



Business and Industry Advisory Committee to the **OECD**

Comité Consultatif Economique et Industriel Auprès de l' **OCDE**

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BIAC Statement

“Towards more Effective SME Policies in OECD and non-OECD Countries”

2nd OECD Conference for Ministers Responsible for SMEs on “Promoting Entrepreneurship and Innovative SMEs in a Global Economy”

Istanbul, Turkey, 3-5 June 2004

Executive Summary

The OECD business community welcomes the focus put on Small and Medium Size Enterprises (SME) development through the implementation of the OECD Bologna Process. The Business and Industry Advisory Committee to the OECD (BIAC) has asked OECD governments on numerous occasions to enhance the favourable framework conditions for more dynamic entrepreneurship which have a direct impact on the overall economic performance. With regard to SMEs, BIAC would like to recommend the following policies as particularly relevant:

- **Investment in entrepreneurship education and promoting lifelong learning;**
- **Strengthening access to technology and e-business;**
- **Reducing and simplifying administrative regulation and costs;**
- **Facilitating access to financing;**
- **Enhancing the role of SMEs for development.**

BIAC believes that creating incentive policies for SMEs, by simplifying heavy bureaucracy procedure and providing a business environment conducive to entrepreneurship and enterprise creation, are the key elements to realise economic and social objectives. While stable macroeconomics environment is vital for small business, these policies should compromise sound fiscal and monetary policies to provide constancy in macroeconomic aggregates. They also include structural policies such as labour markets regulations, tax design, competition law, financial markets and bankruptcy law to improve the overall economic framework.

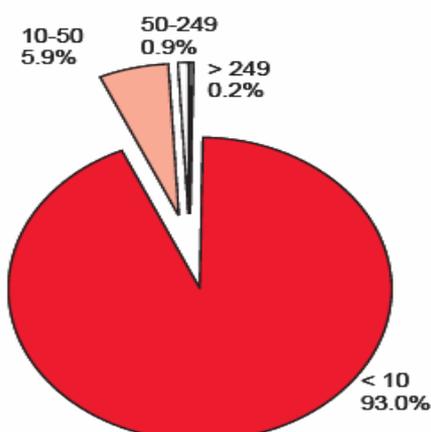
Towards more Effective SME Policies in OECD and non-OECD Countries

Small and medium-sized enterprises (SMEs) must continue to be an important part of industrial policy in OECD and non-OECD countries

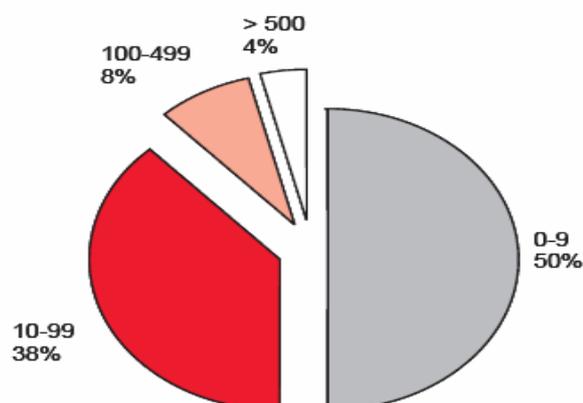
Small and medium-sized enterprises (SMEs) are recognised more and more to be at the forefront of governments' economics policy regarding their contribution to economic growth. The economic dynamism is usually attributed to the ability of SMEs to create new jobs and to develop customised products or services. SMEs represent over 95% of enterprises and generate 60%-70% of private sector employment in most OECD countries. In addition, SMEs accounts for two-thirds of economic activity and employment in OECD services sector and at least half of OECD manufacturing employment. New developments under globalisation and technical changes pave the way for the necessity of diversification in the production to fulfil the large spectrum of consumer's needs. In line with this trend mass production has lost its importance which offers SMEs increasing opportunities.

Share of SMEs in business firms

A. European Union: percentage share of enterprises by size class



B. United States: percentage share of enterprises by firm size (total economy)



Source: Joint OECD/Eurostat database on SME statistics.

Classification by employees

Given this increasing importance of SMEs and their importance for job creation most OECD and many non-OECD governments have developed policies and programmes to promote and boost development of SMEs. These programmes generally aim to remove obstacles - especially in financing - in order to facilitate SME access to global markets. They also seek to identify and implement best practice policies for entrepreneurship and SME innovation.

- Drawing from these developments, BIAC thinks that the OECD should continue to **work on enhancing the performance of small business by promoting best practice policies and international cooperation. We therefore welcome the Bologna Process and support this second Ministerial Conference on SMEs jointly organised by the OECD and the Turkish Ministry of Industry and Trade on "Promoting Entrepreneurship and Innovative SMEs in a Global Economy".**
- **We hope that the major outcome of this meeting - the adaptation of an Istanbul Ministerial Declaration built up on the reaffirmation of governments' commitments**

to SMEs and entrepreneurship through a range of policy actions – will be followed-up by implementation of the recommendations by OECD governments. BIAC believes that this conference will provide an excellent opportunity to set up a realistic action plan to foster SMEs development in OECD and non-OECD countries.

SMEs represent a very large proportion of BIAC's affiliates' member enterprises

A BIAC membership survey conducted in 2000 revealed an interesting picture; a vast majority of companies and their affiliations represented by the 38 BIAC member organisations are SMEs. According to this survey, among the countries responding the total number of SME companies affiliated with BIAC Organisations was estimated by us to be some 8.9 million.

The survey helped BIAC to counter the wrong perception that BIAC – and also the OECD – is representing only “Big Business”.

It is BIAC's firm belief that the strong distinction sometimes made between the “Big Multinational Companies” and the “Small Ones” is somehow artificial and disregarding the convergent interests which exist in reality. Many of policies and recommendations to improve business environment for big business are also relevant for small businesses.

On the other hand given the limited capability of SMEs to access global markets and employ newly developed technologies, special SME policies and recommendations are necessary.

BIAC supports the OECD activities on SMEs issues

BIAC business envisages SMEs as the backbone of economic development and also the driving force of entrepreneurship. In line with high dependency of the market economy efficiency on the private sector development, SMEs, as an essential representative of private sector, play a key role in the reform process in many countries. New job creation and free market entry and exit are key SME contributions to the dynamism of every economy. As life cycle of young firms depends on innovative capacity and productivity, small business is often the source of new process or products and contributes to productivity improvements in the economy as a whole. In addition, the ability of SMEs to create jobs improves social cohesion and reduces poverty.

For BIAC SMEs with their dynamism are crucial potential motors for growth and significant drivers of innovation.

As a starting point, BIAC believes that creating incentive policies for SMEs, by simplifying heavy bureaucracy procedure and providing a business environment conducive to entrepreneurship and enterprise creation are the key elements for governments to realise economic and social objectives. While a stable macroeconomics environment is vital for SMEs, these policies should compromise sound fiscal and monetary policies to provide constancy in macroeconomic aggregates. They also include structural policies such as labour markets regulations, tax design, competition law, financial markets and bankruptcy law to improve the overall economic framework.

Realising favourable framework conditions for more dynamic entrepreneurship has a direct impact on overall economic performance. With regard to SMEs, BIAC would like to recommend the following policies as particularly relevant:

- **Investment in entrepreneurship education and promoting lifelong learning;**
- **Strengthening access to technology and e-business;**
- **Reducing and simplifying administrative regulation and costs;**
- **Facilitating access to financing;**
- **Enhancing the role of SMEs for development.**

I. Investment in entrepreneurship education and promoting of lifelong learning

Business seeks to emphasise the importance of entrepreneurial education as a factor for building an entrepreneurial society. It is an important determinant of career preferences and helps shape attitudes to risk-taking and reward.

- **BIAC recommends that the OECD would work on promoting entrepreneurial spirit and a broad entrepreneurial culture by making it a subject of school and university education.**

We therefore welcome that cultivating an entrepreneurial culture and fostering entrepreneurial attitudes are given increased priority on government agendas. Education and training (including lifelong training) in entrepreneurship are preferred instruments for fostering entrepreneurial behaviour in societies. This suggests that the programmes stimulating the private market's supply of services such as focused courses can have an impact on entrepreneurial activity and enterprise performance and profitability.

In spite of the numerous initiatives launched by governments entrepreneurship is not sufficiently integrated neither into educational curricula nor into national long term economic strategies. The main reason behind this is a lack of public resources causing limited teaching and research capability in this field. Indeed, there are vital needs to improve coordination among government agencies for the design and implementation of initiatives.

- **BIAC suggests entrepreneurial spirit should be integrated into all levels of the formal education system. Access to information, skills and expertise relating to entrepreneurship should be ensured via "lifelong learning" programmes for the adult population. BIAC invites the OECD and the non- OECD governments to outline their activities carried out nationally in the area of promoting entrepreneurship among young people.**

II. Strengthening access to technology and e-business

New progress in telecommunications (mobile phones, e-mail, tele-conferencing) have opened up new opportunities of e-commerce and cost savings for SMEs (almost 10 and 20% on purchasing and procurement). The internet and the e-environment has paved the way for SMEs to access the global market, even to those companies who have no physical presence outside their domestic market. At the cutting edge of the digital economy, the internet reduces "time to market" and gives SMEs the chance to have a more powerful presence on the global market. In line with these advantages, e-commerce offers significant productivity gains and can provide an excellent floor not only for marketing and sales, but also for purchasing and procurement.

- **BIAC promotes the use of information technology in SMEs and encourages the use of e-commerce as promoting SMEs' traditional strengths for the new digital economy. Since there is a direct link between access costs and Internet usage, SMEs' access to the Internet must be easy and affordable. This goal can be achieved through liberalisation in telecommunication and e-commerce related services.**

However in many OECD countries, there is a striking contrast between the Internet usage of small companies and large companies. While large companies are expecting to use e-commerce intensively by 2004, small companies, especially those with less than 10 employees, are more hesitant to use the internet. The reason behind this is that SMEs are more vulnerable to absorbing recovery costs in case of failed e-transactions. Therefore, it is worth highlighting that the demand potential of broadband development as well as security and privacy issues must be vigorously addressed by governments taken into account the special needs of SMEs.

- **BIAC welcomes the recent OECD Council Recommendation on Broadband Policies, which asks governments to assist the development of broadband market and services. Governments must complete the SME friendly policy framework of e-commerce that will allow SMEs to take full advantage of e-business.**

Besides problems relating to trust and transaction security violations of intellectual property rights emerge as major impediments especially for SMEs. Indeed intellectual property rights are important elements of the growth potential of innovative start-ups and SMEs. Intellectual property protection stimulates sustainable economic development because it promotes investment and creativity.

- **BIAC calls upon OECD member governments to provide more capacity building for non-OECD members enabling them to strengthen the enforcement of their intellectual property rights regimes and take action to eliminate counterfeiting.**
- **Furthermore, OECD is requested to look further into the relationship of IP protection and economic development especially in its increased work with non-OECD members.**

Another way of promoting an entrepreneurial spirit can be achieved by strengthening university/industry co-operation. Business and innovation centres and science parks can help especially SMEs to access the development, application and exploitation of new technologies.

- **BIAC suggests that OECD governments encourage the foundation of technology development zones and techno-parks in order to encourage university-industry co-operations.**

III. Reducing and simplifying administrative regulation and costs

Over-prescriptive regulations have the potential to erode the flexibility of SME and often lead to involuntary consequences. Indeed, there is a mounting avalanche of regulation and especially for SMEs it can be extremely difficult to even attaining the knowledge of what they have to comply with. Since the nature of SMEs is different from larger companies governments need to ensure that they always include the interests of SMEs in their policy making and legislation. SMEs require heightened flexibility in the labour market in order to respond to market-shifts, customer needs and competitive pressures, as these changes take at an increasing pace. It is also important that new regulation should not act as a barrier to growth.

- **BIAC continues to believe that the work of the OECD on regulatory reform and regulatory impact analysis will help governments in cutting red tape and simplifying overly bureaucratic regulations that specifically burden SMEs.**
- **Additionally, BIAC would like to underline that in many OECD countries greater flexibility in labour markets and agreements would be beneficial for SMEs.**

Regulatory reform is vital for the reduction of trade barriers encountered by services and investment. Regulatory reform that encourages open markets and competition must overcome entrenched interests and this requires a horizontal approach and an international dialogue. The OECD analysis and data are indispensable to this effort. One of the most important contributions of OECD work is to identify patterns of regulatory reform for which strong logic has been established in one or more member countries. A main focus should be to promote the adoption of these patterns in OECD members and non-members alike.

Studies show that less developed countries tend to have a more highly regulated environment, often inhibiting the potential of business to foster development. In fact, it is the quality of business regulation and the institutions that enforce it, which are the major determinants for private sector investment.

For business, the core test for good regulation is the ability of governments to choose the most efficient policy tools that are least burdensome on commercial activity, whether regulatory or non-regulatory by nature.

Unfortunately, bureaucracies in OECD and non-OECD countries tend to be conservative and there are few incentives for government officials to be innovative in regulatory approaches. Outdated regulations tend to accumulate. From a business point of view, every new regulatory measure impacting the business environment should meet two general criteria:

- Have other possible solutions to regulation (self-regulation, voluntary agreements) been explored?
- What considerations led to the rejection of non-regulatory options?

It is important that alternatives to command-and-control regulation are transparent and can be discussed publicly involving independent business organisations as major stakeholders.

Regulatory Impact Analysis (RIA) is another crucial requirement for modern rule-making. The OECD continues to lead the discussion on RIA and issued in 1997 the publication "Regulatory Impact Analysis: Best Practices in OECD countries".

- **BIAC asks OECD and non-OECD governments to implement these recommendations and to carry out RIAs on a regular basis.**

IV. Facilitating access to financing

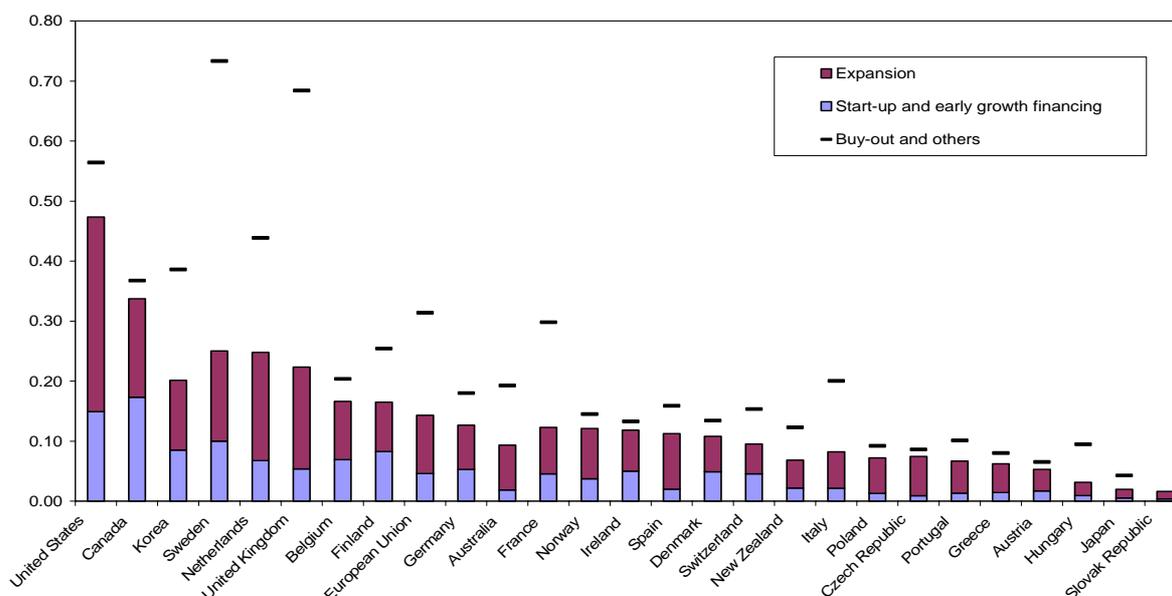
SMEs need a balanced financial structure constituted of a combination of retained profits, internal or external equity and debt funding. Even though a lack of funding continues to be a serious obstacle for SME entrepreneurs, high administrative and investment costs combined with uncertainties about the future returns are often amplifying financing problem of SMEs.

Due to the nature of skewed and highly risky returns from innovative businesses and the adverse selection problem in the market, it is often difficult for SMEs to find proper financing until innovative activities become commercially successful.

A way out of this dilemma can be provided by venture capital which is a crucial financing method for start-ups. A recent study by the British Venture Capital Association demonstrated that venture backed companies increased their staff levels at a rate of over three times that of traditionally financed companies. However, access to venture capital can be very problematic especially in non-OECD countries. Furthermore current regulations in many countries restrict institutional investors from providing venture capital.

- **To this respect, BIAC believes that public financial support and foreign funds originating from international institutions should be channelled to private financial markets capable of providing venture capital. Additionally, an easing of regulations harmful to the inflow of venture capital is required.**

Venture capital investment, 1999-2002 (% of GDP)



Note: 1998-2001 for Australia, Japan, Korea and New Zealand. The definition of private equity/venture capital tends to vary by country.

Source: OECD venture capital database, 2003.

Capital markets play a key role in SMEs financing. However, well-developed financial markets - namely efficient stock markets - are sometimes lacking in emerging market countries. For this reason, SMEs are forced to seek long-term funds from national banks. Due to the mismatch between their assets and their liabilities banks in these countries tend to fund SMEs only with short-term financial instruments. This form of financing is very expensive and tends to distort SME competitiveness.

In this context finding proper guarantees for SMEs from emerging markets is another major financial problem. The establishment of credit back-up funds with the objective of improving the level of risk taken by SMEs and credit institutions can eliminate this problem. This guarantee mechanism should be backed by the creation of capital market access mechanisms through which SMEs can liquidities issue bonds and medium or long-term loans.

- **BIAC suggests that establishing national specialised banks for SMEs and guarantee scheme - namely credit back-up funds - would be a possible solution for financing problems of SMEs in emerging markets.**

Furthermore, worldwide financial regulations designed to secure the soundness of financial systems have the potential of adversely affecting the provision of risk finance to SMEs. The impact of the forthcoming Basel II agreement¹, reviewing capital requirements for banks and investment firms, will directly affect the availability of loans for innovative SMEs in particular in developing countries. Substantial improvements have been made regarding the treatment of SMEs in the proposed framework. However, the recognition of non-financial collateral as a risk-mitigating factor and the procyclical effects of the new rules on bank lending have emerged as specific concerns.

- **Accordingly BIAC would like to highlight that financial regulations should be subject to cost-benefit assessments (RIAs - see III. above) before they are implemented and their impact should be monitored subsequently in order to avoid adverse impact on innovative SME activities.**

V. Enhancing the role of SMEs for development

Globalisation transformed large business into highly integrated networks including many SMEs. New type of competition requires managerial cooperation and efficient management of the supply and demand system between a prime actor firm and its subcontractors. For instance, as SMEs predominate in the important strategic business services sub-sector, successful implementation of network systems between large and small firms are crucial for service outsourcing.

- **BIAC regards it as important to enhance the communication network capabilities amongst SMEs and large business.**

Indeed, the relative role of SMEs in the globalisation process is poorly understood because of the lack of appropriate data. It is clear that governments should strengthen institutions to

¹ In 1988 the Basel Committee introduced a capital measurement system commonly referred to as the Basel Capital Accord. The 1988 Capital Accord was revised in January 2000 and the Basel Committee will release a complete proposal for an additional round of consultation in early 2002 to match the envisaged implementation date for 2005. The New Basel Capital Accord (Basel 2) seeks to establish a new capital adequacy agreement for (internationally operating) banks to ensure international financial stability, fair pricing and integrity of the banking system.

improve the quality and amount of data. Showing policy makers how to build databases and indicators is a vital task for understanding SMEs more methodically, checking progress and comparing situations between countries.

- **BIAC supports the OECD Action Plan on systematic statistical measurement of SME behaviour. BIAC believes that this Action Plan should be aimed at procuring tangible and measurable improvements in SMEs' statistics.**

Despite the progressively important role of SMEs in the export-led industrialisation, the majority of SMEs in developing countries, especially in Sub-Saharan Africa, still do not reap the full range of benefits from globalisation. OECD governments should consider to give SMEs stronger role in important liberalisation processes like the Doha Development Agenda.

- **BIAC would like to highlight that the result of the current Doha Round of trade negotiations should contribute to the enhanced integration of SMEs in the global economy via reinforcing capacity building and promotion of foreign direct investment inflows into developing economies.**

SMEs with their strong capacity in the creation of high value added and its proper distribution within the national economy play a crucial role in poverty reduction. Fostering this major contribution of SMEs to development and poverty reduction requires a strong national consensus on the trade and competitiveness strategy. This must involve SMEs, business association, government and the international donor community.

- **BIAC asks the OECD to continue its work on 'best-practices' to enhance SME competitiveness with national development and poverty reduction goals. In addition the OECD should highlight the possible contributions donor countries can make in this process.**

Key Messages

BIAC believes that this conference will provide an excellent opportunity to set up a realistic action plan to foster SMEs development in a continuously changing environment. To sum up our recommendations to the OECD, OECD governments and non-OECD governments:

- **BIAC recommends that the OECD would work on promoting entrepreneurial spirit and a broad entrepreneurial culture by making it a subject of school and university education.**
- **BIAC suggests entrepreneurial spirit should be integrated into all levels of the formal education system. Access to information, skills and expertise relating to entrepreneurship should be ensured via "lifelong learning" programmes for the adult population. BIAC invites the OECD and the non- OECD governments to outline their activities carried out nationally in the area of promoting entrepreneurship among young people.**
- **BIAC promotes the use of information technology in SMEs and encourages the use of e-commerce as promoting SMEs' traditional strengths for the new digital economy. Since there is a direct link between access costs and Internet usage, SMEs' access to the Internet must be easy and affordable. This goal can be**

achieved through liberalisation in telecommunication and e-commerce related services.

- **BIAC welcomes the recent OECD Council Recommendation on Broadband Policies, which asks governments to assist the development of broadband market and services. Governments must complete the SME friendly policy framework of e-commerce that will allow SMEs to take full advantage of e-business.**
- **BIAC calls upon OECD member governments to provide more capacity building for non-OECD members enabling them to strengthen the enforcement of their intellectual property rights regimes and take action to eliminate counterfeiting.**
- **Furthermore, OECD is requested to look further into the relationship of IP protection and economic development especially in its increased work with non-OECD members.**
- **BIAC suggests that OECD governments encourage the foundation of technology development zones and techno-parks in order to encourage university-industry co-operations.**
- **BIAC continues to believe that the work of the OECD on regulatory reform and regulatory impact analysis will help governments in cutting red tape and simplifying overly bureaucratic regulations that specifically burden SMEs.**
- **Additionally, BIAC would like to underline that greater flexibility in working patterns and work arrangements would be beneficial for SMEs.**
- **BIAC asks OECD and non-OECD governments to implement these recommendations and to carry out RIAs on a regular basis.**
- **To this respect, BIAC believes that public financial support and foreign funds originating from international institutions should be channelled to private financial markets capable of providing venture capital. Additionally, an easing of regulations harmful to the inflow of venture capital is required.**
- **BIAC suggests that establishing national specialised banks for SMEs and guarantee scheme - namely credit back-up funds - would be a possible solution for financing problems of SMEs in emerging markets.**
- **Accordingly BIAC would like to highlight that financial regulations should be subject to cost-benefit assessments (RIAs - see III. above) before they are implemented and their impact should be monitored subsequently in order to avoid adverse impact on innovative SME activities.**
- **BIAC regards it as important to enhance the communication network capabilities amongst SMEs and large business.**
- **BIAC supports the OECD Action Plan on systematic statistical measurement of SME behaviour. BIAC believes that this Action Plan should be aimed at procuring tangible and measurable improvements in SMEs' statistics.**
- **BIAC would like to highlight that the result of the current Doha Round of trade negotiations should contribute to the enhanced integration of SMEs in the global economy via reinforcing capacity building and promotion of foreign direct investment inflows into developing economies.**

- **BIAC asks the OECD to continue its work on 'best-practices' to enhance SME competitiveness with national development and poverty reduction goals. In addition the OECD should highlight the possible contributions donor countries can make in this process.**