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# Unleashing the Full Potential of SMEs: Beyond Financing

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## Key Insights

- Amid global risks of a slow, jobless recovery, promoting the development of small and medium sized enterprises (SMEs) is a critical policy objective because they are major contributors to GDP, job creation, poverty reduction and market innovation.
- Globally, SMEs account for over 60 per cent of GDP and more than 90 per cent of employment.
- Contrary to expectations, most micro and small enterprises operate in the services sector, whereas the more visibly successful SMEs in the manufacturing sector are medium-sized.
- SME growth is hindered not just by a lack of financing, but also by serious non-financial constraints, such as insufficient skills and technology, high transaction costs, poorly defined property rights, inadequate market access and poor coordination of government SME support.
- Asia needs to adopt a more integrated approach to promoting SME development, combining measures to improve access to finance with initiatives to tackle other constraints. Public and private sector stakeholders need to work together (both top-down and bottom-up) to develop a supportive and dynamic ecosystem that draws on public-private sector support mechanisms to enable SMEs to thrive. Talent development and effective use of technology are key.
- Globally and regionally, there are examples of successful SME development initiatives in many countries from which different Asian stakeholders can learn, including:

  **Government:**
  - Determine explicitly the overall approach to SME development and the respective roles of government, business and the education sector.
  - Streamline SME support through a one-stop agency for SME development (simplified procedures, innovation, technology and specialized support services, especially for SMEs expanding overseas).
  - Invest in and support public-private development of consistent information standards and systems (e.g., accounting standards, SME credit bureau, marketing database) to improve information base.
  - As needed, play an enabling and regulating role in the creation of integrated payments and trading platforms for SMEs.

  **Finance sector:**
  - Offer both equity and debt financing options.
  - Take advantage of supply chain finance to improve credit availability.

- Facilitate SME access to bank credit via standardized and simplified loan procedures and improved risk assessment that take advantage of all available information.
- Develop new business models by leveraging on new technologies.
- Establish a dedicated exchange for SMEs to raise funds via capital markets.
- Invest in up-front financial literacy and education for new SME customers.

**Business sector and chambers of commerce:**

- Promote research and development, skills upgrading/apprenticeship programs.
- Improve understanding of how to link with global supply chains.
- Support internationalization of SMEs.
- Working with business schools, use e-learning to spread management and technology faster to SMEs.
- Provide SMEs with mentoring and guidance on marketing and distribution.

**Educational sector and academia:**

- Design curricula, vocational training and apprenticeship programs to develop individuals with the right skill sets for SMEs.
- Take part in periodic joint review and feedback work on the effectiveness of SME programs for innovation, job creation, exports and national competitiveness.

## Introduction

A jobless recovery is the biggest threat to social stability worldwide. Across economies, SMEs account in aggregate for the bulk of jobs and can be a disproportionate source of new job creation. The promotion of a strong SME sector is key to growth, innovation and jobs, and job creation is one of the most effective routes to poverty alleviation. SMEs need to play a major role in economic development. This is particularly the case in emerging countries in Asia, where in many instances large corporations – often state-owned – have received much of the policy attention and support.

There is no single global definition of what makes a company an SME. Different countries have adopted various definitions and benchmarks, but they all share common criteria, namely, the number of employees, size of revenue and assets. The International Finance Corporation has defined SMEs as those enterprises with a maximum of 300 employees, and either less than US$15 million in annual revenue, or less than US$15 million in assets (IFC 2012). The European Union has an alternative definition, as follows (it is necessary to meet the headcount criterion and one of the revenue or total asset thresholds) (EC 2012e):

| Type of Enterprise | No of Employees | Revenue | or, Total Assets |
|---|---|---|---|
| Medium | < 250 | < €50 million | < €43 million |
| Small | < 50 | < €10 million | < €10 million |
| Micro | < 10 | < €2 million | < €2 million |

*NB: If an enterprise is not autonomous (meaning it holds more than 25 per cent of capital or voting rights, whichever is lower, in another/other enterprise(s); or outsiders hold more than 25 per cent of capital or voting rights, whichever is lower, in the enterprise, including domestic and foreign owners), then, it must add a percentage of the other enterprise's staff headcount and financial details to its own data when determining whether it is eligible for SME status. This percentage should be the higher one between the proportion of shares and voting rights.*

*Source: http://ec.europa.eu/enterprise/policies/sme/files/sme_definition/sme_user_guide_en.pdf (pages 12, 14, 16, 20 and 22).*

There are a number of ways in which SMEs continue to be highly competitive with larger corporations and global multinationals:

- They provide a natural means for individual entrepreneurs to harness their own energies to create and run businesses, often with little capital.
- They can start up and hire staff, and, if need be, wind down quickly, given a supportive regulatory and administrative context.
- In labor and knowledge-intensive businesses with lower capital requirements, SMEs can maintain their workforce's motivation and their appeal to customers so

that they prosper without having to grow in scale. This is particularly the case for service businesses. The role of SMEs becomes even more important as the services sector grows in importance in an economy.

- SMEs can be more nimble in innovating and exploiting new market niches. For example, start-ups have often proven more effective at converting the potential of new technologies into businesses, such as Apple, Google and Amazon.
- In other cases, deep expertise in a focused niche can allow SMEs to have sustainable leading market positions even against the largest multinationals.
- And, of course, even the largest corporation started at one time as a small business.

Despite this critical role in creating jobs and economic value, SMEs face a number of constraints. Their success depends on the broader financial, business and policy ecosystem within which they operate. Where the SME ecosystem is already well-established and vibrant (for example, in Germany and Italy), it has taken generations to evolve, and still, in many developed countries, the ecosystem remains far from ideal. This working paper surveys the practical issues involved in creating more holistic and effective ecosystems for SMEs in Asia so that they can thrive and become a sustainable source of growth, employment and innovation. This paper highlights common barriers to SME development, country experiences shown to overcome these barriers and potential ways to build adaptive ecosystems for SMEs across Asia. Annex 1 summarizes the survey of country experiences, while Annex 2 presents key recommendations for SME development advocated by international organizations.

## Key Questions

- What role can the government play in helping SMEs generate growth and jobs at a time when job creation has slowed and many large corporations are restructuring? Is a single agency that is solely responsible for SMEs and job creation the right solution?
- How can the business sector and chambers of commerce help improve the mutual development of large businesses and SMEs in supply chains?
- How can the education sector facilitate the supply of skilled workers that can support SME development?
- What is the role of technology in supporting SME success?

## Background

In the wake of the global financial crisis and the European sovereign debt crisis, the International Labor Organization warned that “the number of jobless people around the world rose by 4 million in 2012 to 197 million and is expected to grow further” (ILO 2013). Global Employment Trends 2013 reported that 6 per cent of the world's workforce did not have a job in 2012, 39 million people left the labor market and young people were the most affected (13 per cent of those under 24 years of age were unemployed) (ILO 2013).

There is now growing recognition among governments that SMEs can make an important contribution to job creation to address youth unemployment. The International Finance Corporation reported that formal and informal SMEs together accounted for more than 60 per cent of GDP and made up more than 90 per cent of employment in both developing and advanced economies (IFC 2010). The UN Economic and Social Commission for Asia and the Pacific showed that SMEs account for more than 80 per cent of sales in the domestic markets of nine out of the eleven Asia-Pacific nations (China, Bangladesh, India, Indonesia, Malaysia, Pakistan, South Korea, Sri Lanka, Thailand, The Philippines and Vietnam) (Abe et al. 2012). European Commission research concluded that SMEs accounted for 6 per cent of European employment in the formal sector and 85 per cent of job growth between 2002 and 2010 (Kok et al. 2011).

### *The Model of the “German Mittelstand”*

In Europe, the most well-known and successful approach to fostering SME development is the “German Mittelstand” model, both in terms of the number of jobs generated and the value-added created (EC 2012d). The success of the German Mittelstand reflects the creation of a supportive SME ecosystem that embraces the following factors, many of which have a long history:

- Effective and well-defined property rights, in place since medieval times.
- Family firms that retain high equity ownership, with a long-term time horizon on business decision-making.
- A traditionally collaborative spirit between labor and management, anchored in artisan-apprentice ties.
- An independent judiciary and professional bureaucracy since the 19th century.
- Strong public support for independent institutions and limits to political patronage, in place since before the Industrial Revolution.
- A strong anti-monopoly institutional framework combined with traditionally decentralized administration, promoting competition and facilitating SME market entry and exit.
- The early adoption of public-private partnerships.

- Chambers of commerce that provide effective support and help SMEs expand overseas successfully.
- A strong tradition of vocational training for most employees where apprenticeships are highly valued alongside more academic career choices.
- Specific government policies to reduce bureaucracy and promote access to finance.

***The Scale of the Financial Constraints that SMEs Face Globally***

In many countries outside of Germany, and especially in emerging markets, SME growth is hampered by structural financing constraints. SMEs are often considered "high risk/high cost" borrowers due to a lack of financial and business information about their activities. This results in a combination of high interest rates (higher than justified by the actual credit risk in the business if the information base were in place), a focus on collateral-based lending rather than business prospects and – all too often – a sheer absence of credit availability as banks focus lending efforts on large corporations. Such credit constraints are amplified by the fact that SMEs depend on banks almost exclusively to finance business expansion.

There are about 365 to 445 million micro, small, and medium sized enterprises (MSMEs) in emerging markets. Of these, 85 per cent still face credit constraints. Due to the reluctance of banks to lend to smaller firms, formal and informal MSMEs in emerging markets face a credit gap of US$2.1 to US$2.5 trillion. This gap widens to US$3.1 to US$3.8 trillion when high-income countries are included (Stein, Goland, and Schiff 2010) (Page and Söderbom 2012).

However, lack of finance is only part of the story. SMEs are also constrained by substantial non-financial barriers. Therefore, addressing financing constraints in isolation is not enough. Policymakers need to adopt an integrated approach to establishing a supportive ecosystem that allows SMEs to thrive and build sustainable businesses. Such an approach needs to consider the full range of issues confronting SMEs, including financing, entrepreneurship and skills development, innovation and technology, market access and the overall appropriate public policy framework for SME development.

## Common Barriers Facing SMEs in their Development

To generate economic growth and jobs, the following common barriers confronting SMEs need to be removed:

- *Lack of access to appropriate forms of finance and capital.* SMEs mostly rely on informal and alternative sources of finance from their families and friends. A wider

range of financing mechanisms is frequently lacking, either in the form of debt or equity. Examples would include bank loans on a collateralized or cash flow basis, supply chain finance provided by non-banks, angel investing, venture capital and small-cap equity markets. Often, new and small businesses fail not because of a lack of business viability and profit potential, but from lack of cash to fund working capital requirements as the business grows. Furthermore, banks' SME loan approval, risk management and loan recovery functions remain largely centralized, despite efforts to set up separate SME departments and decentralization of product sales to branches (Beck, Demirgüç-Kunt, and Peria 2008). This approach justifiably maintains tight risk control, but can slow decision-making and reduce the ability to make appropriate risk judgments based on local knowledge. Moreover, SME owners typically cite speed of credit access as more important than interest rates in evaluating credit offerings.

- *High transaction costs.* Where financing is available, it is typically at a high interest rate, reflecting perceived as well as actual risk. The loan approval process is often cumbersome for SMEs as requirements still remain geared to large corporate customers in many circumstances. Beyond questions of finance, the effective burden of regulatory requirements on SMEs is also significantly higher than on larger companies that can dedicate staff resources to complying with regulations.
- *No clear property rights and lack of collateral assets.* SMEs in the rural sector are often unable to gain access to finance because they lack assets that can be pledged as collateral to banks. Banks, particularly those in developing countries, often base their lending decisions on collateral and credit history, and less on a business plan and projected future cash flows.
- *Lack of information.* Banks generally view SMEs as "opaque" borrowers due to the lack of credit history and inadequate formal documentation and records. For example, most small businesses lack the standardized financial statements that banks require to assess loan applications. This lack of information needs to be addressed to make SMEs more transparent to banks. Malaysian banks, for example, have introduced a guidebook to assist SMEs in applying for bank loans (Bank Negara Malaysia 2013).
- *Insufficient knowledge and skills* (e.g., market intelligence and access, good management and accounting practices, business leadership and development skills). New and inexperienced entrepreneurs may not have the required skills and managerial capacity to exploit new opportunities and markets fully.
- *Limited resources for innovation and technology improvement.* SMEs are usually constrained by the small scale of their operations and cannot afford expensive new technology or research and development activities. Technology companies may own significant intellectual property, but lack the resources for commercialization and testing that would allow them to capture a greater share of the business value.

- *Inadequate market access.* The ability of SMEs to capture new markets beyond domestic ones is highly limited as they lack market information and intelligence. SMEs also find it difficult to network with other institutions beyond their home market. This limits their access to global supply chains and their integration into international markets.

## A Policy Framework to Develop an Effective SME Ecosystem

The main objective of an SME policy framework is to improve the institutional context and ecosystem in which SMEs operate, and to do so rapidly and practically. Such policy initiatives will in turn lead to stronger, more profitable SMEs and increased job creation. This requires initiatives that enable financial institutions and markets to serve SME financing needs profitably. They must also improve understanding and knowledge of the opportunities available to SMEs, so that they can act profitably on them. Finally, initiatives must ensure that government is an enabler rather than a disproportionate burden on the SME sector. The business sector itself can play a critical role. Talent and technology are two key dimensions across all aspects of the SME ecosystem. In particular, the connectivity of the internet and advanced Big Data analytical techniques open up new ways to support SMEs and bolster their success. It will be important to choose the right policy framework in each country, which will be shaped by each country's broader historical, social and developmental context, including the respective roles of state and market.

There are four key dimensions to the policy framework:

**1. Determining the overall policy approach, especially with regard to the roles of government and business**

Essentially, there are two approaches to the role of government in SME development. One is for government to provide focused support to a bottom-up, business sector-led approach. The other is to provide clear, integrated top-down direction and initiatives to strengthen the SME sector, drawing the business sector to support and take ownership. The approaches can be blended and evolve over time. The country survey in Annex 1 provides profiles of the approaches that different countries have taken.

The German Mittelstand model represents the bottom-up approach. The main drivers of SME development are the chambers of commerce, most notably the guilds, within the business sector. The German government assumes a supportive role in SME development, reducing red-tape, providing tax incentives, research and development programs for SMEs, seed funding and loan guarantees for high-tech startups (EC

2012d). In contrast, countries such as South Korea, Malaysia and Singapore have adopted a top-down approach to SME development. This includes the formulation of an SME master plan and/or the creation of a one-stop agency that is responsible for coordinating and approving all SME development efforts among government ministries and the private sector (SME Corp 2011). Specific government initiatives for young innovators that are aligned with a country's overall innovation and growth policies also benefit SME innovation. Agencies such as Singapore's SPRING (Standards, Productivity and Innovation for Growth), promote the funding, capacity and internationalization support needed by dynamic and innovative firms. In South Korea, policies that facilitate innovation and globalization of SMEs include the "inno-biz" and "Global Stars" SME programs.

Government can also play a useful role in facilitating the creation of industry clusters so that firms within the same sector can come together and mutually reinforce one another in terms of supply base, talent pool and customer awareness. Many Chinese city and provincial governments are active in the creation of SME business parks. These parks provide dedicated physical infrastructure and attract support services such as SME-focused bank branches, accountancy and legal support. Moreover, recently, technology developments have enabled more coordination and communication between departments and across institutions. However, technology alone is not enough. Government should set up and/or facilitate the appropriate standards and protocols, in areas such as e-payments and company reporting, to ensure that the communication and coordination facilitated by technology is efficient (BCG 2012).

Whatever approach is taken, adjustments to policy are needed as conditions change. Policymakers need to maintain regular dialogue with SMEs and track the overall health of the sector. Feedback mechanisms are important so that policymakers can be proactive in anticipating and tackling emerging SME issues as the business environment changes.

**2. Enabling a sustainable SME financing sector**

Across Asia, banking dominates the financial sector. Traditionally, most banks have advanced a majority of their lending to finance large, often state-owned, corporate enterprises (Shinozaki 2012). This remains the case today in many economies, most notably China, where the challenge of providing sufficient financing to the SME sector is an important policy priority. This financing focus on large corporations reflects three factors:

- Historical choices of national growth model (where funding of large corporations was usually the priority).
- High credit risk costs given poor information about SME creditworthiness, unclear property rights and a lack of government backing for small private enterprises.

- The banks' own cultures and capabilities that are less adapted to the needs of the SME market given a history of large corporate lending.

There are two key aspects in creating a sustainable SME financing sector. One route is to increase the incentives for banks to lend to SMEs. The second route is to expand the range of financing sources that SMEs draw on for their needs beyond banks. This increases both competitiveness and resilience as dependence on banks is reduced. Policy needs to address both aspects.

On the first point, there are three main ways to increase incentives for banks to lend to SMEs:

1) *Mandating SME lending:* Regulators can either mandate or use informal guidance to steer banks towards greater SME lending. This is a common feature of policy in the UK – not just in emerging markets (DBIS 2011). In the short term, setting specific sector lending targets can be effective. It also sends an important signal about priorities, further influencing behavior. Policymakers in China and South Korea have used this lever, and it can be seen as a quid pro quo for other regulatory support for the finance sector. Inevitably, it leads to a race between banks to lend to the most attractive SMEs, often at ever-lower interest rates. Banks would rather do this than accept higher risk SME customers, even at higher interest rates. Moreover, this measure leads to opportunities for banks to game the system by reclassifying small 'corporate' customers as SMEs in order to meet the quota (Sweeney and Wildau 2013). This in turn necessitates greater auditing and inspection of bank lending practices by regulators, adding to costs and bureaucracy. For SME financing to be sustainable, it must be profitable for lending banks rather than a forced unprofitable practice.

2) *Improving the risk management ecosystem:* The greatest cost element in SME lending that undermines profitability is credit risk. Lack of reliable business information lies at the heart of the challenge in assessing credit risk for SMEs. All lending bears credit risk, but lending to SMEs is especially risky due to the lack of information, standards and property rights. In many emerging economies, SMEs often operate in situations where property rights are not fully defined, accounting standards are evolving and business owners keep multiple sets of books in order to support their interactions with tax authorities and financiers (Berger and Undell 2004). Site visits, talking to suppliers and monitoring bank accounts for items such as utility bills can prove to be a much better guide to credit risk than calculations based on company accounts. Policymakers can assist by ensuring the creation of credit databases, defining and enforcing standardized financial reporting requirements to create an improved information base and steadily improving the property rights environment through the establishment and

enforcement of contract law. Interest rate regulation also needs to give banks the flexibility to price credit based on risk if higher risk clients are to be attractive. Banks then need to ensure their lending and customer relationship management processes strike the right balance between cost, service and risk assessment.

3) *Establishing specific SME financing business units and institutions:* Alongside credit risk, operating processes determine the cost of serving SME customers. Serving large corporations has shaped the internal processes of many banks, attracting more accolades in developed and emerging market banking cultures. This can evolve over time for SMEs, as the profitability of SME relationships proves itself and individuals build successful careers there. However, policy imperatives require an accelerated pace of change. The Chinese Bank Regulatory Commission (CBRC) has mandated that all Chinese commercial banks establish separate SME banking departments together with separate risk management and product lines. This supported the implementation of SME-specific lending quotas, ensured that banks would develop distinct processes for SME lending and also created a management team within each bank with a sole focus on SMEs. Establishing dedicated SME banks, microfinance institutions and micro-lending enterprises goes a step further (PBoC 2012). Policy banks can also adjust their efforts to reflect the policy importance of the SME sector. Both China Development Bank and Korea Development Bank have evolved in this way. Also, microfinance can play a valuable role in funding microenterprises and requires distinct capabilities, regulations and rating systems.

There are four primary ways to increase non-bank sources of SME finance:

1) *Increase the use of equity funding:* Most discussion of SME finance focuses on debt. However, the time horizon and risk profiles of many SMEs point to an opportunity for significantly greater use of equity financing. Angel investing, applicable at the earliest stages of a company's life, is in its infancy in Asia. One successful initiative to increase equity access in the SME sector is the Business Growth Fund funded by the UK banking industry to provide equity to businesses (BGF 2011)[1]. In China, an experiment in equity injection and fundraising, notably for startups and SMEs, is the China Hi-Tech Property Exchange. The Exchange operates as a trading system of stock equity in SMEs involved in the hi-tech area. It provides an information platform for investors and SME issuers and borrowers in corporate finance, stock equity transactions and venture capital investment and exit by science and technology companies for domestic and overseas securities businesses. Its clientele includes listed companies, venture capital

[1] *Business Growth Fund (BGF) is an independent UK company, backed by five main UK banking groups: Barclays, HSBC, Lloyds, The Royal Bank of Scotland and Standard Chartered. It aims to offer a collaborative approach to financing growth companies by working closely with SMEs in which they have invested.*

institutions, consulting companies in investment and financing, investment institutions, industrial groups and other sponsors (Bloomberg 2014).

2) *Creating exchanges and markets for SME financing:* Creating a route for SMEs to raise equity and debt securities via the capital markets will also diversify SME financing channels. In the U.S. market, for example, 60 per cent of the SMEs are funded via the capital market (OECD 2013). The introduction of and support for SME loan securitization (through risk-assessed asset portfolios) would create a new market. Asian sovereign wealth, insurance and pension funds can form the core of the investor side.

3) *Increasing non-bank, supply chain financing:* Currently, trade finance via banks accounts for 30 to 40 per cent of SME credit. Measures to diversify SMEs' dependence on bank financing (such as leasing, factoring, securitization, supply chain open accounts) would ensure more sustainable sources of SME funding (IFC 2010).

4) *Use of guarantees:* Other innovations include the provision of guarantees to equity investors, SME financing guarantee and SME loan guarantee schemes and tax benefits to relieve the financing burden of SMEs and facilitate their development. There is a choice that needs to be made, however, about how and who receives a guarantee and how large it will be. Such guarantees stimulate the entry of new sources of finance into the SME sector.

**3. Strengthening talent and the role of the education sector**

Attracting and retaining the right talent is a critical bottleneck for many SMEs in their future growth. They need, for example, financial and business skills in cash flow management, collections, marketing and product pricing. Vocational training is critical.

Germany has been particularly successful in establishing industry-specific programs. Critically, it has also succeeded in building a national culture where vocational training is seen as a natural and much-valued career path rather than as a second-class option in comparison to a more academic university education. For example, it has integrated work-based and school-based learning where skilled artisan-mentors prepare apprentices for a successful transition to full-time employment (Puckett Davidson and Lee 2012) (OECD 2010).

The system is widely respected and accepted by German businesses as part of their corporate social responsibility to produce a top-notch work force, while helping to support new entrepreneurs. The system offers qualifications across many professional areas and flexibility to adapt to the changing needs of the labor market. Asia can learn

much from this, both in the messages and values that are communicated to young people, as well as in the actual vocational programs that are established.

There are also relevant examples in Asia. In Indonesia, Bank Mandiri successfully implemented a coaching and mentoring program to help SMEs build their businesses to become large customers of the bank (Bank Mandiri 2012). Japan has also established SME universities that provide practical training to SMEs.[2] Such training can include university internship programs, apprenticeship schemes and modifying the curriculum at universities based on input from policymakers and employers. Both government and business can play a role in jump-starting programs that focus on priority, high-potential industry sectors. In addition to these programs, SMEs gain benefits from training that addresses challenges such as branding, marketing and positioning in global supply chains. A range of institutions can provide the training, from government entities, to educational institutions and private sector SMEs, who themselves focus on this market opportunity. Some of the training offered by the private sector may need to be subsidized by the government, in particular in the early stages and when the credibility of private sector providers is not well-established.

**4. Harnessing technology**

Technology is reshaping the SME ecosystem. Increased connectivity and greater, cheaper processing power are opening up new opportunities to acquire customers, transforming SME business models (BCG 2012b). Equally, technology is revolutionizing how SMEs can be financed and the ways in which policy can support them.

Technology is broadening companies' access to customers and suppliers, as well as bringing to light many more competitors. Alibaba, in particular, has developed a large business facilitating this change. These Internet transactions are generating more sophisticated information databases, which are mitigating the lack of information and transparency that has made SME lending so risky for banks. Again, Alibaba has harnessed the data created through its Internet business to gain deep understanding of the credit risk of its customers. As of July 2013, Alibaba had extended loans of over RMB100 billion (US$16 billion) to over 320,000 small businesses in its three years of lending activity (Bloomberg 2013). Its non-performing loan rate is well under one per cent. Alibaba's customers can borrow up to RMB1 million for a period of one year. Alongside this, other internet companies have launched peer-to-peer lending models (for example, Credit Ease 中信 and Paipaidai 拍拍贷. See FGI's Working Paper on Technology for more details). Other opportunities to support SME finance include the creation of websites where SMEs seek to raise equity funding directly from investors.

[2] *The Organization for Small & Medium Enterprises and Regional Innovation is the dedicated institution for supporting SMEs in Japan. www.smrj.go.jp/english/.*

Government policy plays a critical role in shaping how technology helps SMEs. It needs to establish an appropriate:

1) *Information infrastructure:* The first element is to ensure nationwide, high-speed fixed-line and mobile Internet access (the national broadband plan). The Korean government's early focus on broadband adoption in the early 2000's established Korea as a leader in e-commerce and ensured its standing as the world's most connected society. The European Commission now has plans to promote widespread cloud use and cloud provision in Europe. Cloud computing can reduce information and communications technology (ICT) costs, and – when combined with new digital business practices – boost productivity, growth and jobs (EC 2012c). Substantial efficiency improvements across the whole economy can be expected from cloud adoption by businesses and other organizations, especially SMEs. Platforms such as these also provide the basis for greater communication and coordination among government departments and between government and SMEs.

2) *Regulatory framework:* Policymakers have a critical role to play in ensuring that regulations reflect the new opportunities and challenges introduced by technology. Alibaba's success in SME financing relies on a regulatory framework that allows it to operate in that way. In July 2013, CSRC, the Chinese securities regulator, approved Alibaba's sale of RMB5 billion in notes secured by loans to its small business customers. This helps Alibaba continue to expand its lending volume. Alibaba's expansion into SME lending also raises questions about how these activities are best regulated, when competing banks face clear regulatory requirements on the capital that needs to be held against risk-weighted assets. Regulations on data security and the precise mechanics of online transactions also shape the benefits that can be gained from the Internet. One example is the need to set standards and authenticity checks on digital signatures rather than insisting on in-person ones.

## Conclusion

Ultimately, the successful development of SMEs at the firm, supply chain, sector or national level is a question of governance. A strong SME sector can be the major source of job creation and growth in an economy. It rests, however, on creating and maintaining a strong, supportive ecosystem. Developing this ecosystem for the German Mittelstand was the work of generations and is still work in progress as the world continues to change. Policymakers in Asian economies need to accelerate the development of this ecosystem in their own economies. To do this, it is essential that public and private sector stakeholders (government, the education sector, financial institutions, business and SMEs themselves) work together effectively. Oftentimes, SMEs do not receive the support they need with insufficient attention at the policy level and uncoordinated and compartmentalized implementation at the local level. A number of countries have moved to a specialized small business administration model. This focuses coordination in one-point-of-accountability through the designation of a single, one-stop government agency that is responsible for SME development. This approach merits consideration. It will ensure more effective implementation of SME policies and the delivery of specialized support services to promote SMEs as a primary engine of growth and job creation.

Setting a new policy direction on SME development involves both top-down and bottom-up approaches. The latter, business sector-based approach, with some official support, centers around the German Mittelstand experience. As the German model demonstrates, SMEs can prosper in competition with and alongside large corporations. They can also be global leaders in their chosen markets. Alternatively, countries such as Singapore, Korea and Malaysia have adopted a top-down, single SME agency or a dedicated sectoral agency to nurture SMEs.

An SME development strategy cannot be independent of national industrialization, talent, education, ICT and innovation strategies. Academia, vocational and professional institutions play an important role in expanding the talent pool available at all levels so that strong competitive advantage can be nurtured for SMEs and large firms alike.

In all cases, there is a risk that government tries to do too much, taking up roles that the private sector can assume on its own with the right stimulus. Equally, there is a risk of doing too little and foregoing the much-needed job creation and economic value that SMEs can bring. There is no one-size-fits-all policy or implementation model for SME expansion given the different levels of development, institutional and talent capabilities. However, a number of countries have adapted and evolved successful models from which Asian economies can learn.

# Annex 1: Country Experiences of Supporting SME Development

## *(1) German Mittelstand: Recent Policy Initiatives*

The German Mittelstand is among the earliest examples of a successful SME sector, having evolved from the traditional apprenticeship schemes whereby local artisans and trade guilds train young interns to meet their firms' needs for skilled labor and serve the domestic market. The Mittelstand went through a difficult phase due to cheap imports. But German SMEs reinvented themselves and internationalized, focusing on their competitive edge in high quality technological and innovative products. Today, 99 per cent of German companies are SMEs, and provide 60 per cent of all jobs (EC 2012d).

*Support for Entrepreneurship:*

- Training in teaching entrepreneurship and business management skills.
- An integration grant is paid to people who start their own business after being unemployed, during which time they receive subsistence allowances.

*Second chance:*

- The 2012 Company Restructuring Simplification Act strengthens the role of creditors and shareholders in self-administered restructuring of companies.
- The discharge time from bankruptcy and restructuring was reduced from six to three years.

*Think small first:*

- In 2012, measures were introduced to further reduce the bureaucratic burden on companies, such as a shorter statutory period for the retention of tax, trade and social security documents, using electronic channels of communication to minimize multiple requests from different administrative bodies and facilitating communication between administrative bodies and companies.
- The government committed to curb the total compliance costs of federal legislation.

*Responsive administration:*

- In 2011, the federal government simplified electronic invoicing (companies can get sales tax deductions for their invoices from tax authorities).

*Access to finance:*

- In 2011, the Federal Ministry of Economics and Technology (BMWi) the KfW bank (a development bank owned by the government), and twelve large German companies created the Second Equity Fund for High-Tech Start-ups. The Fund provides promising high-tech start-ups with early-stage financing. Moreover, with another program called StarGeld (the Entrepreneur Loan Program, also known as

"Start-Up Money"), the KfW guarantees up to 80 per cent of bank loans made to young companies. By spring 2011, the total amount of loans provided through StarGeld had already reached 100,000 euro.

*Single market:*

- Reduce import and export barriers with other EU countries.

*Skills and innovation:*

- Skilled Labor Concept, a strategy to secure a pipeline of skilled labor for German companies.
- The implementation of the Directive on Highly Qualified Employees Act will ease the recruitment of highly skilled foreign workers by German companies.
- An innovative SME program to support state-of-the-art research on SMEs was extended to medical technologies.

*Vocational training:*

- The default option for people seeking jobs, who are not university graduates. Enterprise-based, one day per week is reserved for public vocational training. The chamber of commerce is responsible for curricula and certification.

*Environment:*

- Regulations on Contract Awards was modified in 2011 to promote energy-efficient products and services in public procurement.

*Internationalization:*

- The Export Initiative for German Security Technology and the Export Initiative for German Health Care Industry was launched in 2011 to promote the export activities of German security technology companies and provide more access to international markets for German health care companies, respectively.
- The German Silicon Valley Accelerator is a private initiative founded by the government. It aimed to provide German start-ups with access to the U.S. and other international markets. Since 2011, four German start-ups have visited Silicon Valley during each quarter.

### *(2) An Integrated Approach to SME Development: The Experiences of France, South Korea and Malaysia*

France, South Korea and Malaysia adopted an integrated approach to support SME development. The initiatives launched by these countries cover a wide range of measures, as summarized below.

### *France*

The French support system for financing and developing SMEs is based on the governmental agency OSEO with central and regional tax incentives. Funding is provided by OSEO and banks, venture capitalists and chambers of commerce. Chart A1 illustrates the French integrated SME development approach (Taftie 2012).

**Chart A1. Integrated SME Development System in France**

**Financial Infrastructure**

- Risk of retail/SME lending is managed under bank regulations and capital requirements under Basel II.

**Legal & Regulatory**

- Fichier Bancaire des Entreprises (FIBEN) companies' database provides credit ratings for companies.
- INFOGREFFE's initiative collects SME financial information.
- OSEO provides financing facilities for SMEs through financial institutions.

**Public Support Scheme**

- Regional and state taxation benefits.
- OSEO innovation facility.
- OSEO guarantees for SMEs.
- COFACE and UBIFRANCE (French agency for export promotion) for export guarantee and promotion.

Source: IFC Scaling-Up SME Access to Financial Services in the Developing World 2010. Page 59, Table 4.3.

Selected support measures:

- The OSEO Guarantee Fund supports bank lending to SMEs by limiting personal guarantees required from SMEs and financing risks for banks.
- Support for equity and seed funding through:
  - OSEO seed capital and development contracts that provide "higher risk" seed capital finance to SME entrepreneurs.
  - OSEO guarantees to equity investors that provide "higher risk" financing to young SMEs.
- OSEO projects that support research and development through:

  - Innovation aid: supports for innovation and growth in SMEs from the point of design to achievement of innovation projects.
  - Strategic Industrial Innovation (SII): supports for breakthrough innovation projects across the entire value chain.
- Regional and state grants and tax benefits that encourage companies to develop and grow in areas with high unemployment.
- Support programs to foster international trade:
  - COFACE (a credit insurance and management service provider): guarantees to support exports on behalf of the French government.
  - UBIFRANCE: public institution in charge of export promotion for French companies.

***South Korea***

The South Korean experience focuses on reducing market failure for SMEs by (Yi 2012):

- Reducing asymmetric information on the demand side by enhancing the expertise of financial institutions about SMEs, and improving SME databases on the supply side.
- Developing capital market infrastructure specifically to serve SMEs with more flexible listing criteria for high-performing SMEs.
- Establishing a strong corporate restructuring system to separate high-performing SMEs from non-performing ones.

The Small and Medium Business Administration (SMBA), a major policy player, has set up more than 100 SME initiatives to promote SME growth. Instead of protecting the weak, the policy is to nurture competitive SMEs and transform traditional SMEs into high-growth SMEs. The buzzwords of the new policy are “inno-biz” and “global stars” (Lilischkis 2011) .

Policy measures to foster high-growth SMEs are divided into three categories: entrepreneurship policies, SME innovation policies and SME internationalization policies (Chart A2).

**Chart A2. Integrated Support System for SME Development: South Korea**

**Entrepreneurship Policies**

- Lectures, education programs and training for start-ups.
- Expanding and improving the infrastructure for one-person creative enterprises to enable such start-ups at home.
- Setting up one-stop business linkage service providers that offer on-site support to SMEs.

**Innovation Policies**

- Provide funding for part of R&D expenditure for new technology and products that can be commercialized within three years.
- Reinforce links between industry, academia and research institutes. Provide "matching funds" for SMEs to get help from universities and research institutes in developing new products.
- "Purchase-Guaranteed New Product Development Program": demands for products that SMEs may develop are voluntarily announced by public organizations and large firms to guarantee the future purchase of new products
- Foster "Inno-biz" program and venture capital investment.

**Internationalization Policies**

- Promote mid-sized enterprises: nurture export-oriented enterprises into strong global enterprises.
- "Global Stars" program: promotes independent global players and supports them with technology, financing and networking. Criteria for selecting "Global Stars" are summarized in Chart A3.

Source: Lilischkis INNO-Grips Policy Brief No. 2: Policies in Support of High-Growth Innovative SMEs, 2011.

**Chart A3. Criteria for Selecting South Korean "Global Stars"**

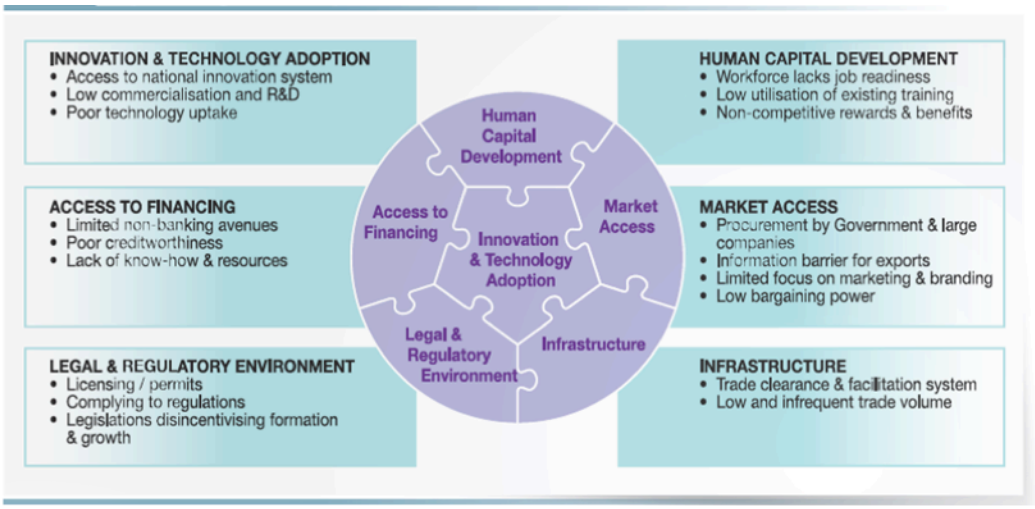

Note: Percentages indicate the weight in the selection process.

Source: Korea Eximbank.

### *Malaysia*

Malaysia's SME Masterplan 2012-2020 set the direction for SME policy and identified growth levers, as well as challenges for Malaysian SMEs in six areas as shown in Chart A4 (SME Corp 2011).

**Chart A4. Growth Levers and Challenges Facing SMEs: Malaysia**




Source: SME Corp SME Master Plan, 2011.

The Masterplan proposes six High Impact Programs (HIPs) supported by 26 complementary measures (Chart A5).

**Chart A5. High Impact Programs in Malaysia**

| HIP 1: Integration of registration and licensing of business establishments | HIP 2: Technology commercialization platform (TCP) | HIP 3: SME investment programme (SIP) |
|---|---|---|
| Create a single registration point through interfacing of the current National business registration system, i.e., myCoID and the National business licensing system, i.e., BLESS. | Establish a national network of privately managed platform to promote innovative ideas from proof of concept to commercialization stage. | Provide early stage financing through the establishment of investment companies to invest in potential SMEs in the form debt, equity or a hybrid of both. |
| **HIP 4: Going export (GoEx) programme** | **HIP 5: Catalyst programme** | **HIP 6: Inclusive innovation** |
| Offer customized assistance to new exporters and SMEs venturing into new markets. Export-ready SMEs can avail to comprehensive support assistance. | Create homegrown champions through a targeted approach with support in the area of financing, market access, and human capital development. | Empower the bottom 40% of the income group to leverage on innovation through transformation of rural community through handholding approach. |

Source: http://www.techmonitor.net/tm/images/c/c3/12jul_sep_start-up_venture.pdf.

Instead of relying solely on government support, the Masterplan advocates strong public-private partnerships. The government encourages entrepreneurship, innovation and investment, acting as a facilitator and catalyst to create an enabling environment for SMEs to thrive. The integrated supporting measures for SME development are shown in Chart A6.

**Chart A6. Integrated SME Development Measures: Malaysia**

| Legal and Regulatory | Financial Infrastructure | Public Support Scheme |
|---|---|---|
| • Comprehensive SME development framework | • SME Competitive Rating for Enhancement (SCORE)<br>• Central Credit Reference Information System (CCRIS) | • Small Debt Resolution Scheme (loan restructuring for SMEs)<br>• Cradle Investment Program helps start-ups to attain commercialization<br>• MAVCAP venture capital funding<br>• Venture debt and project financing facilities for ICT and biotechnology companies<br>• Perdana Fund for venture capital in high growth, high tech start-ups<br>• Credit Guarantee Corporation Malaysia<br>• SME Assistance Guarantee Scheme<br>• Working Capital Guarantee Scheme<br>• Development of a Sustainable Microfinance Framework<br>• Outreach programs to enhance MSMEs' access to finance<br>• Business advisory services for SMEs<br>• SME financial advisory by Bank Negara Malaysia |

Source: IFC Scaling-Up SME Access to Financial Services in the Developing World, 2010.

### *(3) Hong Kong*

Government-sponsored schemes seek to facilitate access to finance, promote exports and support skills training for SMEs (CEDB 2013):

- Government guarantees for bank loans:
  - SME Financing Guarantee Scheme (SFGS).
  - SME Loan Guarantee Scheme (SGS).

- Support for equity and seed funding:
  - The Small Entrepreneur Research Assistance Program (SERAP) provides funding to support small, technology-based and entrepreneur-driven companies to carry out business-oriented research at the pre-venture capital stage.
  - The Microfinance Pilot Scheme (MF) assists those who want to start their own businesses but lack financial means or have difficulty getting loans.

- Development support through grants and advice programs:
  - The SME Export Marketing Fund (EMF) initiates export promotion activities to help SMEs expand their businesses.
  - The Professional Services Development Assistance Scheme (PSDAS) provides financial support to promote projects that may increase the competitiveness of Hong Kong's professional services sector, or enhance Hong Kong's competitiveness of individual sectors in external markets, including Mainland China.

- Skills and knowledge training:
  - The SME Development Fund (SDF) provides financial support to projects on SME development, carried out by not-for-profit organizations (e.g., trade and industrial organizations, professional bodies or research institutes) to promote research on SMEs to enhance their competitiveness in Hong Kong.

### *(4) India*

A 2006 study by the Indian Institute of Planning and Management suggested approaching selected challenges faced by SMEs (Shah and Khedkar 2006):

- Poor risk management capabilities.
- Financiers who have little understanding of SME business operations.
- Banks that lack the managerial and technical expertise to evaluate and monitor companies.
- Insufficient institutional infrastructure and a lack of expertise in SME financing.

To address the above inadequacies, the Small and Medium Business Development Chamber of India provides business and industrial advisory services and helps in SME rehabilitation. The Chamber also assists SMEs in IPOs and makes introductions to multinational companies, foreign buyers, financial institutions, government authorities, technology providers and agencies promoting trade.

The Chamber's supporting system includes a number of platforms, as well as the bilateral trade division councils shown in Chart A7.

**Chart A7. Supporting Platforms Adopted by the SME Development Chamber of India**

| Initiatives |
| --- |
| • SME Export Promotion Council<br>• SME Business Management Institute<br>• SME Finance and Investment Promotion Council<br>• Indian SME Knowledge Forum<br>• SME Technology Development Council<br>• SME Connect – Magazine<br>• Industrial and SME Research Centre of India (ISRCI)<br>• SME Business Club |
| **Bi-Lateral Trade Divisions** |
| • India – UK SME Business Council<br>• India – U.S. SME Business Council<br>• India – China SME Council<br>• India – Canada SME Council<br>• India – Japan SME Business Council<br>• India – Gulf Cooperation Council (GCC) SME Council<br>• India – South Korea SME Council<br>• India – Zambia SME Council<br>• India – Turkey SME Council |

Source: Small and Medium Business Development Chamber of India.

### *(5) Japan*

Japan launched an Organization for Small and Medium Enterprises and Regional Innovation as an independent administrative agency under the Ministry of Economy, Trade and Industry to provide targeted SME support measures in collaboration with government agencies, SME support organizations, financial and research institutions (SME Support, Japan).

**Chart A8. Broad Network of SME Support Organization**

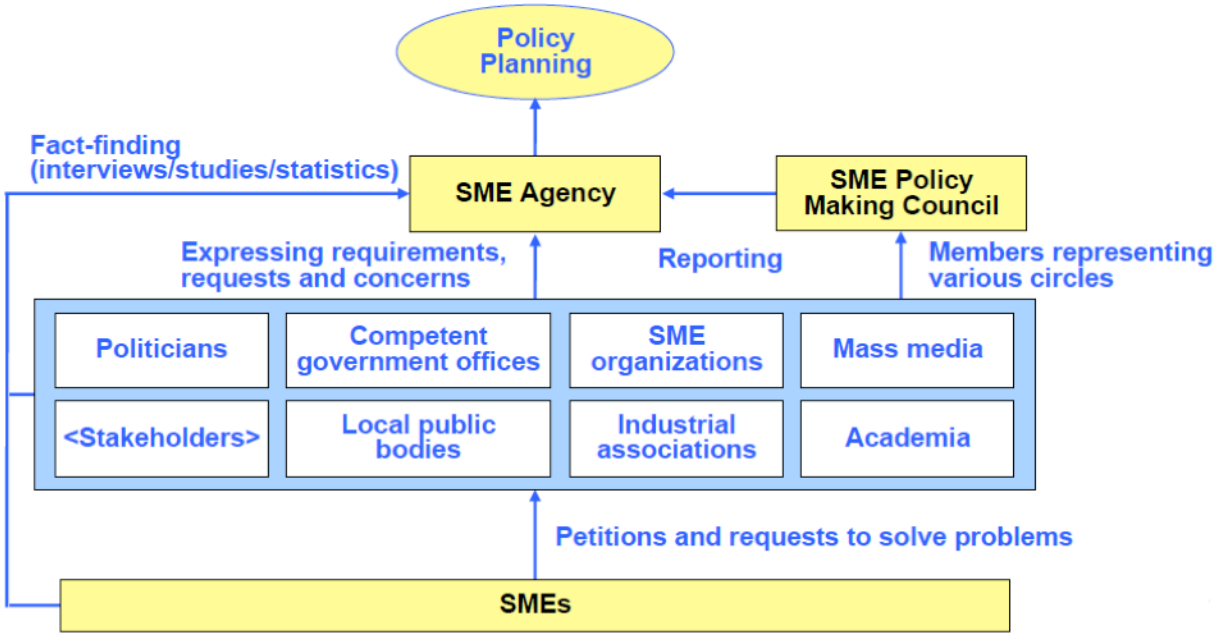

Source: SME Support, Japan.

The SME support network provides four services:

- Support for start-ups/new business development, including advisory and expert services on management, technology, finance, law and intellectual property.
- Safety net support includes a small-scale enterprise mutual aid system that provides funds to sole proprietors when they close their businesses, or to retiring company executives and a business safety mutual relief system that offers emergency financial assistance to SMEs such as client bankruptcy. Participants in this system can borrow up to ten times the premiums they have accumulated without any security or guarantor.
- Support for SME growth and development towards business enhancement, which includes support for internationalization (e.g., providing advice on overseas business promotion and trade fairs), human resource development with practical training at nine SME universities and intellectual property management.
- Infrastructure support includes upgrading program and expert advice, as well as funding to acquire equipment, provision of suitable industrial sites (e.g., large-scale offices, laboratories, distribution centers and commercial facilities) and incubation facilities (e.g., business space with equipment/specifications that can meet varying needs).

The policy planning framework for Japanese SMEs is presented in Chart A9.

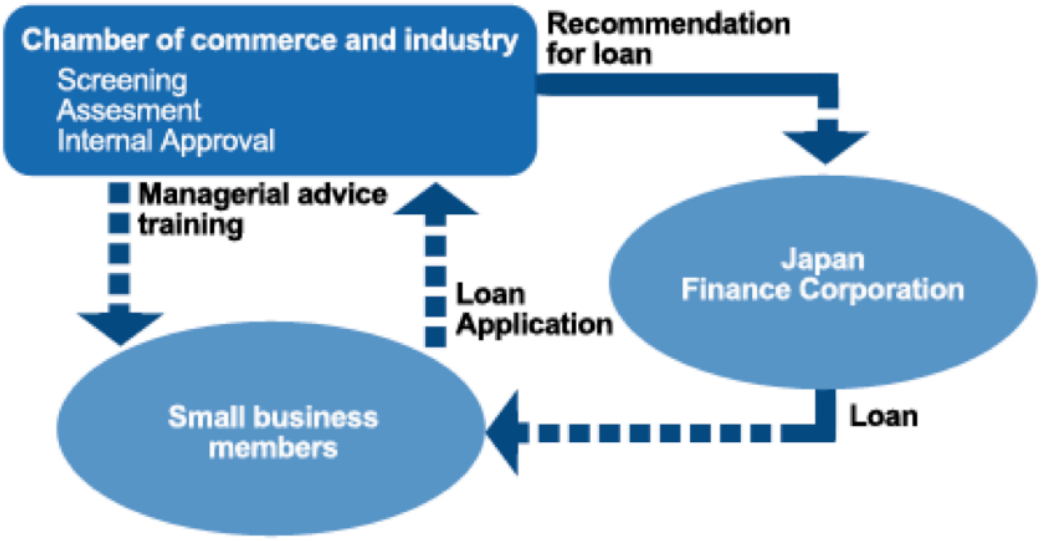
**Chart A9. SME Policy Planning Framework in Japan**




Source: http://www.grips.ac.jp/forum/af-growth/support_ethiopia/document/Sep09_SME090828final_a.pdf.

The Japanese Chamber of Commerce and Industry provides non-collateralized loans to its small business members. A key requirement is that small businesses must get training and counseling by the Chamber before receiving any loans. This process benefits the Chamber as it can understand the conditions facing small businesses better than financial institutions, thus securing their repayment without collateral, while improving members' capacities. This public-private partnership is shown in Chart A10.

**Chart A10. Public-Private Partnership Framework**

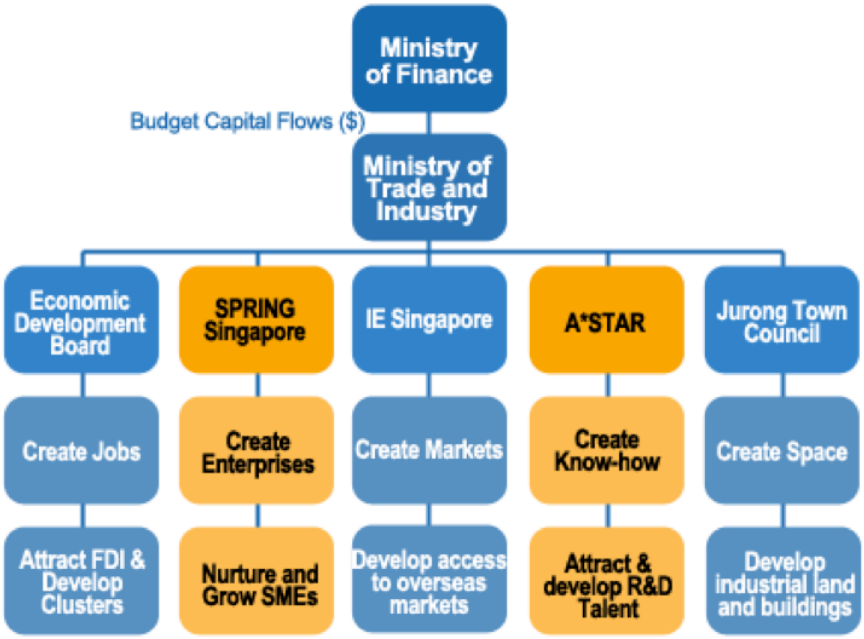



Sources: Kyoto Chamber of Commerce and Industry, and Japan Finance Corporation, 2011.

### *(6) Singapore*

The government of Singapore aims to support a sustainable environment for SMEs, especially for high-growth sectors. The overview of the government's organizational structure is shown in Chart A11. The red areas highlight high-growth SMEs (EC 2011).

**Chart A11. Government Organizations Supporting SMEs**

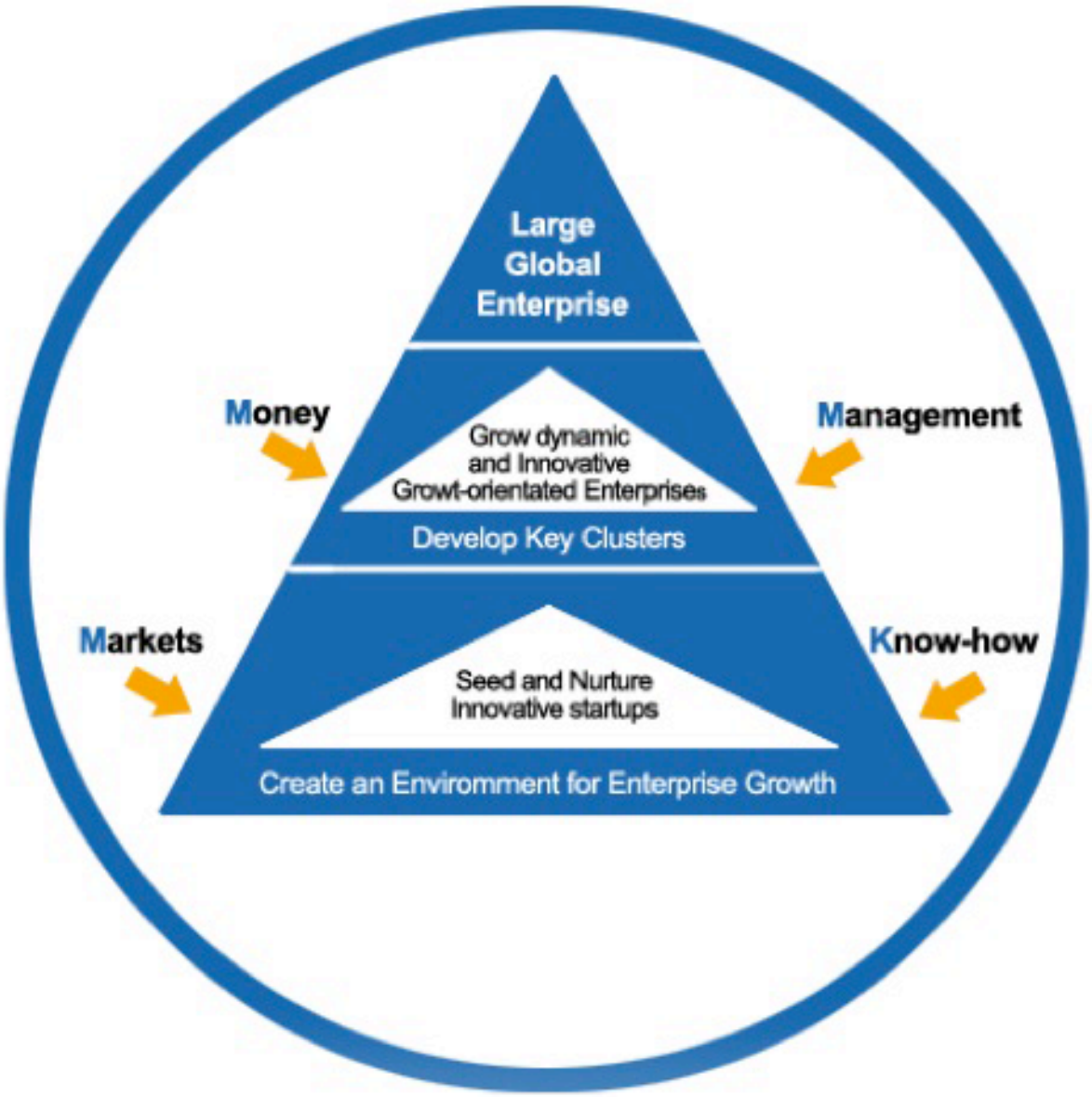



Source: Singapore Ministry of Trade and Industry.

Specifically, there are two agencies supporting high-growth SMEs:

- SPRING (Standards, Productivity and Innovation for Growth) assists promising local SMEs with financing, developing capability and management, advancing technology, innovation and internationalization (see Chart A12).
- A*STAR through the GET-Up (Growing Enterprises through Technology Upgrade) program supports long-term pre-competitive research and development.

**Chart A12. SPRING's Enterprise Development Concept**




Source: SPRING Singapore.

### *(7) United Kingdom*

In March 2011, the UK government announced its “Plan for Growth” to (EC 2011):

- Create the most competitive tax system among the G20.
- Make the UK the best place in Europe for start-up financing and growth.
- Encourage investment and exports to form a more balanced economy.
- Create a more educated and the most flexible workforce in Europe.

SME-related initiatives include:

- Government schemes (TheCityUK 2013):
  - Enterprise Capital Funds – launched to fill the funding gap in equity finance where the amount required may not justify the costs of due diligence.
  - Regional Growth Fund.
  - Enterprise Allowance Scheme – a lump sum and/or weekly payment(s) to benefit those who set up their own businesses.
  - National Loan Guarantee Scheme.

- Banking industry schemes:
  - Business Growth Fund to provide equity to UK businesses (see Box A1 and Chart A13).

- HSBC schemes:
  - Business Growth Grants – grants awarded to businesses that use innovative ideas to grow within the UK.
  - Employer Loans – reduction in small business loan interest rates for every employee taken on by the business, up to three new employees.
  - Investment and exports.

**Box A1. UK's Business Growth Fund**

In October 2010, the British Bankers Association and key UK banks set up a Business Taskforce to review how they could help the UK return to sustainable growth. The Taskforce has committed to 17 actions (including mentoring, creating a lending appeal process, launching a Business Growth Fund and signposting alternative sources of finance).

In 2011, the Business Growth Fund was established to help fast growing British SMEs. The potential for growth is the key criterion. The main characteristics of the Fund are outlined in Chart A13.

Source: http://www.businessgrowthfund.co.uk/bgf-appoints-head-of-external-talent-network/.

## Chart A13. Supporting Measures through the Business Growth Fund (BGF)

**Characteristics of BGF**

- A privately-owned £2.5 billion venture capital company owned by five banks (Barclays, HSBC, Llyods, Royal Bank of Scotland and Standard Chartered).
- Makes long-term equity-linked investments in fast growing companies.
- Will hold a minority equity stake and a seat on the board as a director, by investing between £2 million and £10 million per business.
- Takes a long-term investment horizon with no fund closing date. It may also co-invest.
- Aims to maintain more effective relationships between the banking sector and UK businesses. Also collaborates with the British Bankers' Association, businesses and the UK government.
- Coordinates across the business community, working with banks, advisers, business networks, business schools and universities and the media and government to properly inject equity to drive growth and provide essential funding to any well-capitalized enterprise.

**BGF provides the scale necessary to create benefits from better capital treatment**

- The investment is risk-weighted at 190 per cent when it is a diversified portfolio, improving returns to bank shareholders (subject to rate of loss).
- Gearing means that a low portfolio return can generate a good return on equity given funding costs within banks.

Source: BGF Building British Business: Review 2011/12, 2011.

- UK government schemes:
  - The Exporting for Growth initiative encourages SMEs and intermediaries to consider entering the export markets.

- HSBC Schemes is a private sector initiative without government involvement:
  - A £4 billion International SME Fund was launched in February 2012. It provides loans to UK businesses with a turnover of up to £25 million that engage or aspire to engage in foreign trade.
  - An international overdraft with the interest margin reduced by 1 per cent for each additional export market, up to a maximum 3 per cent reduction for 12 months for facilities up to £25,000.
  - HSBC has supported the UK government in improving knowledge of and support for sectors such as international trade through its global connections, thought exchange events and UK trade and industry through "Exporting for Growth."

- Initiatives to create a more educated workforce:
  - Business taskforce initiative: an industry-sponsored scheme with mentor organizations.
  - UK government initiative provides £180 million for up to 50,000 apprenticeship places.
  - From 2011 to 2015 with 40,000 places for the unemployed and 10,000 advanced and higher apprenticeships, specifically to support SMEs. HSBC also provides apprenticeship places.

### *(8) United States*

The U.S. Small Business Administration (SBA) promotes and delivers programs specifically geared towards small business interests through four programs (EC 2011):

- Access to capital (business financing) via loans, micro-lending, debt, equity and venture capital.
- Entrepreneurial development (education, information, technical assistance and training), such as free counseling and low-cost training to small businesses and nascent entrepreneurs.
- Government contracting (federal procurement): setting goals with other federal departments and agencies to spend 23 per cent of contract dollars with small businesses.
- Advocacy (Voice for Small Business): reviews Congressional legislation, testifies on behalf of small interests and conducts research on the small business environment in the U.S.

# Annex 2: International Agency Views on SME Development

## *Asia and the Pacific*

UNESCAP published its Policy Guidebook for SME Development in Asia and the Pacific in 2012 (UNESCAP 2012).

In addition to measures to improve SME access to financing, it included proposals to enhance the business-enabling environment for SMEs. Interesting suggestions include reform of government procurement systems (e-procurement), trade facilitation measures, the removal of legal and regulatory obstacles and the encouragement of female entrepreneurship.

In the review of best practices for SME financing, the UNESCAP report highlighted the following experience:

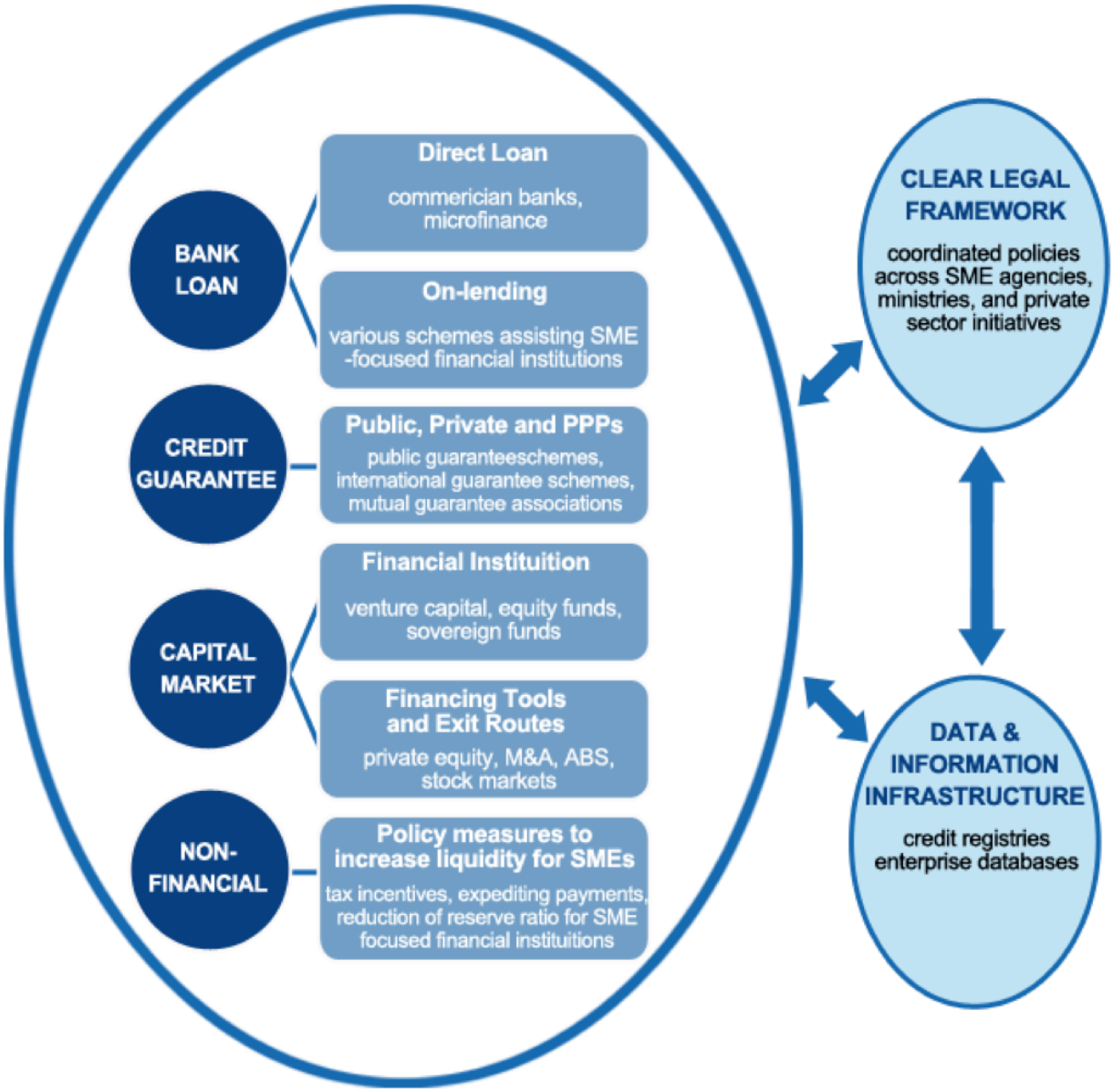
- Avoid introducing direct credit programs or the operation by banks of government programs at subsidized rates.
- Refrain from direct government operation of SME financial assistance programs.
- Pay heed to creditors' rights by introducing appropriate legislation that protects lenders from loan defaults by SMEs.
- Set up formal credit guarantee schemes to promote collateral and a third-party guarantee free lending system to assist SMEs.
- Combine entrepreneurship training with SME lending.
- Encourage small businesses to maintain and report reliable information by improving transparency and by working with commercial players to correct market failures. For example:
    - To fill the gap in SMEs' financing or credit history, there is a need to develop better financial reporting, reliable credit histories and credit registries for SMEs.
    - Since many SMEs lack qualified collateral, establishing clearer property rights to increase the assets that can serve as collateral, or other types of guarantees would help satisfy bank requirements.
    - Given that bank loans remain the primary source of SME financing, there is a need to consider diversifying nonbank financing to increase overall SME access to credit via bond market initiatives, the expansion of trade credit and microfinance.

In the review of improvements in SME market access, UNESCAP listed the following measures:

- Export infrastructure development, including export industrial estates, export processing zones and bonded production centers.

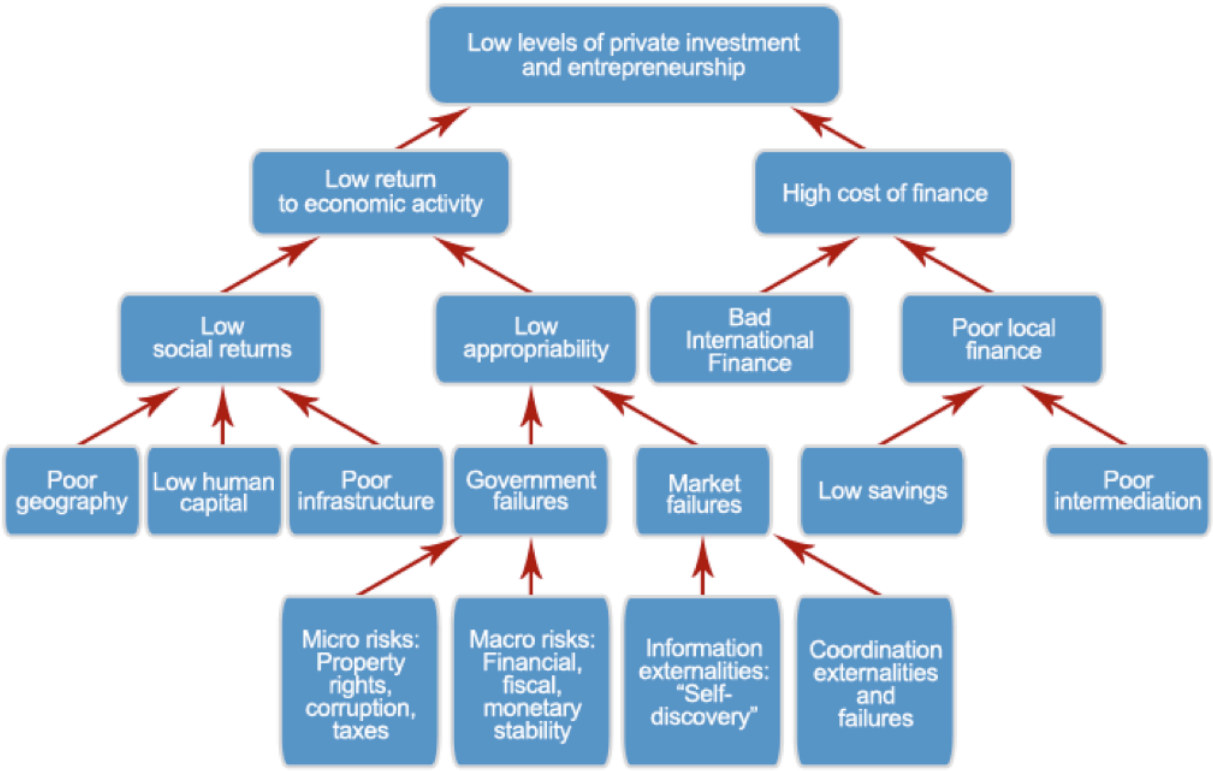
- Product-oriented focus on identification, design, prototype development, modification, dies and moulds, production and assembly.
- Marketing support, such as market information and research, branding, participation in trade fairs, strengthening marketing and distribution channels, buyer-seller matching, assessing creditworthiness of importers and providing marketing outlet and consortia formation.
- Information dissemination on government policies and programs, such as training programs and facilities and trade fairs.
- Trade finance, such as providing support for access to trade and export finance, and facilitating access to funding for small firms without collateral.
- Networking between financial and other SME support institutions, such as research and development institutions, international agencies, as well as SME support organizations in other countries forging links with transnational corporations (TNCs), both between and among SMEs, and connecting with government departments, industry associations and chambers of commerce.
- Foreign direct investment (FDI) promotion, including FDI policies that integrate domestic SMEs into global supply chains, which are consistent with, or may enhance an economy's comparative advantage and development.

**Chart A14. Environment for Financing**




Source: UNESCAP Policy Guidebook for SME Development in Asia and the Pacific, 2012.

**Chart A15. Thought Process Map for Policy Prioritization**




Source: Hausmann, Rodrik and Velasco, 2005.

## *Europe*

In 2012, the European Banking Authority conducted a study to promote SMEs' creditworthiness and access to finance (EBA 2012). The suggested measures include:

- Pursue a more neutral approach to the cost of debt or equity funding that would encourage firms to seek more equity finance.
- Promote angel investing, private equity and venture capital to increase the capital base of SMEs and improve their credit quality and attractiveness to banks.
- Ensure usage of consistent ratings across SMEs to facilitate their access to finance. The widespread use of ratings will help to foster securitization and private placement of bonds, which will in turn reduce SME dependence on bank financing.
- Enforce late payment regulations. SMEs, in particular, have little recourse when larger companies impose long payment terms, exacerbating cash flow needs.
- Employ guarantees from the government or publicly sponsored institutions as these are very effective in promoting lending to SMEs. They can be structured in a manner that minimizes impact on government finances.

The European Commission released a 2011 discussion paper by INNO-Grips that recommended the following policies to support high-growth SMEs (Lilischkis 2011):

- Support high-growth enterprises and leverage on their positive impact on SMEs.
- Review polices to ensure targeting of sustainable growth.
- Promote policies for both general and high-growth SMEs.
- Ensure a broader approach to support high-growth SMEs, not merely a focus on specific areas (such as finance).
- Establish the right conditions for winners to develop, rather than picking winners. Policies should also include "hampered winners", which refer to those that would not grow substantially without support. The reason is that there are many legal requirements that are unfavorable to high-growth SMEs (such as regulations on investment, start-ups, market entry, labor, bankruptcy and tax laws).
- Set up an infrastructure to encourage and facilitate the replication of existing successful coaching networks since many SMEs lack the knowledge to leverage coaching opportunities.
- Facilitate the internationalization of SMEs and help high-growth SMEs gain access to larger markets, especially since national markets may be too small.

A Bruegel paper on "The Contribution of SMEs to Post-Crisis Growth" suggested some general principles (Veugelers 2010):

- Reform bankruptcy laws to allow easier exits, which should be faster, cheaper and not preclude new starts.
- Further integration of capital markets, with a particular emphasis on risk capital.
- Reduce administrative burdens as they disproportionally affect SMEs.
- Foster entrepreneurial attitudes with a long term cultural shift policy focusing on such issues as role models, education and decreasing the stigma of failure.

The paper pointed out that beyond committing sufficient resources to support young innovators, it is more important to get the details of this support right by:

- Incorporating policies for young innovators into an overall innovation and growth policy.
- Addressing specific barriers faced by young, highly innovative firms.

The Bruegel paper also highlighted good practices identified by the European Commission as below (EC 2012a):

- Apply the "Think Small First" principle.
- Simplify start-up procedures.
- Internationalize SMEs.
- Promote entrepreneurship education programs.
- Implement bankruptcy policies that encourage a fresh start.
- Reduce administrative burden.

Under the European Charter for Small Enterprises, Member States and the Commission take actions in ten key policy areas to support SMEs (EC 2012b):

- Education and training programs for entrepreneurship.
- Low-cost and faster procedures for start-ups.
- Better legislation and regulation.
- Availability of professional skills.
- Improvements to online access.
- Getting more out of and going beyond the Single Market.
- Preferential measures on taxation and financial matters.
- Supportive policies to strengthen the technological capacity of small enterprises.
- Taking advantage of successful e-business models to build up top-class small business support.
- Developing stronger and more effective mechanism to represent the interests of small enterprises at European and national levels.

**Chart A16. Key Areas for Action**


Source: Background information for the European Council, 2011.

### *The Group of 20's "Four-Fold" Action Plan*

In 2010, the G-20 Financial Inclusion Experts Group's (FIEG) SME Finance Sub-Group report recommended a four-fold action plan to the G-20 Summit to develop an enabling environment for SMEs to access finance. This plan aimed to design effective government support mechanisms, develop a supportive legal and regulatory framework, build consistent and reliable data sources on SME financing, strengthen the financial infrastructure and enhance financial institutions' capacity (Box A2) (IFC 2010).

**Box A2. Measures to Strengthen Financial Infrastructure and Enhance the Capacity of Financial Institutions**

Strengthen the financial infrastructure by:

- Establishing auditing and accounting standards, credit registries/bureaus, collateral and insolvency regimes for SMEs to maintain the balance between transparency and regulatory simplicity.
- Developing public credit registries and/or private credit bureaus to help creditors better manage SME credit risk and extend their lending to SMEs.
- Establishing SME rating agencies to provide more information on SMEs to lenders.
- Setting up a secured transaction regime/collateral registry with clear priority rankings of claims over collateral and effective enforcement (seizure and disposal) in case of default.

Build the capacity of financial institutions by:

- Establishing a Global SME Finance Forum (to be led by the G-20) as a knowledge sharing platform to further identify, promote and disseminate best practices in SME financing. The Forum offers a network of peer institutions and global access to tools and benchmarks. It also improves access to SME information, facilitating the framework of SME financial data collection, analysis and dissemination.
- Funding the winners of the SME Finance Challenge, scaling up successful interventions and practices in SME financing and improving financial infrastructure. This will help financial institutions build capacity and mitigate risks. In addition, it will create incentives for financial institutions to deliver sustainable and scalable financial services to SMEs.
- Establishing a platform to gather cross-country SME financial data in a coordinated and consistent manner.

Source: IFC Scaling-Up SME Access to Financial Services in the Developing World, 2010.

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