amendment to competition law
- Creation of the ‘Fund of Funds’ supplying equity and venture capital for long-term investment projects
- Stock market law

Annex III.

The Bologna Charter on SME Policies

*Adopted at the 1st OECD Ministerial Conference on SMEs
in Bologna, Italy on 15 June 2000.*

Ministers and Representatives of governments¹ of Algeria, Argentina, Australia, Austria, Belgium, Brazil, Bulgaria, Canada, Chile, Czech Republic, Denmark, Egypt, Finland, France, Germany, Greece, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, Morocco, Netherlands, New Zealand, Norway, Philippines, Poland, Portugal, Romania, Russian Federation, Slovak Republic, Slovenia, South Africa, Spain, Sweden, Switzerland, Tunisia, Turkey, United Kingdom, United States and Vietnam, ***participating in the Bologna Conference:***

RECOGNISING the increasing importance of small and medium-sized enterprises (SMEs) in economic growth, job creation, regional and local development, and social cohesion, also through the role played by women and young entrepreneurs;

RECOGNISING that entrepreneurship and a dynamic SME sector are important for restructuring economies and for combating poverty;

RECOGNISING that globalisation, the acceleration of technological change and innovation create opportunities for SMEs but also involve transition costs and new challenges and that globalisation should lead to higher living standards for all and that its benefits should be accessible to all on an equitable basis;

RECOGNISING that SME policies need to be tailored to the circumstances and priorities of individual countries and sectors, while contributing to sustainable development and social progress;

WELCOMED the work on SMEs by the OECD and other international institutions and encouraged continued multilateral exchange of experience and best practice policies with a view to strengthening partnership and co-operation among SMEs in OECD and non-OECD countries. In this

perspective, **this first Conference of Ministers responsible for SMEs and Industry Ministers, jointly organised by the OECD and Italy**, is a major opportunity to identify public and private sector actions to help SMEs develop their local strengths while capturing the benefits of globalisation and trade liberalisation.

ACKNOWLEDGED that SME competitiveness would benefit from:

- A regulatory environment which does not impose undue burdens on SMEs and is conducive to entrepreneurship, innovation and growth through, *inter alia*: promoting good governance and greater accountability in public administration; pursuing a fair and transparent competition policy, and implementing effective anti-corruption measures; and fostering the implementation of transparent, stable and non-discriminatory tax regimes.
- Education and human resource management policies that: foster an innovative and entrepreneurial culture, including continuous training and lifelong learning; encourage mobility of human resources; and reduce skill disparities by improving the match between education and labour market demand.
- Effective access to financial services, particularly to seed, working and development capital, including innovative financial instruments to reduce the risks and transaction costs of lending to SMEs.
- An environment that supports the development and diffusion of new technologies for and by SMEs to take advantage of the knowledge-based economy.
- Strengthening public-private partnerships and political and social dialogue involving territorial and institutional actors as a tool for exchange of information, utilisation of knowledge and elaboration of policy.
- Ensuring the cost-effectiveness of SME policies and their consistency with other national policies, as well as with existing international programmes.

RECOGNISING the vital contribution of innovation to SME competitiveness, the central role played by SMEs in national innovation systems, and the importance of improved access to information, financing and networking in facilitating the innovation process, RECOMMENDED that in developing SME policies, the following be considered:

- SMEs' ability to manage innovation be improved by: facilitating the hiring and training of qualified personnel; diffusing an innovation culture; disseminating technological and market information and providing related assistance (*e.g.* through improvements in relevant labour market mechanisms, and linkages between enterprises and education systems, and between industry and public and university research).
- Financial barriers to innovation in SMEs be reduced by: *i*) facilitating the development of market mechanisms for equity financing, and related services, especially for innovative start-ups; *ii*) promoting risk-sharing programmes and measures, including financial support and tax incentives to R&D and innovation; and *iii*) supporting initiatives which facilitate "partnerships for innovation" between entrepreneurs, public agencies and financiers.
- SME access to national and global innovation networks be facilitated and their participation in public R&D programmes and procurement contracts encouraged.

RECOGNISING that, in a number of countries, clusters² and networking can stimulate innovative and competitive SMEs, RECOMMENDED that in developing SME policies, the following be considered:

- Partnerships involving private actors, NGOs and different levels and sectors of public administration in local cluster and networking development strategies be facilitated.
- The private sector lead cluster initiatives, with the public sector playing a catalytic role according to national and local priorities (*e.g.*, *inter alia*, facilitating private investment with public incentives, facilitating seed funding and monitoring the results of network initiatives).
- Public and private sector bodies foster the growth of clusters (existing and embryonic) by: improving their access to accommodation and efficient communications and transport infrastructures; facilitating local specialisation in university/industry linkages; disseminating targeted information, including on locational advantages and investment attractiveness; promoting suppliers' networks, technical support services, learning circles and other collaborative undertakings.

RECOGNISING that electronic commerce creates opportunities and challenges for SMEs, RECOMMENDED that in developing SME policies, the following be considered:

- Full account be taken of SME perspectives in the drafting of guidelines, rules and regulatory initiatives and instruments related to information and communication technologies (ICTs) and electronic commerce, taking into particular consideration the conclusions of the OECD Ministerial Conference on Electronic Commerce held in Ottawa in October 1998.
- Greater awareness among SMEs of the benefits of the Information Society and of integrating Internet use and electronic commerce in their business strategies be fostered by: *i)* encouraging the dissemination of information on opportunities and obstacles related to electronic commerce; *ii)* removing paper-based legal barriers to commercial electronic transactions and administrative impediments to the creation and development of new firms; *iii)* fostering a competitive market for high-quality network infrastructure; and *iv)* making use of the Internet in public administrations' interactions with SMEs and promoting electronic public procurement initiatives that provide equal access to SMEs.
- SMEs' participation in electronic commerce be enhanced by: *i)* fostering an environment conducive to business-led initiatives to promote the use of ICTs and electronic commerce (*e.g.* resource and demonstration centres, training initiatives, pilot projects); *ii)* encouraging the development of effective and user-friendly frameworks for certification, authentication, transaction security systems, privacy, and consumer protection and, more generally, providing an attractive business environment for electronic commerce in areas such as trade, competition, intellectual property rights (IPRs), standards, and taxation; and *iii)* enabling SMEs to work within a clear, consistent and predictable legal framework for electronic commerce, which allows access to "out-of-court" dispute resolution mechanisms, without imposing undue costs or burdens.

With regard to enhancing the competitiveness of SMEs in transition economies and developing countries in the global economy and their partnership with SMEs of OECD countries, RECOMMENDED that in developing SME policies, the following be considered:

- Co-ordination between governments, and regional and international organisations as regards industrial development programmes and

initiatives aimed at supporting the growth of SMEs in transition and developing economies be improved.

- Support and financial services, including those carried out by intermediaries (e.g. self-help organisations, business associations, technical assistance centres, etc.), be promoted in ways that foster international co-operation and partnership among SMEs and provide improved access to information, financial and technological resources and new markets.
- SME policies in developing and transition economies promote the long-term development of the sector and encourage networking. Policy and institutional mechanisms favouring large, often state-owned enterprises over SMEs, notably in sectors not characterised by economies of scale or other conditions of "natural monopoly", should be removed.

FUTURE ACTIONS

Ministers and Representatives of governments of countries participating in the Bologna Conference:

AGREED to work together and within international organisations to improve the complementarity of bilateral and multilateral initiatives to foster global SME partnerships and enhance the availability of financial and non-financial instruments to promote SME development.

AGREED on the usefulness of benchmarking the effectiveness of SME policies, regulatory environment and performance, based on data and statistics collected at national and sub-national level, including on electronic commerce.

TOOK NOTE, with interest, of the Italian proposal for an International Network for SMEs (INSME) and the Italian initiative to promote it. They **WELCOMED** Italy's offer to carry out a feasibility study, including a need assessment, to define its possible design and development, which could also benefit from support by interested countries and private sector inputs. Ministers and the OECD will be kept informed on the results of the feasibility study [*see the Conference document entitled: Italian Proposal for an "International Network for SMEs (INSME)"*].

AGREED on the importance of building on the achievements of the Bologna Conference and of pursuing the policy dialogue among OECD Member and non-member countries, and **LOOKED FORWARD** to the possibility of holding a second Conference of Ministers responsible for SMEs and Industry Ministers to assess the impact on SMEs of new developments relating to globalisation.

Notes

1. Including the European Community.
2. Clusters can be characterised as production networks of strongly interdependent firms (including specialised suppliers) linked to each other in value-adding production chain. In some cases, clusters also encompass alliances with universities, research institutes, knowledge-intensive business services, bridging institutions (brokers, consultants) and customers. [OECD (1999), Boosting Innovation: The Cluster Approach]

Annex IV.

The Istanbul Ministerial Declaration on Fostering the growth of innovative and internationally competitive SMEs

*Adopted at the 2nd OECD Ministerial Conference on SMEs
in Istanbul, Turkey, on 5 June 2004.*

Ministers and Representatives of governments participating in the OECD conference held in **ISTANBUL** on 3-5 June 2004¹, (hereafter the Ministers),

RECOGNISING that small and medium-sized enterprises (SMEs):

- Are the dominant form of business organisation in all countries, typically accounting for over 95 percent of the business population;
- Constitute an important dynamic element in all economies as they drive innovation, especially in knowledge-based industries; and
- Play a key role in driving sustainable economic growth and job creation while contributing to the social, cultural and environmental capital of nations;

ACKNOWLEDGING:

- That for SMEs and entrepreneurship to flourish there needs to be a conducive business environment where the rule of law is paramount; and
- That SMEs operate within distinct business cultures around the world, but that the economic and dynamic market conditions they face create similar challenges for the firm and how it prospers;

RECALLING 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;

NOTING that the “*The Bologna Charter on SME Policies*” provides a frame of reference for the design of SME policies to contribute coherently to economic growth and social development, both in OECD countries and the rest of the world;

REAFFIRMING their commitment to working to put in place policies which support the development, growth and competitiveness of SMEs and to pursuing policy dialogue and co-operation among OECD countries and non-member economies;

RECALLING the “*Future Actions*” agreed upon at Bologna and **WELCOMING** those that have been undertaken to date, in particular:

- The analytical work of the OECD in preparation for this Conference of Ministers responsible for SMEs, in line with the recommendations of the Charter, which has focused on: entrepreneurship, including women’s entrepreneurship; access to financing; partnerships, networks and clusters; SMEs’ access to international markets; information and communication technologies and e-business; and promoting SMEs for development²;
- Practical outputs, including the development of a framework for strengthening evaluation of SME programmes and policies which should benefit both OECD and non-OECD economies; the creation of educational instruments for SMEs wishing to resolve e-business disputes on line; and the first steps towards the improvement of SME-related data and statistics;
- The launch of the “OECD Bologna Process” which brings together OECD and non-OECD economies for strengthened dialogue and co-operation to foster the entrepreneurship agenda and SME competitiveness at the global level, and encourages increasing co-operation between the OECD and other international organisations in this area;
- The increased role of the OECD in providing a forum for sharing best-policy practices in the area of women’s entrepreneurship, in partnership with the private sector; and
- Following a successful feasibility study, the International Network for SMEs (INSME) was set up on the initiative of Italy. INSME is a non-profit international association aimed at improving transnational co-operation and public and private partnership in the field of innovation and technology transfer to SMEs. INSME, which groups a number of OECD and non-OECD stakeholders, including governments, benefits from OECD sponsorship;

WELCOMING the second Conference of Ministers responsible for SMEs, jointly organised by the OECD and Turkey in **ISTANBUL** in June 2004, which has provided a major opportunity to extend the policy dialogue on enhancing *entrepreneurship and SME innovation* as drivers of growth in a global economy;

WELCOMING the participation of the business community through the Business Symposium, **NOTING** the recommendations endorsed at the Symposium, and **CONFIRMING** that these recommendations have been taken into account in the framing of this Declaration [See the Conference document containing the recommendations of the Business Symposium on “*SMEs Competing in a Knowledge Economy*”];

HIGHLIGHTING the benefits of exchanging views and experiences with regard to: strengthening entrepreneurship and SME innovation; policy tools for supporting innovation using an interdisciplinary approach; and ways to take advantage of international markets and to contribute to development; and

RECOGNISING that an important theme cutting across this discussion is the need to *build a culture of evaluation* in which programmes and policies are systematically reviewed in order to strengthen and improve those that should be retained;

I. REAFFIRM the need to support the development of the best set of public policies that will foster the creation and rapid growth of innovative SMEs. This requires:

a) Policies and an institutional framework that contribute to a business environment that is conducive to entrepreneurship and facilitates entry, growth, transfer of ownership and smooth exit of enterprises. These should be coherent at international, national, regional, and local levels and should include:

- Stable macroeconomic policies and well-designed structural policies in areas that impinge on SMEs, such as competition, international trade and investment, financial markets, labour markets and education; and, as regards to developing economies, embedding private sector SME strategies in broader development strategies and poverty reduction programmes;
- Enabling regulatory frameworks, which are developed taking into account the needs of SMEs and facilitating their integration into the formal sector; tax systems that entail low compliance costs; the transparent and equitable application of rules and legislation; simple and transparent licence and permit systems;

efficient bankruptcy laws and procedures; understandable and coherent product standards in world markets; clearly defined property rights; fair and reasonably priced dispute settlement procedures; and light, predictable administrative procedures;

- Laws and systems of governance that support the development and diffusion of new technologies in ways that enable and encourage SMEs to take full advantage of them, notably by strengthening the science-innovation interface; ensuring that intellectual property rights systems are coherent, easy to understand and used effectively; and promoting access to and use of quality information and communication infrastructure and promoting enhanced security and trust in the digital economy;

b) SME assistance and development programmes which are clear in terms of their rationale, objectives and beneficiaries. These policies and programmes should be:

- Based on sound research, empirical evidence, public-private dialogue and partnerships, and evaluated regularly for effectiveness and efficiency;
- Cost-effective and designed to encourage activity that would otherwise not have taken place and help SMEs overcome the effects of market failures, without unduly distorting market structures or creating barriers to competition;
- Designed to provide support to large groups of SMEs, including micro-enterprises, for example by helping them to: improve their management skills; obtain finance on reasonable terms; increase their capacity to compete for government procurement; have access to timely advice and information; enhance their ability to take full advantage of information and communication technologies; and improve linkages with other SMEs and large firms to encourage the emergence and development of innovative clusters;

c) Policies that contribute to mobilising human resources in order to promote entrepreneurship. This involves:

- Developing a culture that encourages entrepreneurship and recognises entrepreneurial success. The integration of entrepreneurship at all levels of the formal education system can facilitate this. Formal education should be complemented by learning-by-doing activities and other practical workshops. This

objective requires paying particular attention to teacher training programmes;

- Promoting the diffusion of training programmes and lifelong learning opportunities by stimulating market provision of such services and, where the need exists, providing hands-on focused courses funded by the public sector;
- Promoting women’s entrepreneurship through the elimination of barriers to enterprise creation and growth, such as impediments to the right to hold property or to sign contracts, where such impediments exist, and by taking into account at the design stage the impact of SME-related policies on women’s entrepreneurship;
- Mobilising disadvantaged groups. One way to pursue this objective is to develop policies and programmes which provide business support services targeted to these groups and disseminate information to those wanting to start and grow a business;

II. RECOGNISE that, while priorities in terms of specific elements of SME policies vary greatly among participants due to their differing stages of development, political contexts and institutional arrangements, several key themes stand out as being of particular importance:

a) The need to reduce barriers to SME access to global markets.

Policies should aim to encourage the smooth, cross-border growth of SMEs including in some instances through the promotion of business linkages between large enterprises and SMEs. This can be achieved by reducing administrative and legal burdens, by facilitating compliance by internationally active SMEs with multiple sets of rules and requirements (in areas such as intellectual property rights, product standards, financial market regulations and customs procedures), by promoting harmonisation—as appropriate—of rules and requirements in order to reduce the cost of such compliance, and by fostering—to the fullest possible extent—the development of alternative dispute resolution mechanisms;

b) The need to improve access to financing for SMEs on reasonable terms. While SMEs’ financing requirements differ at each stage of their development, policies should aim to ensure that markets can provide financing for credit-worthy SMEs and that innovative SMEs with good growth prospects have access to appropriately structured risk capital at all stages of their development. Policies should also contribute to increasing the managerial and technical expertise of those

intermediaries whose role is to evaluate and monitor companies with a view to matching expanding small firms with investors;

c) The need to develop a strong “*evaluation culture*” in ministries and agencies responsible for SME policies and programmes.

Evaluation provides a means of ensuring that SME programmes remain cost-effective and adapt to changing conditions in a dynamic world. Ideally, evaluation would be mandated and budgeted for when programmes are designed, would be carried out by independent but informed evaluators, and would generate recommendations for improving and strengthening those programmes that should be retained;

d) The need to strengthen the factual and analytical basis for policy making so that policy makers can make decisions in an informed manner based on empirical evidence.

This requires both reliable and internationally comparable data and statistics on which analytical work can be based as well as cross-country comparative studies and longitudinal analyses which can assess the impact of economic forces and developments on SMEs over time. The lack of an empirical foundation is particularly marked in the area of women’s entrepreneurship;

III. TAKE NOTE with interest of the “**Regional Emerging Markets Technology Transfer Network – REMTECH**”, initiated by Turkey, which aims at integrating and promoting technology- oriented SMEs at global level in various strategic sectors, and **WELCOME** the intention to implement a pilot project in the field of automotive components, with the goal of developing technology transfers among clusters of specialised innovative SMEs in this market at the global and sub-regional levels;

IV. COMMIT to:

- Working co-operatively to achieve progress in reducing barriers to SMEs’ access to international markets;
- Considering SME needs, including for simplified, streamlined and integrated administrative processes, when formulating new legislation, regulations and product standards;
- Assessing the effects of globalisation on SMEs and in particular examine issues related to SME access to financing and to support for innovation;
- Recognising and building on SMEs’ role as engine for growth, employment and poverty alleviation, particularly in developing countries;

V. ACKNOWLEDGING that the OECD offers a global perspective and should capitalise on its access to sources of information and inspiration from around the globe, identifying good and innovative practices in areas of well-established interest to encourage the development of SME and entrepreneurship policies and initiatives that work, **INVITE** the OECD to consider:

- Strengthening its peer-review processes for specific thematic issues and policies affecting SMEs, and of the SME sector as a whole. Peer reviews would be carried out on a voluntary basis;
- Developing a robust and comparable statistical base on which SME policy can be developed. *The action plan emerging from the Istanbul Conference Special Workshop on SME Statistics* provides a good basis for this work;
- Enabling a better understanding of *international value chains* and the way in which SMEs can benefit from them;
- Identifying ways in which unnecessary *barriers to SMEs' access to international markets* can be removed, in collaboration with interested countries and other relevant international organisations and fora;
- Proactively disseminating the work it has carried out on best practices for the *evaluation of SME policies and programmes*, for example by working with OECD members and interested non-member economies and organisations to develop and test a handbook of best practices for evaluation of SME policies and programmes;
- Organising focused thematic workshops and conferences involving interested OECD members, non-member economies and international organisations with a view to making concrete progress in specific areas identified for analysis and policy action. One such conference could be focused on *financing SMEs* at all stages of their development, with a particular emphasis on innovative SMEs;
- Proactively disseminating OECD activities related to the development of *women's entrepreneurship*. This could be undertaken through the organisation of meetings and seminars, as well as training workshops, to enable the exchange, transfer and diffusion of best practices amongst member and non-member economies. The OECD-Istanbul Private Sector Development Centre can play a particular role in this regard.

Annex IV.a. Adherents to the Declaration

- Albania ▪ Algeria ▪ Argentina ▪ Australia ▪ Austria ▪ Azerbaijan
- Bangladesh ▪ Belarus ▪ Belgium ▪ Bosnia & Herzegovina ▪ Brazil ▪ Bulgaria
- Canada ▪ Croatia ▪ Czech Republic ▪ Denmark ▪ Egypt ▪ Finland ▪ France
- Georgia ▪ Germany ▪ Ghana ▪ Greece ▪ Hungary ▪ Iceland ▪ India ▪ Indonesia
- Ireland ▪ Israel ▪ Italy ▪ Japan ▪ Jordan ▪ Kazakhstan ▪ Kenya ▪ Kyrgyzstan
- Korea ▪ Latvia ▪ Lithuania ▪ Luxembourg ▪ FYR Macedonia ▪ Malaysia ▪ Mexico
- Moldova ▪ Morocco ▪ Netherlands ▪ New Zealand ▪ Nigeria ▪ Norway ▪ Pakistan
- Papua New Guinea ▪ Poland ▪ Portugal ▪ Romania ▪ Russian Federation
- Senegal ▪ Serbia & Montenegro ▪ Slovak Republic ▪ Slovenia ▪ Spain ▪ Sweden
- Switzerland ▪ Chinese Taipei ▪ Tajikistan ▪ Thailand ▪ Tunisia ▪ Turkey
- Ukraine ▪ United Kingdom ▪ United States ▪ Uzbekistan ▪ Venezuela ▪ Vietnam
- European Community

- Albanie ▪ Algérie ▪ Allemagne ▪ Argentine ▪ Australie ▪ Autriche
- Azerbaïdjan ▪ Bangladesh ▪ Belarus ▪ Belgique ▪ Bosnie-Herzégovine
- Brésil ▪ Bulgarie ▪ Canada ▪ Corée ▪ Croatie ▪ Danemark ▪ Égypte
- Espagne ▪ États-Unis ▪ Fédération de Russie ▪ Finlande ▪ France
- Géorgie ▪ Ghana ▪ Grèce ▪ Hongrie ▪ Inde ▪ Indonésie ▪ Irlande ▪ Islande
- Israël ▪ Italie ▪ Japon ▪ Jordanie ▪ Kazakhstan ▪ Kenya ▪ Kirghizistan
- Lettonie ▪ Lituanie ▪ Luxembourg ▪ ERY Macédoine ▪ Malaisie ▪ Maroc
- Mexique ▪ Moldavie ▪ Nigeria ▪ Norvège ▪ Nouvelle-Zélande ▪ Ouzbékistan
- Pakistan ▪ Papouasie Nouvelle-Guinée ▪ Pays-Bas ▪ Pologne ▪ Portugal
- République slovaque ▪ République tchèque ▪ Roumanie ▪ Royaume-Uni
- Sénégal ▪ Serbie et Monténégro ▪ Slovénie ▪ Suède ▪ Suisse
- Tadjikistan ▪ Taipei chinois ▪ Thaïlande ▪ Tunisie ▪ Turquie ▪ Ukraine
- Venezuela ▪ Vietnam ▪ Communauté européenne

Annex IV.b.

OECD Background Documents

1. Fostering Entrepreneurship as a Driver of Growth in a Global Economy
2. Women's Entrepreneurship: Issues and Policies
3. Facilitating SMEs Access to International Markets
4. Financing Innovative SMEs in a Global Economy
5. Networks, Partnerships, Clusters and Intellectual Property rights: Opportunities and Challenges for Innovative SMEs in a Global Economy
6. ICT, E-Business and SMEs
7. Alternative Dispute Resolution (ADR) on-line Mechanisms for SME Cross-border Disputes
8. Promoting SMEs for Development
9. SME Statistics: Towards a more Systematic Statistical Measurement of SME Behaviour
10. Evaluation of SME Policies and Programmes

Notes

- 1 The full list of adherents to the Declaration is provided in Annex IV.a.
- 2 The full list of OECD background documents is provided, for information, in Annex IV.b to the Declaration.

Annex V.

The OECD Brasilia Action Statement for SME and Entrepreneurship Financing

*Adopted at the OECD Global Conference
in Brasilia, Brazil, on 30 March 2006.*

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.

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.

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.

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.**

Main findings and actions required:

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 programmes and programmes 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 programme, 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.

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:**

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.

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 Vækstfonden 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.

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): (see Box on following page)

Notes

- 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.

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.

Annex VI.

The Athens Action Plan for Removing Barriers to SME Access to International Markets

*Adopted at the OECD-APEC Global Conference
in Athens, Greece, on 8 November 2006.*

Background

At the invitation of the Hellenic Government, the OECD-APEC Global Conference on *Removing Barriers to SME Access to International Markets* took place in Athens on 6-8 November 2006. Convened within the framework of the OECD Bologna Process on SME and Entrepreneurship Policies, the meeting brought together *members of the international business community (including SMEs), organisations involved in the facilitation of world trade, and senior government representatives from members of the OECD and APEC as well as non-member economies.*

Globalisation offers both opportunities and challenges for businesses. Increasingly, SMEs are seeing participation in international markets as critical to their survival, job creation and growth. Already SMEs¹ are significant contributors to the global economy accounting for approximately 50% of local and national GDP, 30% of export and 10% of FDI². While it is not possible to accurately quantify the number of SMEs currently involved in international markets – it appears to be increasing, particularly for SMEs in the service sector. The opportunities for international business dealings³ have grown dramatically as the traditional barriers associated with distance and cross-border transactions have been reduced through new technology and trade negotiations. But the development of a fast-changing and increasingly complex global marketplace has also placed considerable pressures on firms, particularly SMEs.

Operating successfully in international markets requires, amongst other things, learning to manage at a distance using a variety of informal and

formal contractual business relationships, gaining familiarity with different business regulations, customs, cultures and languages, and developing appropriate solutions for all the markets in which the firm operates.

This poses challenges for the managers of those firms and requires them to use, or develop, a much larger range of managerial competencies than if they operated solely in their domestic market. It involves aligning the financial, human, marketing, technological and innovative capacity resources of the firm with the decision to internationalise. It also poses challenges for governments (and business associations and others who assist SMEs) in providing the right, targeted support programmes and other incentives to encourage SMEs to internationalise and to help them overcome the internal and external barriers they face in doing that.

The Conference found that SMEs involved with, or wishing to enter, international markets face a number of common issues. A key conclusion of the Conference was that governments, international institutions and business associations could play a significantly greater role in assisting SMEs to meet the challenges of internationalisation of their businesses, particularly if they work co-operatively.

Therefore, 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, 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*, and the *Hanoi Declaration on Strengthening SME Competitiveness for Trade and Investment* issued on 29 September 2006, **Participants endorsed this Action Plan.**

Key challenges faced by SMEs in international markets

SMEs appear to go through a learning process when they engage in international activities. This process can be shaped by the size and the industrial sector of the firm. Each step of this learning process presents special challenges for SMEs. The set of firms that are not yet active exporters often underestimate the barriers present in the external business environment, such as those associated with financial matters and access to markets. They may also lack awareness of how their capabilities match the challenges of operating in international markets and also the knowledge about how to evaluate their capabilities in this respect. However, when these firms become engaged in international trading activity, there is

increased awareness that the key barriers relate to the business environment and their own management capabilities rather than finance and access.

Identifying international business opportunities, locating and analysing suitable markets

Because of the limits on the time, competency and financial resources available to SMEs, they often are not able to identify and pursue new international market opportunities. Even when they have identified a possible new market, they often experience real difficulties in accessing even the limited data available on which to assess expected profit and risk of doing business in that market. Often, when they are able to obtain data about the new market, it is frequently unreliable or outdated and so may open the business to additional risks if acted upon. Thus, identifying and accessing appropriate information, both from private and government sources, remains a key challenge for SMEs seeking to enter international markets. SMEs that are already established in international markets tend to have developed a greater competence, and the networks needed, to assess new markets.

Contacting potential overseas customers

Having identified an opportunity to internationalise SMEs face a variety of barriers, many of which are specific to their operations or industry. Those firms that are new to internationalising, in particular, lack knowledge on the best way to enter or to make the greatest use of a commercial engagement in that market. They also lack the ability to identify potential high-value customers in new markets. They may decide not to take-up the opportunity, or they may take an approach to the market which ends up being unsuccessful.

Obtaining reliable foreign representation

The ability to get access to the right customers is a problem for any businesses seeking to enter an unfamiliar market. Many firms need to engage agents to represent and advance their interests in a target market. Large firms leverage their existing international staff in order to access new markets, but this is often not an option for SMEs. The process of engaging suitable agents and then of effectively managing them at a distance is complex and places a heavy additional demand on an SME manager's time and capabilities. Agents are in high demand and an SME may be only one of the several clients whose interests the agent represents. There is also the risk that agents might also engage in business practices that are not supported by the SME, or deliberately promote their own interests over

those of the SME. Distance means that the SME can often remain unaware of a problem for too long and getting remedies in a foreign jurisdiction may also prove problematic. In some cases, governments provide in-market support for their firms, but again the service provided and the time allocated to the interests of an individual SME by such agents may be limited. However, managing foreign representation is a skill that can be built up by the SME, with experience.

Accessing finance for internationalisation

Firms seeking to enter new markets can face shortages of working capital. This can be due to difficulties in obtaining finance, because funders have a higher perception of risks based on concerns about exchange rate volatility, differing regulatory environments in the target market, perceived cultural difficulties and, in some cases, political risks. Also, entering new markets places increased demands on the financial and management skills of a business, including understanding the use of more sophisticated financial instruments, the ability to assess risk and to grant credit to clients, the collection of payments and contract enforcement. In some economies, the problem may be the lack of financial institutions with the experience of funding internationalisation efforts. Access to finance appears to become less of a problem for SMEs after they have become active in international markets.

Allocating managerial time to deal with internationalisation

Time is probably the most limited resource available to any SME owner. The daily struggle to maintain the viability of the business often crowds-out new, future and forward thinking. The time and effort to gain entry into international markets therefore pose considerable risks to the viability of the business as a whole and the owner's risk aversion becomes a barrier to an SME seeking market access.

Engaging specialist staff to assist with the management of international markets

It is difficult and costly for any firm to enter and then establish itself in a new market. Even when it is necessary, SMEs often cannot afford to retain specialist staff (or engage external experts) to set-up and manage their international operations. Technical, legal, marketing, e-commerce and supply-chain management expertise are often required for the operations to be successful. These skills are in short supply worldwide and are often only available in large multinational enterprises.

Meeting the costs of accessing markets

Managing the costs over which the business has limited influence (*e.g.* in-market transportation and distribution costs) is often a problem, although the intensity of this problem will differ according to the market to which the SME wants to have access. The internationalising SME faces costs of travelling to or getting goods to the market that are not faced by local competitors.

Dealing with anti-competitive behaviour

SMEs may face anti-competitive behaviour by local firms or governments (*e.g.* charging foreign firms fees that are not imposed on local producers, special licensing for foreign service providers) or by competing foreign firms (*e.g.* dumping).

Difficulties in accessing or identifying support from government

In some economies there is little effective government support and assistance available to firms wishing to access international markets. In other economies there are programmes, but SMEs often do not know about them or how to access them. Where they do, the process of gaining support often appears complex, time-consuming and burdensome. Therefore, SMEs often choose not to use the support available, although the majority of those that take advantage of it judge the assistance to be useful. Similarly support is sometimes available to attract business to enter a new market - but usually that is only for larger firms or for select groups of smaller firms.

Recommendations for future government support for internationalising SMEs

Participants considered that, where market failure arguments suggest that there may be an appropriate role for them, **governments can play an important role in helping SME internationalise** because of the positive overall effects for economic growth. However in doing this, governments must recognise that the needs of internationalising SMEs differ according to the age and experience of each firm and their sector and should focus their assistance accordingly.

In order to open up greater opportunities for international trade and investment, governments should consider the following actions:

1. Concluding outstanding trade negotiations leading to open markets, reduced trade barriers and contributing to a stable and transparent business environment.
2. Actively removing non-tariff barriers to international trade (*e.g.* through mutual recognition of product standards and business and occupational licensing, efficient legal systems, improved customs procedures, facilitating business travel).
3. Promoting clear and accessible public consultation mechanisms to facilitate SME participation in the trade policy process.
4. Encouraging regulatory co-operation among governments to reduce trade-related compliance costs.
5. Providing a simplified, transparent and non-discriminatory domestic business regulatory environment (*e.g.* allowing equal access to government contracts for both foreign and domestic suppliers in authorised sectors).
6. Ensuring high quality policy frameworks for encouraging private investments are in place.

Priority areas for proactive government support would be:

1. Better support and facilitation for SMEs that are intent on entering international markets, for example:
 - Informed and up-to-date advice on market opportunities;
 - Addressing the shortage of people with the skills to advise SMEs on accessing international markets; and
 - Specific training and advisory support, for example funding for the development of marketing plans, for access to market experts, for advice on supply-chain management and IP protection and for technical support in establishing franchises or joint ventures and creating cross-border alliances.
2. Better, and better targeted, support for SMEs already operating abroad. This includes in-market facilitation and also facilitation by the government and government agencies of the SME's home economy, such as support for attending trade fairs, and provision of skilled and informed foreign representatives.
3. The development of better data and statistical information both on international markets and on the population of SMEs that regularly access international markets.

In the provision of that support, governments should ensure the effective alignment, integration and efficient delivery of all policies and programmes, including trade policy, customs and security procedures, SME-targeted support and business regulation. The efficient integration of support services for SMEs is considered good practice, particularly when efforts have been made to ensure the information is accessible for SMEs.

Policies and programmes that have been utilised successfully by governments wishing to assist SMEs to more effectively enter new international markets, have included:

1. Encouraging the formation of clusters of (and other forms of co-operation and collaborative action for) SMEs interested in sharing information among themselves on how better to pursue international opportunities in specific product areas or markets or in entering the same market or wishing to offer complementary products or services to international markets.
2. Encouraging all forms of appropriate co-operation and networking amongst SMEs, or between SMEs and larger firms, so that the experience of firms already engaging with foreign markets can be shared by SMEs seeking to access to those markets. Depending on the circumstances, governments could consider providing incentives (amongst other things appropriate financial incentives) to initiatives that encourage greater co-operation between SMEs and multinational enterprises (MNEs).
3. Disseminating information on initiatives to facilitate SME access to international markets, such as the Business and Industry Advisory Committee to the OECD (BIAC) Initiative. This initiative involves the creation of a SME web portal that provides access to publicly available information about trade rules and market support in a variety of economies, and that identifies BIAC member multinational enterprises that are willing to co-operate with SMEs4.
4. Supporting forums in which government officials (or other institutions, such as chambers of commerce or professional organisations) can diffuse, collate and publish best policy practice on:
 - Assisting SMEs to be ready to access international markets.
 - Developing high quality, transparent and efficient business regulation.
 - Providing up-to-date information on markets to assist SMEs.

- Encouraging and enforcing responsible international business conduct.
 - Providing support (*e.g.* legal documentation) that can be used to establish relationships with clients or partners in international markets.
 - Developing sufficient people with the expertise to advise and support SMEs wishing to enter international markets.
 - The development of diagnostic tools to assess the capabilities of firms wanting to enter new markets.
 - Supporting SMEs domestically and in-market to assist them to become established in new international markets.
 - Providing effective in-market government representation.
 - Assisting deserving SMEs to gain access to appropriate financial instruments for funding internationalisation.
 - The use of e-commerce as a tool for overcoming distance to markets, for reducing the cost of compliance with government regulations, and for encouraging the up-take of efficient business practices.
5. Encouraging the development of websites that provide opportunities for SMEs, at minimal cost, to present the products or services that they wish to offer to international markets.
 6. Providing programmes to assist SMEs to access the finance needed to fund potentially successful entries into new markets and, where necessary, develop or create additional financial instruments, such as innovation funds, for financing the internationalisation of SMEs.
 7. Involving business and non-government organisations more effectively in the development and delivery of policy and programmes aimed at assisting SMEs to access international markets.
 8. Utilising and communicating more effectively (including making better use of resources in the private sector such as business associations, chambers, trade associations, etc.) the full range of government and non-government support that is available for SMEs seeking to access international markets and ensure that the activities of the various government agencies supporting SMEs are fully integrated. For their part, the business international organisations have to play an active role in promoting simplified tools for SMEs, for example issuing letters of credit.

In devising such programmes, governments should take into account that a multifaceted approach targeted at the generic problem faced by SMEs entering international markets (*e.g.* business capability) may more quickly produce benefits for SMEs. They should also consider how barriers to internationalisation reinforce each other, so they can develop more effective support programmes.

Governments should establish evaluation frameworks for their programmes and keep constantly under review the support schemes they provide for SMEs about to or already engaged in internationalisation. The research carried out for this Conference suggests that in undertaking such reviews, governments could consider the following framework: **sustaining** current programmes addressing those barriers identified as important by both governments and SMEs; **reconsidering** those programmes aimed at addressing barriers which are reported as important by governments but of little importance by SMEs; and, **increasing** levels of support to address barriers reported as important by SMEs but of little importance by governments. Alternatively, governments could devise their own framework for programme evaluation.

Recommendations for further work by OECD and APEC

(in partnership with other international institutions)

Participants called upon the OECD and APEC to continue their co-operation (in partnership with other international institutions), in order to further develop work on removing barriers to SME access to international markets and assist policy makers to promote SME internationalisation and competitiveness. Building on the valuable work of the *OECD Working Party on SMEs and Entrepreneurship* (in close co-operation with the *Working Party of the Trade Committee* and the *Investment Committee*) and the *APEC SME Working Group*, Participants invited the OECD and APEC to further develop the following areas (subject to the availability of resources):

1. Collation and assessment of good practice in member economies for government support programmes to assist SMEs to internationalise, including a review of the evidence on the practices and experiences of SMEs who are internationalising successfully.
2. Collation and assessment of best practice in developing key performance indicators and other methodologies to evaluate and monitor the effectiveness of support programmes for the internationalisation of SMEs.

3. The improvement of the data and statistical information available for better understanding the issues faced by SMEs accessing international markets, and consequently, for factual and analytically-based policy development.
4. Continue the current work investigating the benefits accruing to SMEs involved in global supply chains.

Notes

- 1 There is no single agreed definition of a SME. A variety of definitions are applied among OECD and APEC economies, and employee number is not the sole defined criterion. SMEs are considered to be non-subsidiary, independent firms which employ less than a given number of employees.
- 2 This refers to firms in the formal sector only.
- 3 In this Action Plan the international activities of SMEs include all forms of transferring goods and services across borders such as export activity, joint ventures, non-equity strategic alliances, licensing, establishment of subsidiaries or branches and franchising. Importing is also a form of internationalisation.
- 4 Nevertheless, it is not meant to serve as a platform for the exchange of confidential information: should companies recognise between them that there may be some additional business opportunities, this would be undertaken at their own discretion and not in the context of this BIAC-OECD initiative. In any case, it will not replace or override member countries existing similar initiatives.

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SMEs in Mexico

ISSUES AND POLICIES

Although small and medium-sized enterprises (SMEs) in Mexico comprise the near-totality of firms in the formal economy, they are hampered by a lack of financing and skilled workers, with only a small percentage able to compete successfully at home and abroad. This book assesses the comprehensive SME policies introduced by the Federal Government during the past six years aimed at improving the efficiency and competitiveness of Mexican SMEs by reducing barriers to entrepreneurial activity.

While lauding the improvements achieved by the new policy measures, including better access to financing, reduced lead times for firm creation, and higher survival rates, the review cautions that there is room for improvement. Specifically, the capacity of states and local authorities to absorb federal policy programmes needs to be enhanced, and tailor-made initiatives in favour of micro firms need to be expanded.

In addition to examining the SME policies and programmes that have been put in place, the review makes practical recommendations on how to improve policy co-ordination, create an efficient evaluation culture at all levels of government and strengthen the entrepreneurial business environment.

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