

**DEVELOPMENT CO-OPERATION DIRECTORATE
DEVELOPMENT ASSISTANCE COMMITTEE**

DAC Network on Poverty Reduction

PROMOTING SMEs FOR DEVELOPMENT

**HELPING SMEs INTEGRATE INTO THE GLOBAL ECONOMY: THE ROLE OF GOVERNMENT,
DONORS, AND THE PRIVATE SECTOR**

(Note by the Secretariat)

OECD - Paris, 13-14 November 2003

The present document provides the table of contents, the executive summary, and the preliminary key recommendations for Theme 4 of the 2nd OECD Ministerial Conference on Promoting Entrepreneurship and Innovative SMEs in a Global Economy, to be held in Istanbul, Turkey, 3-5 June 2004.

This document will be circulated at the POVNET meeting on 13-14 November, 2003 and at the 21st session of the Working Party on SMEs and Entrepreneurship on December 1-3, 2003. In its future versions, it will include comments raised at these meetings. Furthermore, it will include the results of the Workshop on Trade Capacity Building and Private Sector Development in Asia (Cambodia, 2-3 December 2003).

Promoting SMEs for Development is one of the main four themes of the Bologna Process and of the 2nd OECD Ministerial Conference on Promoting Entrepreneurship and Innovative SMEs in a Global Economy. This report is being prepared by the OECD Development Co-operation Directorate in collaboration with the Directorate for Financial, Fiscal and Enterprise Affairs, the Development Center, the Directorate for Science, Technology and Industry, and UNIDO.

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JT00153695

THE BOLOGNA PROCESS

Theme 4: Promoting SMEs for Development

Helping SMEs integrate into the Global Economy: The role of government, donors, and the private sector.

In-Progress Draft Background Report

For review by the POVNET at its November 13-14, 2003 meeting and by the Working Party on SMEs and Entrepreneurship (WPSME) at its December 1-3, 2003 meeting.

Note by Secretariat

The present document provides the table of contents, the executive summary and the preliminary key recommendations for Theme 4 of the 2nd OECD Ministerial Conference on SMEs, to be held in Istanbul, Turkey, 4-5 June 2004.

This document will be circulated at the POVNET meeting on 13-14 November, 2003 and at the 21st session of the WPSMEs on December 1-3, 2003. It will include comments raised at these meetings.

The document and recommendations will be revised and finalized following the Workshop on *Trade Capacity Building and Private Sector Development in Asia* to be held in Phnom Penh, Cambodia, December 2-3, 2003 (a key contribution to theme 4 and the Bologna Process). It will also include results from the *Global Forum on International Investment*, held in South Africa in November 2003, the *International Conference on Trade and Investment: Maximising the Benefits of Globalisation for Africa* held in Dakar, Senegal, in April 2003, and *Trade Capacity Building: Experiences in an African Context*, held in Mombasa, Kenya in August 2002.

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Executive Summary and Key Recommendations

Executive Summary

Promoting SMEs for Development is one of the main four themes of the Bologna Process and of the 2nd OECD Ministerial Conference on *Promoting Entrepreneurship and Innovative SMEs in a Global Economy*. This report on *Promoting SMEs for Development* is being prepared by the OECD Development Co-operation Directorate in collaboration with the Directorate for Financial, Fiscal and Enterprise Affairs, the Development Center, the Directorate for Science, Technology and Industry, and UNIDO.

The purpose of this report is to draw policy recommendations and an action plan to be presented at the 3-5 June 2004 Istanbul Ministerial for endorsement by Ministers and to be included in the Istanbul Ministerial Declaration. The policy recommendations (outlined below) and action plan will be targeted to local governments, business sector (local SMEs and foreign investors), OECD member-countries and the OECD, and bilateral and multilateral donors.

The report will rely on two documents prepared by external consultants, case studies on clusters in developing regions prepared by UNIDO, and current work of the different OECD participating directorates. It will also draw significantly from the December 2003 Cambodia *Workshop on Trade Capacity Building and Private Sector Development in Asia*-- a key contribution to the Bologna Process and to this theme. It will also draw lessons from the *Global Forum on International Investment* (South Africa, November 2003), the *International Conference on Trade and Investment: Maximising the Benefits of Globalisation for Africa* (Senegal, April 2003) and the Regional Workshop on *Trade Capacity Building: Experiences in an African Context* (Mombasa, August 2002). Finally, it will also benefit from comments from experts of the POVNET and Working Party on SMEs and Entrepreneurship.

The report focuses on Small and Medium Enterprises (SMEs) in developing and transition economies. Small and Medium Enterprises (SMEs), as an integral part of the larger private sector, are driver of economic growth and development by contributing to employment, income, and poverty reduction in local economies.

The report is divided into two main parts: (I) Analysis and (II) Policy recommendations/Action Plan. The analytical part includes three sections: (1) Creating an enabling environment for SMEs development; (2) Enhancing SMEs capacity to integrate into global economy; (3) Enhancing SMEs contribution to poverty reduction. Each section highlights the different circumstances and policy implications for developing and transition economies.

The analytical part focuses on the key elements for building the enabling environment for private sector and SMEs development -- such as sound macroeconomic policies, legal and regulatory environment, and institutional framework. It also discusses the importance of finance, infrastructure, human capacity and labor for building a competitive investment climate. Furthermore, it reviews the general key requirements, policies, tools and instruments for enhancing SMEs competitiveness and capacity to trade and to establish links with foreign investors -- such as trade and investment support services, clusters and value chains. A case study by UNIDO will provide examples of clusters in developing countries. The report also highlights requirements and policies specific to enhancing trade capacity (e.g SMEs ability to meet trade rules and regulations such as certification and standards) and those specific to investment (e.g., building linkages between foreign investors and local SMEs). The report also reviews the policies and instruments to enhance the private sector/SME contribution to poverty reduction-- such as policies that encourage participation of the poorest segments of society (for example in rural areas and policies targeted at gender participation).

The key policy recommendations and an action plan section will be targeted to the different stakeholders – government, private sector, business (local SMEs and international), OECD countries and OECD. The key recommendations below are preliminary and will be revised following comments by the POVNET meeting (Nov. 13-14, 2003) and the Workshop on *Trade Capacity Building and Private Sector Development in Asia* (Dec 1-3, Cambodia).

Preliminary Key Recommendations for the Istanbul Ministerial

1. Embed national private sector/SME strategies in the broader national development and poverty reduction strategy. Private sector/SMEs strategies in many developing countries must be integrated into the national development strategy and poverty reduction strategy (PRSs) of a country to ensure their successful and coherent implementation (e.g., that approaches and policies towards private sector, SMEs, trade, investment, education, financial, and fiscal policies are coherent and self-reinforcing and perceived as relevant for the poor segments of society).

2. Increase efforts to create an enabling business environment. The business environment should be conducive to facilitating domestic entrepreneurship and SME development and to promoting trade and attracting FDI. This should include removing obstacles to doing business, administrative simplification, improvements in administrative structures and processes, transparency with respect to information on all regulatory measures affecting businesses. The latter should include minimizing restrictions on ownership, reviewing administrative requirements for business, as well as taxation, investment incentives, access to finance, property protection and competition policy, using easily available channels, such as Websites and official gazettes. Such measures would help entrepreneurs “move away” from the informal sector or formalize informal activities.

3. Strengthen the dialogue and partnership between and among the public sector, the private sector, civil society, and academia. Enhanced dialogue and partnership between the various stakeholders is essential to identify obstacles and to tailor policies to private sector/SMEs needs in order for SMEs to become more competitive and integrate into the global economy. Furthermore, this dialogue creates an atmosphere of mutual trust that can facilitate the implementation of sustainable reforms. Dialogue and partnership is also needed between SMEs and MNEs -- for SMEs to be better local partners and to increase the development and capacity building benefits of FDI. Donors and multilateral organizations (OECD and others) can play an important role in facilitating such dialogue and partnership.

4. Facilitate access to finance is crucial for SME development. While the availability of finance is an important issue, access to the money available and the attached conditions/requirements may be a major impediment. Improving access to finance requires *inter alia* building the institutional and human capacity of SMES and lending institutions. Such capacity building will enable 1) lending institutions to better assess SMEs ability to borrow and grow, and 2) SMEs to improve the preparation and presentation of their proposals.

5. Strengthen infrastructure services delivery to facilitate market access and reduce the cost of doing business. More investment is needed in key areas such as energy, transportation and communications. Attention should especially be given to sustainably managed infrastructure that will help better connect up SME products to markets and the different ways to provide infrastructure (e.g. local/foreign participants or PPP involvement) that most involve and benefit the SME sector.

6. Reinforce support structures for private sector/SME development, particularly institutional support. These support structures can be public or private, but over time the trend should be towards greater private provision so that the support structures meet the rapidly changing needs of the private sector (i.e. standards and certification requirements abroad, market information, packaging, product upgrading etc.). Donors and other appropriate intermediaries can develop capacity building programs to facilitate the development of backward linkages (i.e., linkages from MNEs to SMEs) and other positive spillover effects between foreign investors and local suppliers. Such programs will need to pay attention to quality control, training and management development programs.

7. Maximize local SMEs involvement. FDI enterprises should actively investigate the scope for maximizing local sourcing in host economies and fostering the sustainable involvement of local SMEs in various forms of inter-firm co-operation, working with national and regional authorities, donor organizations and other intermediaries, as appropriate.

8. Strengthen the gender dimension of SME development by bringing in gender as a central element of private sector/SME strategies (mainstreaming) and by developing specific/targeted initiatives to address critical issues e.g. collateral, property rights.

9. Enhance aid effectiveness by 1) using official development assistance (ODA) to help promote private investment and trade (e.g., through capacity building, public-private partnerships, innovative instruments, etc) and 2) by enhancing donor co-ordination and pooling of technical and financial resources. Donors could play an important role by helping promote capacity building programs involving SMEs in transition and developing countries. Donors should also seek to identify and actively disseminate good practice examples that include co-operation between inward investors and domestic SMEs, with potential capacity building benefits.