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TOWARDS AN OECD STRATEGY FOR SMES

(Note by the Secretary-General)

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BRA	Brazil	**LVA**	Latvia
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DEFINING SMEs FOR STATISTICAL PURPOSES

It should be noted that a standard international definition of small and medium-sized enterprise (SME) does not exist. SMEs are defined differently in the legislation across countries, in particular because the dimension "small" and "medium" of a firm are relative to the size of the domestic economy. For statistical purposes, the OECD refers to SMEs as the firms employing up to 249 persons, with the following breakdown: micro (1 to 9), small (10 to 49) and medium (50-249). This provides for the best comparability given the varying data collection practices across countries, noting that some countries use different conventions.

NOTE: The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

1. This document provides a synthesis of the current state of knowledge about small and medium-sized enterprises (SMEs) and their contributions to economic and social well-being. It describes the diverse characteristics of SMEs and the opportunities and challenges they face in a globalised and digital economy. It also identifies areas where knowledge or data gaps exist and where more analysis is needed. The document presents the case for launching the future development of an OECD Strategy for SMEs, to help Members and Partners take a coherent approach to policies which impact and/or target SMEs, including across levels of government; enhance policy synergies; and address potential trade-offs. The future development and implementation of an OECD Strategy would help governments level the playing field for SMEs and enable them to enhance their contributions to inclusive growth in different economic and social contexts.

1. SMEs are essential for delivering more inclusive globalisation and growth

2. In many countries, and in particular OECD countries, governments are facing the challenges of low growth, weak trade and investment, and rising, or persistently high inequality (OECD, 2016a). They also face a growing dissatisfaction among citizens with the current state of affairs, which is also manifesting itself in the form of a backlash against globalisation and technological change. Against this backdrop, there is a need to create the conditions that enable the benefits of open markets and technological progress to be enhanced and shared more broadly across the economy and society.

3. SMEs are key players in the economy and the wider eco-system of firms. Enabling them to adapt and thrive in a more open environment and participate more actively in the digital transformation is essential for boosting economic growth and delivering a more inclusive globalisation. Across countries at all levels of development, SMEs have an important role to play in achieving the Sustainable Development Goals (SDGs), by promoting inclusive and sustainable economic growth, providing employment and decent work for all, promoting sustainable industrialisation and fostering innovation, and reducing income inequalities.

4. However, boosting SME potential for participating in and reaping the benefits of a globalised and digital economy depends to a great degree on conducive framework conditions and healthy competition. Due to constraints internal to the firm, SMEs are disproportionately affected by market failures and barriers and inefficiencies in the business environment and policy sphere. SMEs' contributions also depend on their access to strategic resources, such as skills, knowledge networks, and finance, and on public investments in areas such as education and training, innovation and infrastructure. Furthermore, for a large number of SMEs, a conducive environment for the transfer of business ownership or management represents an important condition for ensuring business viability over time, with implications for jobs, investment and growth.

5. These issues have gained prominence in the policy debate, as SMEs in some countries continue to struggle with the prolonged impact of the 2007-08 global crisis, which hit new and small businesses disproportionately and marked a widening of the gap in productivity growth between SMEs and large firms (OECD, 2017a, 2017b). This gap is an important driver of the observed rise in inequality, including wage inequality, in many countries (OECD, 2016a).

6. The SME policy space is complex. It comprises framework conditions; broad policies that impact SMEs; and specific targeted policies. These areas often cut across the boundaries of ministries and government agencies, as well as across levels of government. Since SMEs are often embedded in local eco-systems, which represent their primary source of knowledge, skills, finance, business opportunities and networks, it is also important to consider how policies developed at national level are tailored to local conditions, as well as how they coordinate with policies that are shaped at the regional or territorial level (OECD, 2016e). Furthermore, policy strategies should take into account the changes in regulations,

markets and technologies that occur across borders which may affect SMEs' opportunities and performance.

7. The sections below examine the opportunities and challenges SMEs face in a global and digital economy, building on the OECD's large body of analysis conducted across OECD Committees on SMEs, including on finance, innovation, taxation, regulation, digitalisation, employment, skills, trade, internationalisation and global value chains (GVCs), environment, among others, as well as on its unique statistical expertise. Taken together, these findings present a strong case for developing a cross-cutting OECD Strategy for SMEs, which can advance the debate and catalyse improvements in framework conditions and SME policies in Members and non-Members to deliver more sustainable and inclusive growth.

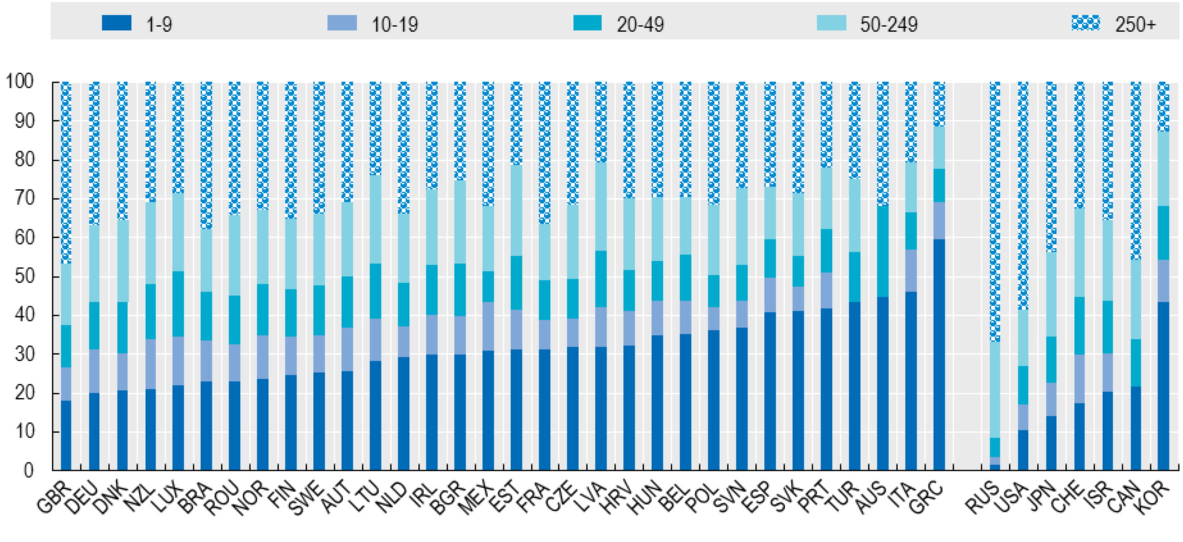
2. SMEs make diverse contributions to economic and social well-being, which could be further enhanced

SMEs play a key role in national economies around the world, generating employment and value added…

8. In the OECD area, SMEs are the predominant form of enterprise, accounting for approximately 99% of all firms. They provide the main source of employment, accounting for about 70% of jobs on average, and are major contributors to value creation, generating between 50% and 60% of value added on average (Figure 1) (OECD, 2016b). In emerging economies, SMEs contribute up to 45% of total employment and 33% of GDP. When taking the contribution of informal businesses into account, SMEs contribute to more than half of employment and GDP in most countries irrespective of income levels (IFC, 2010). In addition, SME development can contribute to economic diversification and resilience. This is especially relevant for resource-rich countries that are particularly vulnerable to commodity price fluctuations.

Figure 1. SMEs are the main source of jobs in the business sector

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



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

Source: OECD (2017), Entrepreneurship at a Glance 2017, OECD Publishing, Paris, forthcoming.

… and contributing to innovation

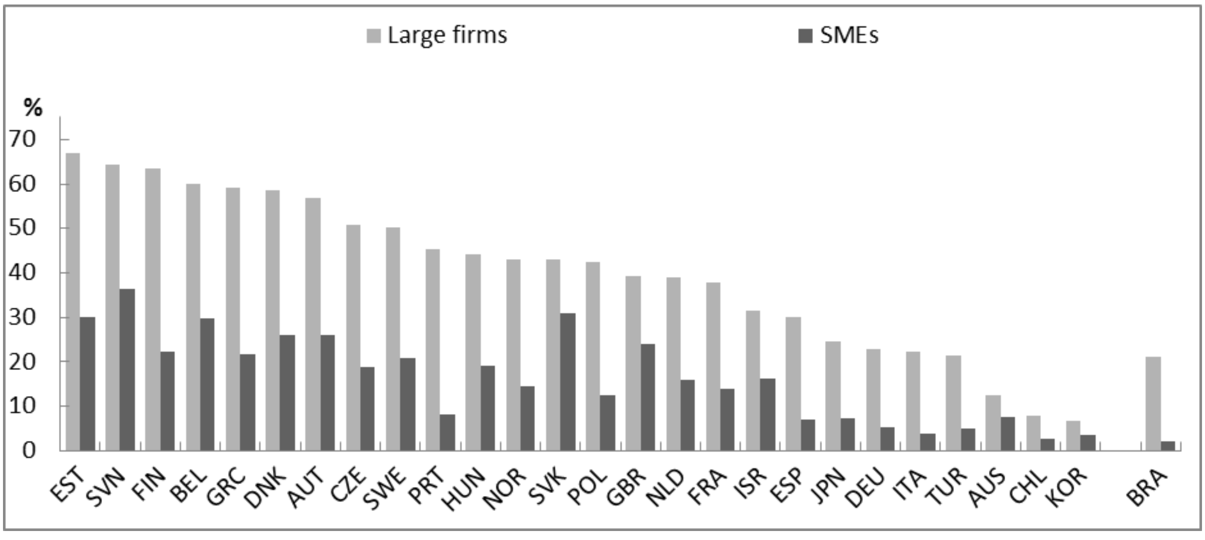
9. The contribution of SMEs to innovation dynamics has increased in recent decades, as income growth, more niched market demand and changing technologies have reduced the structural disadvantages of SMEs stemming from resource constraints and their more limited ability to reap economies of scale.

10. While not all SMEs are innovative, new and small firms are often the driving force behind the sort of radical innovations that are important for economic growth, since they can work outside of dominant paradigms, exploit technological or commercial opportunities that have been neglected by more established companies or enable the commercialisation of knowledge that would otherwise remain un-commercialised in universities and research organisations (Baumol, 2002; OECD, 2010a). For instance, SMEs account for about 20% of patents, one measure of innovation, in biotechnology-related fields in Europe (Eurostat, 2014). SMEs also contribute to value creation by adopting innovation generated elsewhere, and adapting it to different contexts through incremental changes, and by supplying new or niche products which respond to diverse customer needs. They also contribute by serving locations that do not have a large enough scale to attract larger firms.

11. The knowledge-based economy, a rise in non-technological innovation and the emergence of open or network-based modes of innovation have also enabled new and small firms to increase their contributions to innovation (OECD, 2010a). Innovation by SMEs is largely influenced by knowledge spillovers, access to networks and opportunities to partner with other players, including larger enterprises. Globalisation has increased the importance of cross-border collaboration in innovation – both in obtaining inputs for innovation (ideas, finance, skills, technologies) from abroad and in exploiting its outputs (products and services, patents, licenses, etc.) in foreign markets. However, a key challenge for many SMEs is to identify and connect to appropriate knowledge partners and networks at the local, national and global levels, as well as to develop appropriate skills and management practices for co-ordinating and integrating knowledge created by external partners with in-house practices and innovation processes (Figure 2) (OECD, 2013b).

Figure 2. SMEs are less connected than large firms to international knowledge networks

Firms engaged in international collaboration for innovation, by firm size, as a percentage of product and/or process-innovating firms in each size category, 2010-12



Source: OECD (2015), OECD Science, Technology and Industry Scoreboard 2015, OECD Publishing, Paris, based on Eurostat Community Innovation Survey (CIS-2012) and national data sources, June 2015.

SMEs are central to the efforts to achieve environmental sustainability…

12. SME participation in the transition to more sustainable patterns of production and consumption is crucial for the greening of economic development. Although the individual environmental footprint of small businesses may be low, their aggregate impacts can, in some sectors, exceed that of large companies. Reducing the environmental impact of SMEs by achieving and going beyond environmental compliance with existing rules and regulations in both manufacturing and services, is a key factor for success in the green transformation. This is particularly urgent for SMEs in the manufacturing sector, which accounts for a large part of the world's consumption of resources, air and water pollution and generation of waste (OECD, 2013a).

13. The green transition also opens up business opportunities for SMEs as important suppliers of green goods and services. In many OECD countries, innovative SMEs play a pivotal role in the eco-industry and clean-tech markets. For instance, in the United Kingdom and Finland, SMEs represent respectively over 90% and 70% of clean technology businesses (Carbon Trust, 2013; ETLA, 2015). SMEs are especially well positioned to seize opportunities of greener supply chains in local clean tech markets, which may be unattractive or impenetrable for large global firms, including in emerging economies and low-income countries (IBRD, 2014). Furthermore, small "green entrepreneurs", driven by financial profit combined with environmental consciousness, can drive a bottom-up transformation and job creation, by developing new business models and pioneering green business practices that influence mass markets and eventually are adopted by the wider business community (OECD, 2013a).

14. However, the willingness and capability of SMEs to adopt sustainable practices and seize green business opportunities often face size-related resource constraints, skill deficits and knowledge limitations. Environmentally sustainable improvements in SMEs are often held back by perceived technical complexities, burdens and costs, as well as lack of awareness about financially attractive opportunities. Furthermore, a lack of appropriate skills and expertise often prevents SMEs from acting upon win-win opportunities, and resource constraints often lead to SMEs to be more risk-averse and less willing to invest in new technologies than larger firms (Mazur, 2012; EaP Green, 2016).

… and more inclusive growth

15. SMEs create job opportunities across geographic areas and sectors, employing broad segments of the labour force, including low-skilled workers, and providing opportunities for skills development. They also help support their employees' access to health care and social services. SMEs that generate jobs and value added are therefore an important channel for inclusion and poverty reduction, especially but not exclusively in emerging and low-income economies. In this regard, upgrading productivity in a large population of small businesses, including in traditional segments and the informal economy, can help governments achieve both economic growth and social inclusion objectives, including escaping from low productivity traps and improving the quality of jobs for low-skilled workers (OECD, 2009, 2017b).

16. Small businesses can also represent an effective tool to address societal needs through the market and provide public goods and services. This is the case of social enterprises, which bring innovative solutions to the problems of poverty, social exclusion and unemployment, and fill gaps in general-interest service delivery (EU/OECD, 2016). In many countries, the economic weight of the social and solidarity economy, in which social enterprises operate, has increased steadily in recent years, including in the aftermath of the global crisis. For instance, in France, in 2014, the social economy accounted for 10% of the GDP. In Belgium, over 2008-14, employment in social enterprises increased by 12% and accounted, in 2015, for 17% of total private employment (EU, 2016). In the United Kingdom, in 2015, 41% of social enterprises had created jobs compared to 22% of SMEs (SEUK, 2015).

17. In addition, entrepreneurial opportunities can represent an important channel for economic and social participation and upward mobility, by allowing disadvantaged or marginalized groups, including young people, women, seniors, migrants, ethnic minorities and the disabled, to create their own opportunities to participate in the economy.

18. In many countries, corporate social responsibility (CSR) is increasingly viewed as a way for businesses, including SMEs, to contribute to societal goals. By committing to sound labour and environmental practices and good community relations, small businesses can contribute to sustainable and inclusive development, particularly at the local level. CSR can also help improve the image customers, investors and other stakeholders have of the business, and enhance their capacity to attract and retain qualified and motivated employees.

However, these contributions vary widely across firms…

19. Firm heterogeneity matters for innovation, productivity, job creation and inclusive growth. While large differences exist between SMEs and large firms, the SME population itself is typically composed of very diverse businesses, in terms of age, size, ownership, business models, and entrepreneurs' profile and aspirations.

20. SMEs play an important role in the wider eco-system of firms. Start-ups and young firms, which are generally small or micro firms, are the primary source of net job creation in many countries. However, the majority of new enterprises either fail in the first years of activity, or remain very small (OECD, 2016c). High-growth firms of different ages and sectors also contribute disproportionately to job creation (OECD, 2010b).

21. Established medium-sized enterprises that innovate and scale up are the driving force behind growth in many OECD economies, often ensuring the coordination, upgrading and participation in supply chains of smaller suppliers. For instance, in Switzerland, medium-sized enterprises (50-249 employees) represent about 4% of the business population, but account for 23% of employment and 25% of value added (OECD, 2016b). There are also many viable small enterprises in mid or low-tech sectors which are embedded in competitive local production systems, and which generate innovation, largely incremental, and contribute to employment, social inclusion and territorial cohesion. At the same time, many small enterprises do not go beyond small local markets. These firms, which produce limited innovation and do not have strong growth aspirations, often remain small throughout their life cycle.

… and across countries and sectors.

22. SMEs are a dynamic and evolving population. Their composition varies widely across countries and sectors, with implications for their ability to thrive in and contribute to an open and digitalised economy. In all countries, micro-enterprises (up to 9 employees) dominate the business landscape, accounting for 70% to 95% of all firms. Nevertheless, significant cross-country differences are observed in the contribution of micro-enterprises to employment and value added. For instance, in the services sector, their share in employment ranges from more than 60% in Greece to 20% in Denmark and Germany, while their share in value added ranges from about 45% in Luxembourg to 15% in Switzerland (OECD, 2016b).

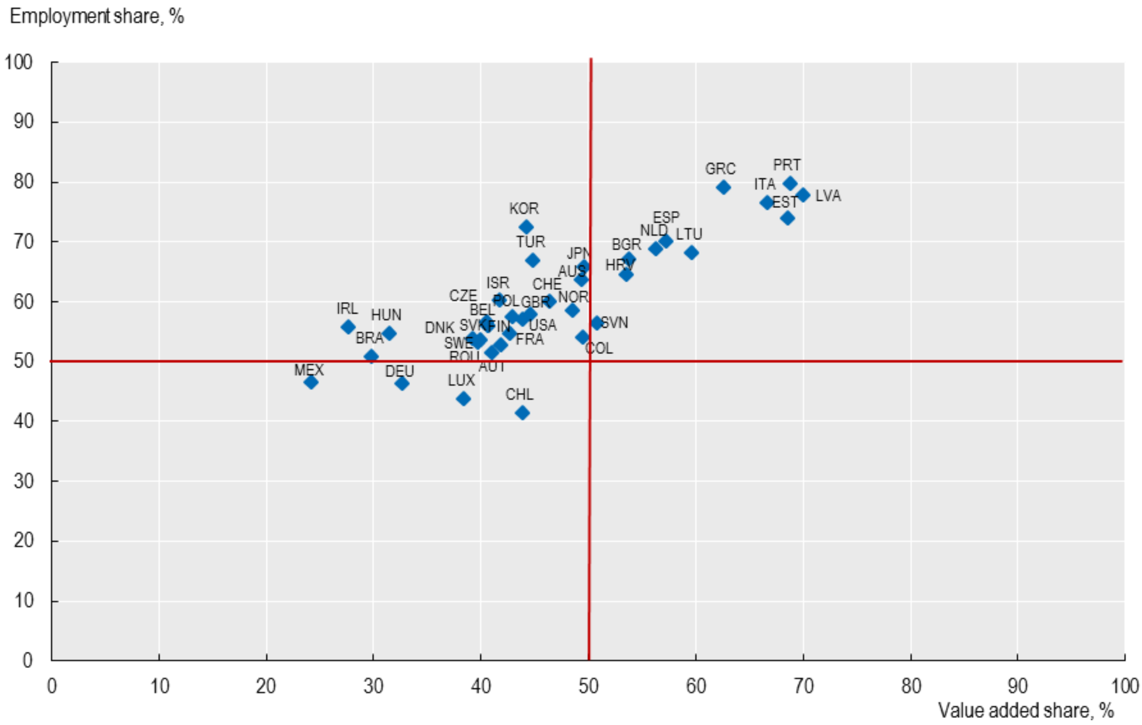
23. SME performance also varies across sectors. In services, SMEs account for 60% or more of total employment and value added in nearly all countries. In contrast, in manufacturing, although relatively few in number, large firms provide a disproportionate contribution to employment and value added, in large part reflecting increasing returns to scale from more capital-intensive production, as well as entry barriers related to investment. In some countries, such as Germany and Mexico, large manufacturing groups capture a significant share of total employment and value added. However, there are some exceptions

(Figure 3). These include smaller economies, such as Latvia and Estonia, as well as larger economies where SMEs have traditionally dominated manufacturing activity, such as Italy (OECD, 2017c).

24. A deeper understanding of the contributions and challenges of different types of SMEs (i.e. a typology of firms) is needed to guide structural and targeted policies.

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

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



Notes: Size of SMEs: AUS: SMEs refer to < 200 persons employed; JPN, KOR: SMEs refer to < 300 persons employed; CHE, JPN, USA: data do not include non-employers. GBR data exclude an estimate of 2.6 million small unregistered businesses. For CHL, only enterprises with more than 10 employees are covered.

Source: OECD (2017), Entrepreneurship at a Glance 2017, OECD Publishing, Paris, forthcoming.

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

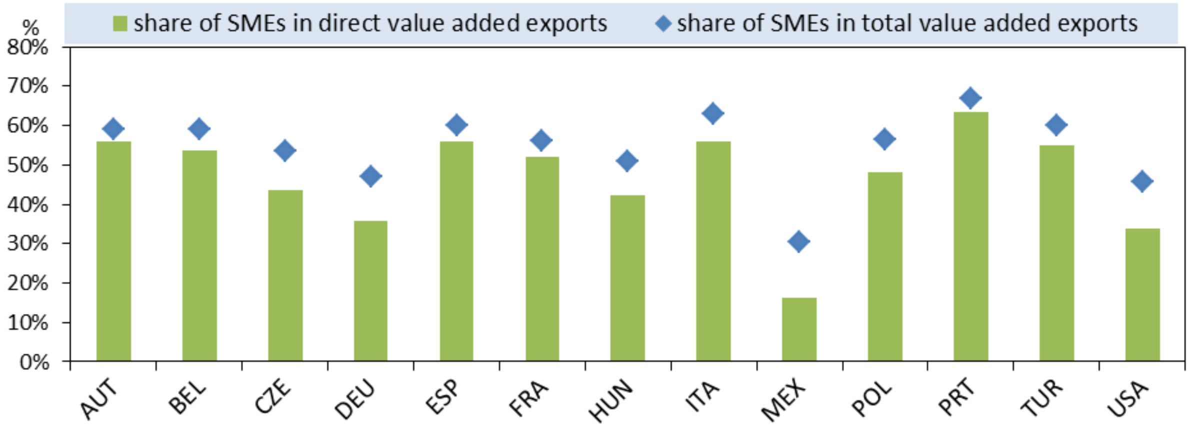
25. Stronger participation by SMEs in global markets can help to strengthen their contributions to economic development and social well-being, by creating opportunities to scale up, accelerating innovation, facilitating spill-overs of technology and managerial know-how, broadening and deepening the skill-set, and enhancing productivity. At the same time, closer global integration increases competition for SMEs in local markets, in some cases with disruptive effects, demanding enhanced market knowledge and increased competitiveness also for small businesses that do not operate internationally.

26. SMEs tend to be under-represented in international trade. Across OECD and non-OECD Members, few SMEs export directly and for those that do, exports typically represent a lower share of trade turnover (relative to larger firms) and generally target neighbouring countries (OECD, 2016b). However, when considering SMEs' indirect contribution to exports, as suppliers to larger domestic firms

or multinational companies (MNCs) that export, SMEs in OECD countries can represent more than half of total exports in value added terms (Figure 4) (OECD and World Bank Group, 2015). The quality and responsiveness of specialised suppliers, largely SMEs or even micro firms, can be crucial for the competitiveness of entire supply chains, at both local and global levels, and of larger groups that are directly engaged in fierce global competition. In this respect, close interdependence and coordination between large and small businesses can be an important source of value and competitiveness along supply chains.

Figure 4. SMEs account for a larger share of value added in international trade when indirect linkages are taken into account

Share of value added in exports by SMEs, direct and total, 2009



Source: OECD and World Bank Group (2015), based on OECD/Eurostat Trade by Enterprise Characteristics (TEC) Database; OECD Structural and Demographic Business Statistics (SDBS) Database; OECD Intercountry Input-Output Trade in Value Added (ICIO/TiVA) Database.

27. Participation in global markets and value chains is uneven across the SME population. There are a few “born global” firms and highly innovative SMEs that are fully integrated into global markets (“small multinationals”), and a sizeable share of SMEs that export or are embedded in GVCs as suppliers of exporters. At the same time, for many SMEs export-relationships can be short-lived, with new exporters ceasing to export after one or two years in many countries and, for longer-term exporters, frequent switching of products and destinations (Wagner, 2015). Smaller and less experienced exporters are typically more vulnerable to a sharp drop in external demand, such as in the aftermath of a global crisis (IBRD, 2010; Beverelli et al., 2011).

28. Furthermore, recent evidence suggests that developing country SMEs might struggle to take advantage of new opportunities offered by the evolving GVC landscape. Many SMEs might integrate GVCs at the low-value end, where links between MNCs and their local suppliers can be limited and difficult to develop, including when the MNC has a business interest in developing a local supplier base and actively pursues the objective (OECD and World Bank Group, 2015). In fact, evidence suggests that developing country SME indirect exports might be lower than developed country indirect exports (OECD, 2017d).

29. In order to develop policies that can support SMEs in making the most of the new opportunities offered by GVCs, a better understanding is needed of the interaction of SMEs with larger firms and MNCs

within different contexts and along different value chains, of the role of clusters for SME participation and upgrading, as well as of how GVCs are evolving, including as a consequence of the digital transition.

… but trade and investment barriers undermine SME participation…

30. Trade and investment openness, as well as trade facilitation, intellectual property protection, infrastructure and institutional quality, are key to SME engagement in global markets. SMEs are less able than large firms to face the costs of engaging in international trade due to their limited resources and management capacities. Institutionalising transparency and other good regulatory practices, including the option to reduce regulation, can control regulatory costs and burdens and promote SME competitiveness in global and emerging markets. While complying with diverse standards, technical regulations, and conformity assessment procedures is costly for larger firms, it is potentially prohibitive for SMEs since many of the costs to engaging in international markets are fixed, and often sunk, regardless of a firm's size or revenue. Predictable and efficient customs procedures and logistics services are especially important for SMEs, which may find the related administrative and financial burdens particularly onerous (OECD, 2015a; USITC, 2014). National Trade Facilitation Committees as specified under the new WTO Facilitation Agreement can be a useful tool to seek SME input.

31. In addition, constraints to importing might be limiting the ability of SMEs to take advantage of benefits arising from more efficient sourcing. For example, in Southeast Asia, a region which has embraced GVCs, SMEs tend to source a lower share of their value added from abroad relative to larger firms (OECD, 2017d).

… and poor physical and ICT infrastructure prevents SMEs from operating efficiently and accessing international markets at competitive costs.

32. In a world in which just-in-time delivery is the standard, and in which transit is rapid and storage is expensive, time is a crucial driver of competitiveness. The quality of physical infrastructure, such as roads, ports, and airports, as well as the efficiency of the procedures followed in the operation of these facilities, are important for businesses to enter foreign markets and participate in GVCs. In emerging economies, these are often the most important adverse factors signalled by SMEs seeking to seize global opportunities (COMCEC, 2013). The development of an efficient Information and Communication Technology (ICT) infrastructure, as well as enhanced interoperability and standards, are also increasingly important to access global markets, as they facilitate information exchange and communication as well as participation in e-commerce platforms (BIAC et al., 2016; OECD, 2017a).

Digitalisation offers new opportunities for SMEs to participate in the global economy

33. Digital technologies allow SMEs to improve market intelligence, reach scale without mass and access global markets and knowledge networks at relatively low cost. The digital transition facilitates the emergence of "born global" small businesses and provides new opportunities for SMEs to enhance their competitiveness in local and global markets, through product or service innovation and improved production processes. It also facilitates the emergence of "lean start-ups" that leverage the Internet to lower fixed costs and outsources many aspects of the business to stay agile and responsive to the market (OECD, 2017f). Furthermore, Big Data and data analytics provide a wide range of opportunities for SMEs, enabling a better understanding of the processes within the firm, the needs of their clients and partners, and the overall business environment.

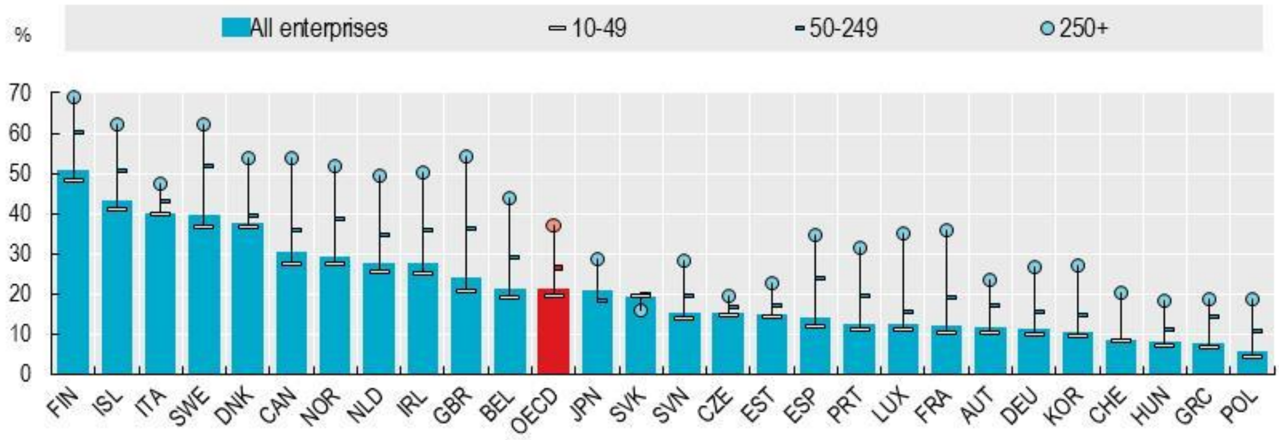
34. The use of digital technologies can also ease SMEs' access to skills and talent, through better job recruitment sites, outsourcing and online task hiring, as well as connection with knowledge partners (OECD, 2017f). It can also facilitate enhanced access to a range of financing instruments.

… but SMEs are lagging behind in the digital transition

35. While digitalisation offers new opportunities for SMEs to reach global markets, the reality is that a large number of SMEs have not been able to reap the benefits of the technological transition. Evidence shows that SMEs are lagging behind in adopting digital technologies. While, in most countries, the divide is narrow for simple connectivity and web presence, the gap broadens when considering participation in e-commerce and, especially, more sophisticated applications. For instance, across OECD countries, enterprise resource planning (ERP) software applications to manage business information flows are popular among large firms (more than 75% adoption rate in 2014) but less used by SMEs (less than 20%). In many countries, a large adoption gap is also observed for cloud computing, i.e. the renting of computer power from an external provider, which can allow smaller firms to use Big Data, while overcoming some of the barriers associated with the high fixed costs of ICT investment (Figure 5).

Figure 5. SMEs lag behind in the adoption of more sophisticated digital technologies

Enterprises using cloud computing services by size, as a percentage of enterprises in each employment size class, 2014



Notes: Unless otherwise stated, sector coverage consists of all activities in manufacturing and non-financial market services. Only enterprises with ten or more persons employed are considered. Size classes are defined as: small (from 10 to 49 persons employed), medium (50 to 249) and large (250 and more). For Canada, data refer to enterprises with expenditures on "Software as a Service" (e.g. cloud computing). Medium-sized enterprises have 50-299 employees. Large enterprises have 300 or more employees. For Japan, data refer to businesses with 100 or more employees. Medium-sized enterprises have 100-299 employees. Large enterprises have 300 or more employees. For Canada and Korea, data refer to 2012 instead of 2014. For Japan and Switzerland, data refer to 2011 instead of 2014. For Switzerland, data refer to enterprises with five and more employees.

Source: OECD (2015), OECD Digital Economy Outlook 2015, OECD Publishing, Paris.

36. The adoption lag of SMEs is mainly due to lack of investment in complementary knowledge-based assets, such as R&D, human resources, organisational changes and process innovation, and has implications for their capacity to turn technological change into innovation and productivity growth. For instance, lack of investment in in-house innovation processes and organisational capabilities limits the capacity of SMEs to take full advantage of new technologies to enhance data analytics and increase their participation in knowledge networks. In fact, the ICT revolution has made it easier for firms to innovate through collaborative networks with other businesses, including multinationals, universities and research organisations. However, this requires innovation competencies, as well organisational and management capacities to coordinate with external knowledge partners and effectively incorporate knowledge from external sources into internal processes (OECD, 2010a, 2015b).

… and disruptive effects need to be considered

37. Furthermore, for many SMEs, digitalisation has resulted in disruption of markets, including increased contestability of local markets, rapid obsolescence of knowledge, skills and business models, and increased complexity in the business environment. In addition, “winner-takes-all” dynamics, whereby digital technologies allow for full and instant upscale of the winning product or idea, often at the global level, could have far-reaching implications for the distribution of dividends and participation of new firms and SMEs in markets. A deeper understanding of the implications of all these digital developments for SMEs is needed.

3. The business environment is critical to enhance SME participation in and benefits from an open and integrated economy

38. A sound business environment and a well-functioning entrepreneurial “eco-system” for business, including at the local level, matter for countries and regions to foster participation of SMEs in a globalised economy. This is even more important in the current context, as increased competitive pressures and the fast pace of technological change demand agility, innovative behaviour, including in public governance, and ease of access to strategic resources. While framework conditions affect overall business investment, innovation and growth, some dimensions impact new and established SMEs disproportionately (OECD, 2017a).

Certain features of the institutional and regulatory framework result in disproportionate burdens on SMEs

39. Regulatory uncertainty, complexity and inconsistency affect SMEs disproportionately. SMEs are typically less efficient than large firms in screening the regulatory environment and dealing with relevant norms. Since they might lack information or expertise in house, SMEs often incur in other indirect costs, paying for external advisors’ expertise or investing in specific training of staff to comply with new obligations. Thus, the complexity of regulatory procedures and conditions for regulatory compliance are especially important for SMEs. In some countries, administrative burdens that businesses, especially small ones, cannot easily meet represent one explanatory factor for widespread informality (OECD, 2015a). Furthermore, for SMEs to participate in global markets and GVCs, regulatory divergence across countries can impose an additional layer of difficulty.

Inefficient insolvency regimes limit business dynamism, restructuring of viable firms and access to external finance by SMEs

40. Bankruptcy regulation that excessively penalises or stigmatises failure reduces incentives for the efficient exit of less productive firms and the reallocation of resources to more productive uses. In some countries, in the case of unincorporated micro and small firms, the treatment of individual defaulters is very severe, leaving full personal liability for many years beyond liquidation of the business (Bergthaler et al., 2015). Lengthy and complicated processes can significantly affect the capital and reputation of small entrepreneurs, drastically decreasing the chance of starting a business again. In addition, legal uncertainties increase risk to lenders and constrain the supply of finance to SMEs (OECD, 2017a).

High costs of tax compliance fall disproportionately on small and young firms

41. Given a substantial fixed cost component to tax regulatory requirements and compliance costs (record keeping, filing and payment processes etc.) at national, regional and municipal levels, small businesses are at a disadvantage with respect to large enterprises. For young firms, which also tend to be small, high compliance costs can exacerbate the resource and cash-flow constraints often experienced in the early stages of business development, and may act as a deterrent to formalisation. In some cases, tax

compliance costs for small firms may even exceed their tax cash payments (OECD 2015c; Eichfelder and Vaillancourt, 2014). Furthermore, certain aspects of business taxation, including asymmetric treatment of profits and losses, the distribution of taxation between capital and labour income and the design of R&D tax credits and incentives, can unintentionally disadvantage some young and small firms (OECD, 2015c).

Public sector integrity and transparency, public administration efficiency and the quality of public services are essential for a level playing field

42. Businesses interact in multiple ways with the public administration, whose integrity, transparency and efficiency affect business creation and growth. The costs associated with administrative burdens and red tape are relatively higher for SMEs than for large firms. Also, while lack of transparency and corruption in the public sector are detrimental to all businesses, they pose particular problems to SMEs, which often lack the capacity to cope with an opaque public sector, design and implement anti-corruption strategies and lobby for their needs in the absence of an established framework for participation in public decision making.

4. The ability to access strategic resources is critical for SME competitiveness

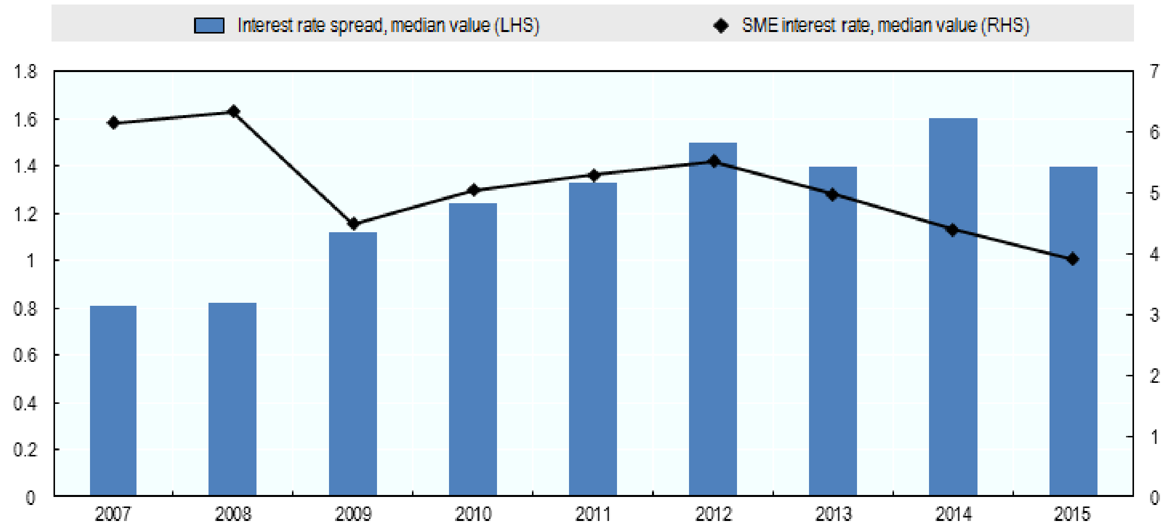
43. Specific barriers and market failures may prevent SMEs from accessing strategic resources, including finance, management capacity and skills, and knowledge networks, placing them at a competitive disadvantage in the global and digitalised economy

For many start-ups and SMEs, access to finance in the appropriate forms is hampered by a range of demand- and supply-side obstacles

44. Failures in financial markets, due to asymmetric information and agency problems, typically limit access to credit by SMEs and start-ups, which are often undercollateralised, have limited credit history and, and may lack the expertise needed to produce sophisticated financial statements (OECD, 2013c). This is an area where the case for policy intervention to correct these failures is well recognised. Credit constraints are especially severe in mid- and low-income countries, where funding gaps are often the main barrier to formalisation and SME development. Across OECD and non-OECD Members, credit conditions for many SMEs deteriorated in the aftermath of the global crisis, exacerbating the effects of long-standing challenges, such as lack of collateral and fixed costs for banks in processing loan applications. The spread in the average interest rates charged to SMEs and to large firms has considerably widened compared to the pre-crisis period, even though the costs of financing have been decreasing steadily in recent years, pointing to a higher credit risk for SMEs (Figure 6).

Figure 6. The gap in credit costs between SMEs and large enterprises has widened

Average interest rate charged to SMEs and average spread between interest rates charged to SMEs and large enterprises, median values, 2007-15



Source: OECD (2017), Financing SMEs and entrepreneurs 2017. An OECD Scoreboard, OECD Publishing, Paris.

45. Recognising that financing needs and constraints vary widely across the business population and along the life-cycle of firms, the *G20/OECD High-level Principles on SME Financing* call for strengthening SME access to credit, while also supporting the diversification of their financing sources. In fact, most SMEs, including new, innovative and fast-growing firms, remain heavily reliant on internal resources and traditional bank debt. The lack of appropriate forms of finance, especially of the equity-type, stands in contrast with large businesses, and is limiting entry, long-term investment, expansion and innovation (OECD, 2015d). The availability of bank lending and of alternative sources of finance is held back by a combination of demand-side barriers, most notably limitations in financial knowledge, strategic vision, resources and sometimes even the willingness or awareness to successfully attract sources, as well as supply-side hurdles, such as the overall opacity of the SME finance market, a lack of exit options for investors in SME finance markets, persistent regulatory impediments, such as to the broadening of the investors' base to retail and institutional investors, and costs of regulatory compliance (OECD, 2016d).

Skills shortages, poor management practices and workforce training limit SME productivity and innovation

46. SME participation in the knowledge-based economy is held back by skills shortages, poor internal management practices and low levels of workforce training. There is evidence that SMEs have higher skills deficiencies than large firms and SME training effort is on average significantly weaker per employee than in larger firms (OECD, 2013b). SMEs often face challenges in attracting and retaining highly qualified personnel and staff with relevant skills, and have greater difficulties in identifying workers with sought-after skills in the labour market. Furthermore, SMEs appear to be relatively behind in establishing collaboration with education and training institutions, and in the use of company-level learning strategies, i.e. the use of managerial practices and methods that promote learning and autonomy (OECD, 2015b). Lack of investments in this area also limits the uptake of digital technologies and their effective use to enhance productivity and access markets. In addition, lack of entrepreneurial skills may hold back adjustment to and greater participation of SMEs and entrepreneurs in the "new world of work" brought about by increasing digitalisation and fragmentation of production processes.

47. Poor management practices, as well as lack of an appropriate corporate governance structure, also pose challenges to business transfer and management transition processes in many SMEs, particularly family enterprises. In some cases, management limitations are compounded by financing constraints, regulatory hurdles, administrative and tax burdens, and small markets for business transfer. This represents a growing policy concern in many countries, particularly where the entrepreneur population is ageing rapidly, but limited evidence on business transfers in many regions represents an obstacle to policy action.

Access to public procurement is generally more difficult for SMEs than for large firms

48. Representing one third of government expenditures, public procurement is a direct source of income for companies, including SMEs. While targeted policies are vastly adopted by OECD Members and non-Members (OECD, 2017e), tangible impacts on the development of SMEs remain to be evidenced. Barriers include lack of information on procurement opportunities, large volumes and broad capabilities requests, restricted access to certain contracts, disproportionately high technical and financial qualification levels demanded, short time limits to submit tenders, costs of submission, insurance and financial guarantees required, administrative burdens and finding bidding partners.

5. A cross-cutting perspective on SMEs is needed

49. The drivers of the disparities in firm performance, including within the SME population, and the implications of the digital transition for SMEs and their participation in the global economy, are not yet fully understood. SMEs are typically more dependent than large companies on their business ecosystem and, due to their internal constraints, are more vulnerable to market failures, policy inefficiencies and inconsistencies. While the disproportionate effects of these failures on SMEs are well documented, perspectives differ on how they should be tackled and on the policy instruments which are effective in levelling the playing field or addressing specific barriers to SME development, while promoting healthy market dynamics. Furthermore, while many governments increasingly recognise the need for a cross-cutting perspective when developing SMEs policies and have taken steps in this direction, the synergies, trade-offs and complementarities within and across policy areas are often not well considered, due also to limited evidence and insufficient understanding of the interdependency of policies.

50. A major effort is needed to better understand the combined effects of structural reforms on the SME business environment, as well as on the role and impact of policies targeted to SMEs, including to foster innovation, sustain business dynamism, support skills development, ease access to finance, and enable access to public markets. Such an effort should consider the potential synergies and trade-offs across diverse policy areas, including distortionary effects that may be introduced by some policy actions; recognise the heterogeneity of the SME population; and acknowledge the multidimensional contributions SMEs make to the economy and society.

51. Additional work is also needed to craft policies across different domains and levels of government in a coherent and mutually reinforcing way. A holistic approach is critical because the broad umbrella of “SME policy” includes areas that cut across the boundaries of different ministries and government agencies, and that require close consultation with other stakeholders, such as the business sector, trade unions, and financial institutions, among others. Attention also needs to be paid to how policies developed at national level can be tailored to local conditions, as well as to framework conditions and policies that are shaped at the regional or territorial level (OECD, 2016e). This is all the more urgent to address the challenges of the increasing integration of global markets, the spread of global value chains and the rise of the digital economy.

An OECD Strategy for SMEs can support policy making in OECD and non-OECD countries

52. An OECD Strategy for SMEs would bring value added by delivering a comprehensive framework, which would identify key levers for enhancing SME contributions to sustainable and inclusive growth, provide guidance to support policy making in Members and non-Members and yardsticks for measuring progress. It would also build on a stocktaking of recent experiences at the national and supra-national levels. It would seek to deliver a stronger evidence base, including by addressing SME data gaps. Preparatory work would be undertaken in 2017, including a detailed scoping paper for discussion in the relevant Committees, with the aim of launching the development of the Strategy in early 2018, with progress reports in 2018 and 2019 and delivery of the Strategy in 2020.

53. The OECD is uniquely placed to undertake this initiative. For more than two decades, the Organisation has been at the forefront of international SME policy dialogue and efforts to provide an evidence base for more effective SME policies in both OECD and non-OECD Members. It can leverage effectively its unique expertise in developing, collecting and understanding business statistics across Members and non-Members, and build on the strong foundation of policy analysis developed across OECD Committees, in areas such as SME finance, innovation, taxation, regulation, digitalisation, employment, skills, trade, internationalisation and GVCs, environment, and others, and provide an effective impetus for reform. It can also make use of its extensive networks, including with stakeholders from the private sector and financial institutions, and its recent experience in developing cross-cutting policy strategies in other areas. This breadth of expertise and depth of analysis offer a unique opportunity to address the complexities of the SME policy space in different economic and social contexts. By supporting the development and implementation of effective policies for SMEs, the OECD can help to level the playing field and enable SMEs to increase their contribution to sustainable and inclusive growth.

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