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Aid for Trade

BACKGROUND NOTE ON AID FOR TRADE AND SME COMPETITIVENESS: CONNECTING DEVELOPING COUNTRY SMES TO GLOBAL VALUE CHAINS

JOINT COMMUNICATION FROM THE INTERNATIONAL TRADE CENTRE AND THE WTO SECRETARIAT[1]

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1 EXECUTIVE SUMMARY

1.1. This joint ITC-WTO study discusses the constraints that small- and medium-sized enterprises (SMEs) face in engaging in international trade, notably those highlighted by SMEs in Least-Developed Countries (LDCs), and reviews how Aid for Trade is addressing these obstacles. It builds on the analysis conducted for the 4th Global Review of Aid for Trade: "Connecting to Value Chains", and is submitted as a contribution to the Aid-for-Trade Work Programme for 2014-15 in preparation of the 5th Global Review of Aid for Trade.

1.2. Some 95% of enterprises across the world are SMEs, accounting for 60-70% of private sector employment. In developing economies, SMEs are strongly linked to employment, poverty reduction, women's economic empowerment, and income distribution.

1.3. SMEs are integral to private sector development, particularly in LDCs, and an essential component of inclusive, sustainable development. Fragmentation of trade into value chains has increased the trade exposure of SMEs – as importers and exporters of goods and services themselves, and as suppliers of other exporters and importers – opening new opportunities and offering fresh challenges.

1.4. SMEs with greater "internationalization" tend to report higher turnover and growth; these SMEs are more productive than their counterparts. But in low-income countries, seven out of every 10 new export relationships fail within two years. Only a minority of SMEs manage to sustain adequate growth patterns for a significant period of time. The SME sector is characterized by a high level of "churn": of exit and re-entry.

1.5. And yet, SMEs are disproportionately important to low-income economies, employment, and economic growth. The challenge to policymakers is two-fold. First, how does one encourage a higher fraction of SMEs to survive by avoiding that they are unduly and disproportionally affected by market failures and fixed costs, and second, how might one support these high growth SMEs and ensure that these firms are able to successfully transition from one state of development to another (e.g. from small to medium to large, or national to international)?

1.6. SMEs face a number of inherent challenges due to their size. These include: access to finance, notably trade finance; lack of institutional support; insufficient skilled personnel; disproportionately high trade costs; lack of access to technology; and an unfavourable business environment. Challenges are amplified in a trade context where SMEs must navigate a set of further constraints – constraints that, in part, explain the low survival rates observed for SME exporters.

1.7. From analysis of the obstacles faced by SMEs in LDCs, drawn from a sample of 23 Diagnostic Trade Integration Studies (DTISs) undertaken by the Enhanced Integrated Framework (EIF) for LDCs, three key bottlenecks emerge:

- quality of the business environment;
- access to finance; and
- lack of institutional support to overcome trade related challenges.

1.8. Improving the business environment emerges as a priority action area for all LDCs, alongside strong institutional structures that actively promote investment and address market failures, such as lack of information on potential trading partners. Other bottlenecks vary by region. For example, in Oceania, lack of institutional support ranked highly, while in Central Africa, lack of a skilled workforce was a more pressing concern.

1.9. The global economic crisis has brought new energy to initiatives to bridge the financing gap faced by SMEs and to help SMEs to realize their economic growth and development potential. The G20 has taken up this challenge in the context of its work on financial inclusion. This focus has renewed interest in the on-going work of a broad range of development finance institutions (DFIs) and their related investment vehicles. DFIs have for many years been working on SME financing, often with innovative solutions and approaches that mix training and advisory services with commercial financing products. South-South partners are also adding their own stamp to this area through new institutions, approaches and products – and, in so doing, connecting SMEs to a dynamic segment of global trade.

1.10. This joint background note aims to discuss how Aid for Trade is seeking to address the challenge of SME competitiveness. An important issue discussed in this context is that of "additionality". DFIs, and Aid for Trade, cannot alone bridge the SME funding gap or address all of the trade-related constraints of SME training. There must be close collaboration with partner country governments, and with the private sector both in implementation and in finding long-term solutions to market failures.

1.11. This study highlights some of the actions being taken by companies to integrate SMEs into their supply chains, and how DFIs are seeking to utilize new techniques and insights (such as base of the pyramid approaches) to catalyse and leverage the private sector to address market failures.

1.12. The study concludes with an analysis of evaluations of recent private sector programmes with significant SME components. A clear message that emerges is that while the trade elements of SME programmes are growing, more work is still needed to arrive at a coherent trade perspective, not just in project design, but also in monitoring, evaluation and results. The study concludes with two open questions for the trade and development community where further work is suggested:

- How to scale up trade support to SMEs without institutions and instruments becoming too diffuse, losing both focus and impact?; and
- How to mainstream trade, at a conceptual and implementation level, into SME project design, implementation and reporting?

2 INTRODUCTION

2.1. The study builds on the results of the 4th Global Review of Aid for Trade: Connecting to Value Chains, and is being submitted as a contribution to the Aid-for-Trade Work Programme for 2014-2015.

2.2. It comes at a time when G20 discussions have increased their focus on small- and medium-sized enterprises (SMEs), when SMEs are being discussed in the context of the United Nations' (UN) post-2015 Development Agenda and when the UN is reviewing the implementation of the General Assembly Resolution A/67/202 "Entrepreneurship for Development".[2] While the G20 discussions and the UN resolution deal with SME entrepreneurship in general, the present study provides a specific focus on SMEs in an international trade context. The report has therefore been prepared jointly by the ITC and WTO, in recognition of the fact that much of ITC's activities over the past five decades focused on the international competitiveness of SMEs (ITC, 2014).

2.3. In most countries, SMEs represent the overwhelming majority of enterprises; they are an important source of private sector employment creation and contribute significantly to Gross Domestic Product (GDP). SMEs are often among the most dynamic players in any economy, notably because small size facilitates flexibility and creativity. SMEs also have an important social policy dimension, notably in the areas of poverty alleviation and the empowering of otherwise disadvantaged groups, including women.

2.4. SMEs face inherent challenges linked to their size. Failure rates among SMEs are high, both in developed and developing countries. At the same time, SMEs are operating in an ever more globalized and complex trading system in which value chains are the predominant form of industrial organization. SMEs are internationalizing, both by design and by default. Internationalization may take different forms including: the import of inputs, the supply of inputs to an exporting (often multinational) firm, or the direct involvement in exports.

[2] See the Communiqué to the B20 leaders and G20 Finance Deputies and Sherpas at the occasion of the Conference "The G20 Agenda for Growth: Opportunities for SMEs" on 20 June 2014.

2.5. The study starts with a description of the typical characteristics of SMEs, their role for development, and their role in international trade. It then continues with an overview of the challenges SMEs face in general and when wanting to get involved in international trade. These challenges are further examined in the context of Least-Developed Countries (LDCs) through an overview of SME-specific challenges that have been identified in recent Diagnostic Trade Integration Studies (DTISs) conducted by the Enhanced Integrated Framework (EIF).

2.6. The study then examines how Aid for Trade is seeking to address relevant constraints and discusses how Aid-for-Trade initiatives fit within the wider context of development finance. Results achieved so far and the challenges inherent to SME-specific Aid-for-Trade programming are also examined.

3 SMES, TRADE AND DEVELOPMENT

3.1. The importance of small- and medium-sized enterprises (SMEs) to the performance of national economies is a subject of increasing interest among policymakers in national governments and international institutions, in both developed and developing countries. This is unsurprising given that, in most countries SMEs constitute the overwhelming majority of firms, are a major source of employment, and contribute significantly to Gross Domestic Product (GDP).

3.2. Studies indicate that "formal-sector" SMEs contribute up to 45% of employment and up to 33% of GDP in developing economies; these numbers are significantly higher if the contributions from the "informal sector" are taken into account (International Finance Corporation (IFC), 2010). As an example, in Morocco 93% of industrial firms are SMEs, accounting for 38% of production, 33% of investment and 30% of exports (Edinburgh Group, 2013). In Ghana, SMEs represent about 92% of Ghanaian businesses and contribute about 70% of Ghana's GDP (Abor and Quartey, 2010). Further studies find that the contribution to employment by SMEs is 51% in low-income countries, 44% in lower-middle income countries and 38% in upper-middle income countries (Ayyagari et al., 2011). The picture is similar in Least-Developed Countries (LDCs). For instance, in Lao PDR, SMEs account for 98% of firms and generate more than 81% of employment. Add to this the positive correlation observed between the relative size of the SME sector and economic growth (see Beck et al., 2005) and the importance of SMEs becomes clear.

3.3. The SME sector is characterized by a high level of "churn". In other words, many SMEs will fail within a few years and be replaced by new ones. The World Bank, looking at data from OECD countries and Latin America, finds that after the seventh year since starting up, 60% of firms have exited and 35% remain micro or stagnating enterprises (Tewari et al., 2013). Only around 5% of the initial cohort are characterized by strong and sustained growth (Tewari et al., 2013). It is this group which contributes disproportionately to the economy and which is a driver of innovation, employment, and growth for the economy as a whole. Moreover, it is this group which is best positioned to join national and international value chains through relationships with larger companies. Therefore, the challenge presented to policymakers is two-fold. First, how does one encourage a higher fraction of SMEs to survive by avoiding that they are unduly and disproportionally affected by market failures and fixed costs, and second, how might one support these high growth SMEs and ensure that these firms are able to successfully transition from one state of development to another (e.g. from small to medium, or national to international)?

3.4. To overcome these challenges, it is essential for policymakers to understand the many factors that encourage and discourage SME creation and development. This section provides an overview of some of the unique characteristics that SMEs possess and seeks to explain why the health of this segment is a pre-requisite for any vibrant and productive economy.

3.1 What is an SME?

3.5. The term "SME" encompasses a broad spectrum of definitions which vary between country and region. Even within countries, definitions may vary or indeed be non-existent. International organizations and financial institutions use their own guidelines for defining an

SME. However, almost all definitions are based on some combination of the number of employees, turnover and assets (see Table 3.1).

Table 3.1 Criterion used by listed institutions for defining "SME"

Institutions	Maximum No. of Employees	Maximum Revenue or turnover (US$)	Maximum Assets (US$)
World Bank	300	15,000,000	15,000,000
Inter-American Development Bank	100	3,000,000	None
African Development Bank	50	None	None
Asian Development Bank	50	None	None
UNDP	200	None	None

Source: ITC and WTO research

3.6. As is clear from Table 3.1, not only does the definition for an SME vary considerably, but the criteria are often broad and therefore encompass a wide variety of firms with very different properties. The traditional view of the differences within the SME category in developing countries is as follows. Micro firms (i.e. businesses which employ 10 or less individuals) often exclusively serve the local economy, use basic technologies in the production of their goods and services, and have little in the way of fixed assets. Small businesses may employ up to 50 individuals, and also serve the local economy. However, the additional scale increases the likelihood that they are also active at the national level. Turnover and assets are expected to be of the order of US$100,000. Medium-sized companies may employ up to 300 people, and are likely to be focused on serving the national economy. Turnover and assets are expected to be in the region of millions of dollars. These companies will likely use competitive production methods, and be equipped to join existing global value chains[3] (GVCs) either by direct exports or by serving large/foreign firms in the domestic market. Moreover, integration into GVCs need not be production based; services based GVCs have been shown to enhance trade and economic growth, as the recent experience of Costa Rica demonstrates (Marín-Odio, 2014).

3.7. Although the above view is in line with recent economic modelling of trade (e.g. Melitz, 2003), it is important to note that many companies will not fit into this characterization of micro-, small- and medium-sized enterprises. This is partly due to the "levelling effect" of new technologies, and the unique strengths and weaknesses an economy may possess. For instance, online platforms like e-Bay have made it possible for firms administered by less than 10 people (ostensibly a micro-SME) to run a global enterprise with an international client base. It is also the case that the existence of GVCs makes it easier for relatively small firms to internationalize, although this does not necessarily imply exporting directly.

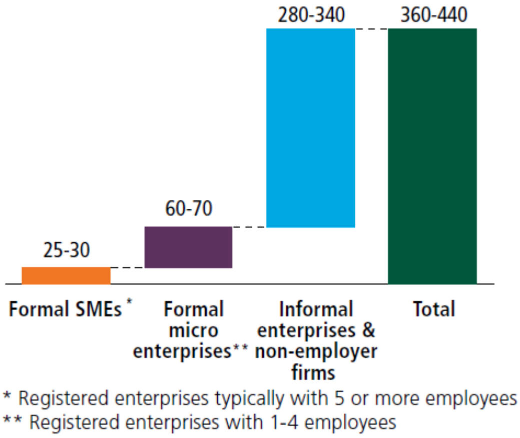
3.8. Adding to the complexity is the distinction between "formal" and "informal" SMEs. Formal SMEs are usually defined by whether they have been officially registered by tax authorities. While being registered has the "disadvantage" of being subject to taxation, it improves access to finance and access to other services. Nevertheless, the overwhelming majority of firms in the developing world are in fact informal (see Figure 3.1).

3.9. Figure 3.2 shows the prevalence of formal micro-, small- and medium-sized businesses by region. What is striking is the level of variation from region to region. For example, in South Asia 82-100% of formal SMEs are estimated to be very small (i.e. micro), while this is only true for 22-27% of SMEs in sub-Saharan Africa.

3.10. The differences between SMEs serve as an added complication to the design of SME policies. Nevertheless, it is still useful to categorize companies by their size as it can give insights into the structure of an economy. It is the variety exhibited by SMEs which makes the sector both vibrant and productive.

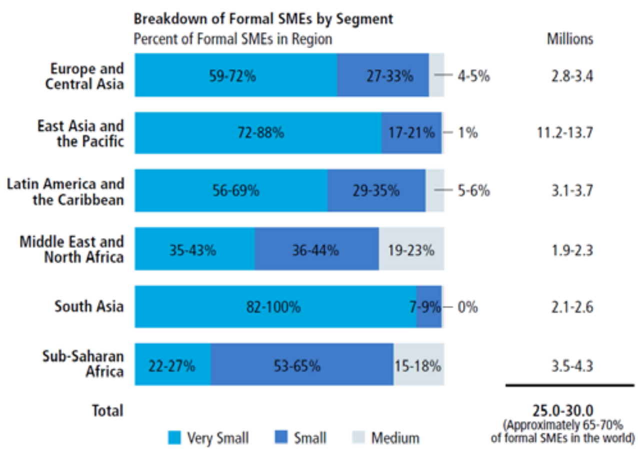
[3] In this study, GVCs refers to global and regional value chains.

Figure 3.1 Number of formal and informal SMEs (in millions) in developing countries.



Source: IFC (2013)

Figure 3.2 Breakdown of formal SMEs by region.



Source: IFC (2013)

3.2 SME's contribution to development

3.11. SMEs, as a group, account for a significant share of economic activity and employment. However, there is considerable variation by geographical region, and indeed by SME size. Table 3.2 provides statistical information of the contribution SMEs make to employment and highlights differences between regions. For instance, in the Middle East and North Africa only 32% of total employment is due to SMEs with 100 or less employees, compared to 55% for sub-Saharan Africa. In the SME500 category, it can be inferred that the North American economy is dominated by large firms to a much greater extent than any other region, as the employment contribution by SME500s is relatively low. Understanding the fraction of employment due to SMEs can yield valuable information on the employment structure of any given economy.

Table 3.2 SME contribution to employment shares by region (median values)

Region	SME100	SME150	SME200	SME250	SME300	SME500
Sub-Saharan Africa	54.8	63.8	68.2	76.9	80.6	85.1
East Asia and Pacific	56.8	61.6	67.4	65.7	71.3	71.3
Europe and Central Asia	44.7	53.1	59.5	66.3	67.5	75.5
Latin America	53.7	56.7	64.4	67.8	71.0	78.3
Middle East and North Africa	32.2	48.1	36.6	57.3	58.6	62.3
North America	41.7	39.3	42.0	-	59.3	56.6
South Asia	56.6	65.3	73.6	78.0	80.3	88.5

Note: Estimates are subject to an error margin of several percentage points.
Source: Ayyagari et al., (2011)

3.12. While employment figures are certainly instructive, they do not tell us the "quality" of employment or the productivity of the work done. The literature suggests that SMEs tend to be less productive than large companies, partly because SMEs tend to be engaged in more labour-intensive sectors and do not benefit from economies of scale (Wymenga et al., 2011). This is especially true in developing countries, where advanced manufacturing techniques may not be used due to insufficient financing, a poor regulatory environment, or other market failures. Lower productivity is born out in the statistics presented in Table 3.3, where the share of employment and the contribution to GDP are shown for a select number of countries. In most cases, the share of employment is higher than the share of GDP, implying the average productivity of an employee working for an SME is lower than that found for large firms. An exception is the United States where employees working for SMEs appear to be as productive as those working for large firms.

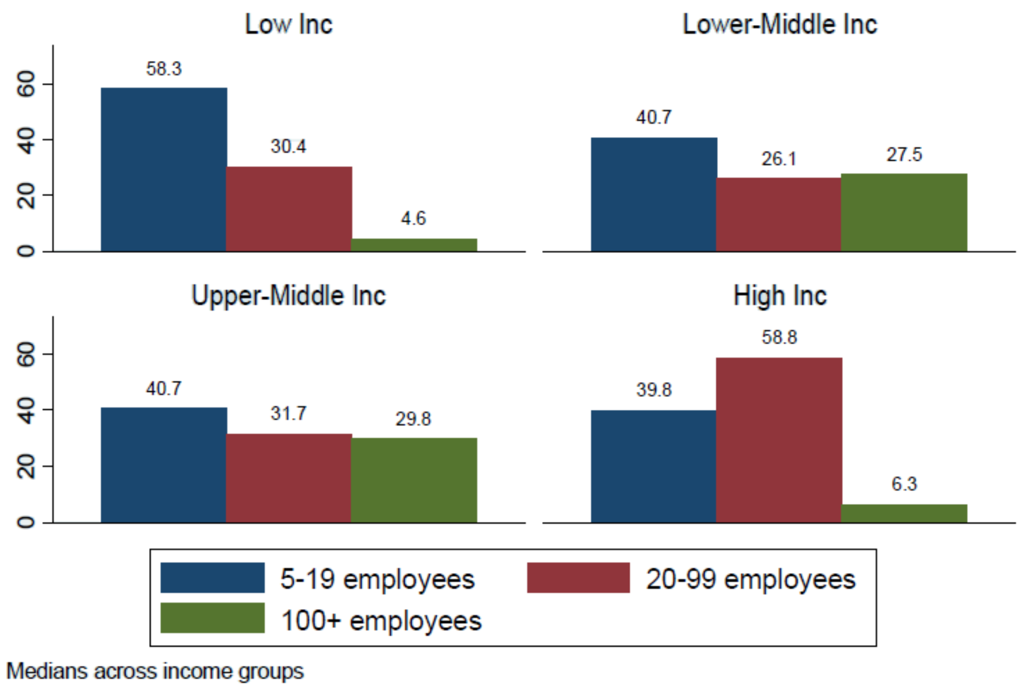
Table 3.3 The importance of SMEs for trade and economic activity

Country	Share of firms (%)	Share of employment (%)	GDP Value Added (%)	Share of SMEs Exporting (%)
Brazil	99.9	77	61	11 (S)
Canada	99.7	60	-	-
Chile	98.9	80	25	15
China	99.0	73	60	40-60 (M)
Columbia	96.4	84	-	20
EU	99.8	70	61	-
India	95.0	80	40	32 (M)
Japan	99.0	72	52	14 (M)
Mexico	99.8	74	52	-
New Zealand	99.8	75	-	-
Sweden	96.3	60	57	24 (M)
Taiwan	96.3	80	-	56 (M)
US	99.9	50	50	31 (M)

Note: SME share of firms, employment and GDP. Fraction of SMEs engaged in export activities. (M) and (S) denote data for manufacturing and services data only.
Source: OECD (2014)

3.13. SMEs are drivers of job creation. Over the last 30 years, the SME share of employment in OECD countries has been rising. This implies that SMEs have been creating jobs at a faster pace than large firms. Indeed, the European Commission estimates that 85% of new EU jobs created between 2002 and 2010 were created by SMEs. The data covering developing countries tells much the same story. In a survey of 104 developing countries, Ayyagari et al. (2011) find that small firms have the largest shares of job creation, a trend which is strongest for low-income countries (Figure 3.3). Even in countries with net job losses, small firms are found to be creating jobs.

Figure 3.3 Job creation shares by size (only countries with net job creation are included)

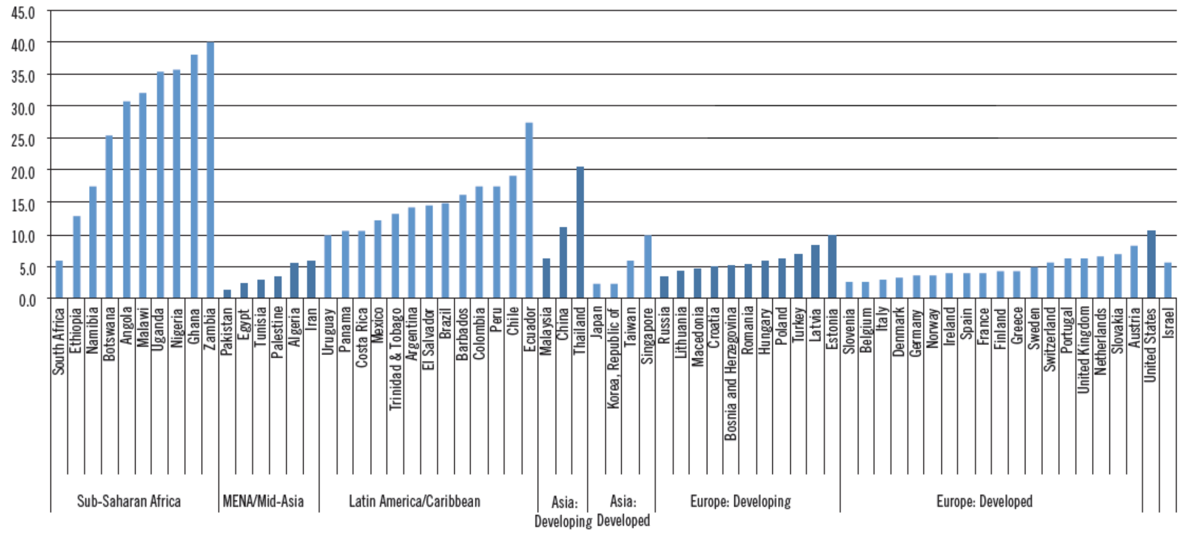


Source: Ayyagari et al., 2011

3.14. SMEs play a particularly powerful role in employing and empowering women in LDCs and developing countries. According to the World Development Report 2012, women have made enormous strides in nurturing SMEs, spurring local development and generating employment opportunities. In many developing countries women entrepreneurs are helping their respective governments to establish and develop strong SMEs that contribute to economic growth and poverty reduction. SME development and promotion helps to encourage autonomy and at the same time strengthens pluralistic and social emancipation processes (Singh et al. 2007). Women entrepreneurs seem to be motivated to start a business to be their own boss, to have job satisfaction, to have economic independence, or to have an opportunity to be engaged in more creative work (Kandasaami and Tibbits, 1993), although financial pressures are often an important factor.

3.15. The Global Entrepreneurship Monitor (GEM) measures entrepreneurship via Total Entrepreneurial Activity (TEA). TEA summarizes various entrepreneurial indicators such as the fraction of individuals who have started a business and attitudes towards entrepreneurial activity. Figure 3.4 shows the TEA score for women by region. It is clear that women score highly in sub-Saharan African countries; this is partly due to positive attitudes towards women entrepreneurship, low fear of business failure, and connections with other entrepreneurs. However, the high number of women seeking self-employment may also reflect a lack of employment options for women, and a need for income possibilities.

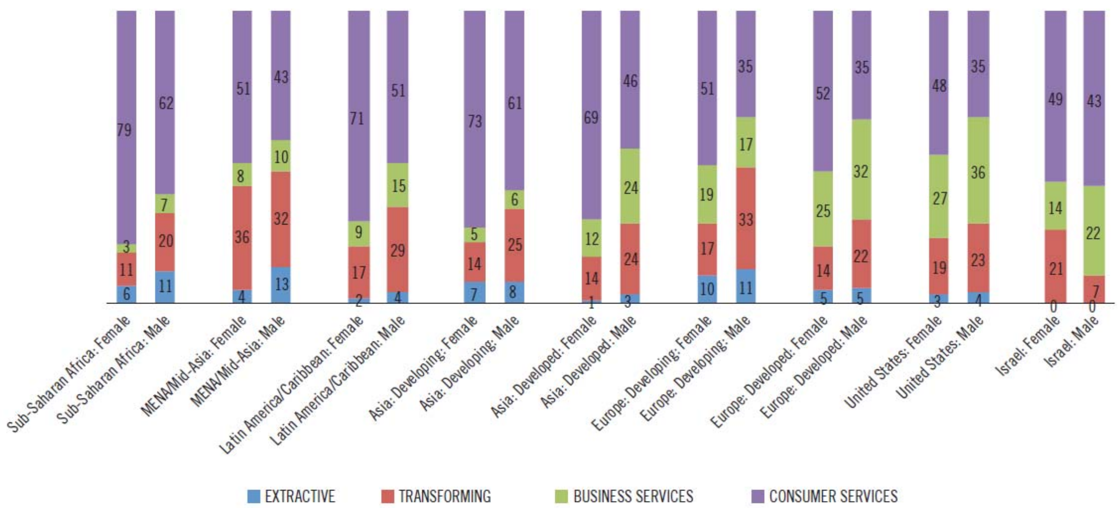
Figure 3.4 Total Entrepreneurial Activity (TEA) for female adults in 67 economies



Source: GEM, 2012

3.16. It is also instructive to see the kinds of SMEs women tend to create. Figure 3.5 divides business into four categories: extractive, transforming, business services, and consumer services. The information shows that women tend to establish a higher proportion of service-oriented businesses than men, although significant variation exists across regions. Policies aimed at closing the gender gap by encouraging women participation in SME creation can leverage this information to design targeted interventions.

Figure 3.5 TEA by industry sector for females and males by region.



Source: GEM, 2012

3.3 The internationalization of SMEs

3.17. The internationalization of different kinds of firms has been a topic of great interest since the 1970s when researchers first tried to define the process. The most traditional way of describing the internationalization process involves four key stages: (i) direct exports to a foreign country; (ii) exporting with the help of independent foreign agents; (iii) the use of subsidiaries to carry out this function; and (iv) the establishment of production facilities in the said export market.[4] One of the points often stressed is that the lack of knowledge of external markets and operations is the major obstacle to internationalization. It is generally accepted that these shortcomings may, in part, be overcome through the strengthening of experiences accumulated by operations executed abroad. However, there are gaps and problems associated with this view of internationalization. Among these are: being too deterministic; not including acquisitions; not including the role of imports; not emphasising the impact of social and business networks; and not accounting for so called "born-globals" (i.e. firms which operate internationally from or near their founding; Knight and Cavusgil, 2004).

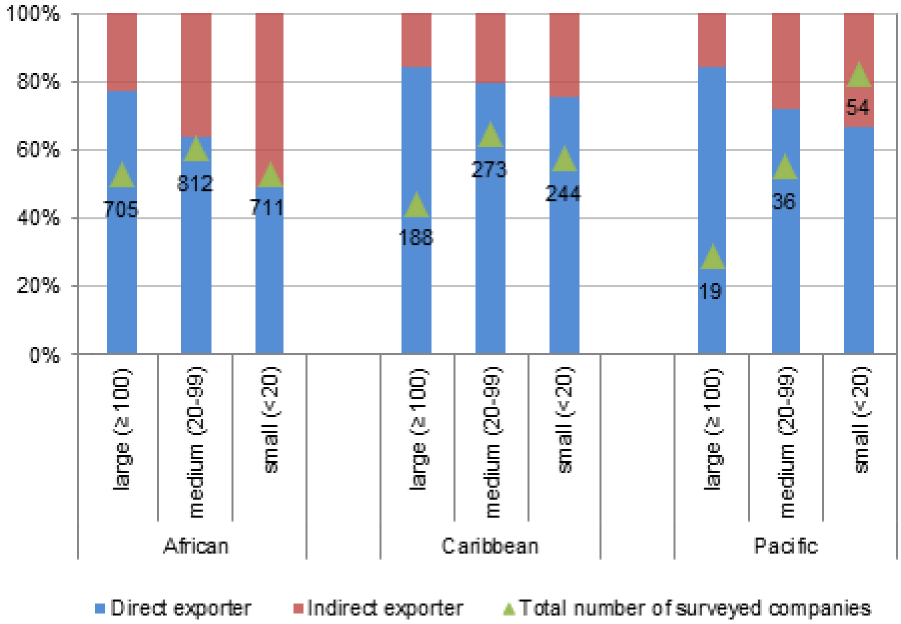
3.18. A second view of internationalization, seen more as an evolution of the first view rather than a radical departure from it, stresses the importance of "networks". Here, "network" is defined as the set of relationships a business has with its suppliers and customers. In this instance, there are two types of networks and two types of firms, both of which are distinguished by their level of internationalization. For example, a firm may exist within a highly internationalized network, but may itself serve a purely national production role. Alternatively, a firm may exist within a predominantly national network but also engage in substantial foreign trade. This highlights that the challenges and opportunities presented to firms in these various categories are different, and that distinct support programmes are required to help further "internationalization".

3.19. Economists also point out that importing as well as exporting, need to be taken into account when referring to internationalization, as a firm’s experience of importing goods may help it to enter export operations (Welch and Luostarinen, 1988). This fits well with our current understanding of the importance for SMEs to integrate into GVCs.

3.20. Data shows that SMEs are major contributors to total exports. For instance, in India SMEs accounted for 38-40% of exports in the 10-year period from 1998-2008 (Tambunan, 2009). In China SMEs contributed 60% to the country’s exports; in Vietnam 20%; and in Thailand 46% (Tambunan 2009). However, it should be noted that in developed countries, exports tend to be dominated by large firms. The above statistics do not include the significant contribution made by indirect exporters (i.e. firms which provide goods or services to direct exporters). Figure 3.6 provides firm-level statistics on the African, Caribbean and Pacific (ACP) group of countries’ exporters. We find that indirect exporters usually make up around 20% of total SME exporters, but that in some instances this increases to 50%. The initial step of SME internationalization therefore does not necessarily have to involve direct exporting.

[4] The stages described here are the essential features of the Uppsala model (U-model; Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977).

Figure 3.6 Company size by export status

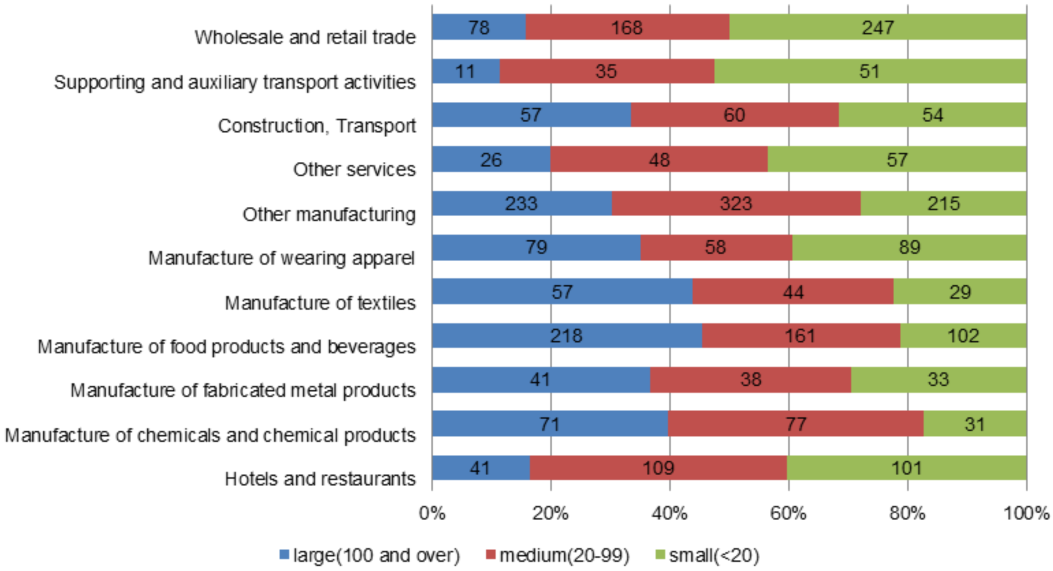


Source: ITC calculations based on the World Bank's Enterprise Surveys data collected between 2006 and 2013

3.21. Understanding in which sectors SME exporters are concentrated may provide insights into the types of activities in which SMEs engage. Data on the ACP group of countries' companies reveal that sectors such as wholesale and retail trade, auxiliary transport activities, hotels and restaurants, and other services, comprise a large proportion of small and medium enterprises, while the manufacture of textiles, food products and beverages, and chemical and chemical products, relies more on large companies (Figure 3.7). Thus, there appears to be a tendency for SMEs to gravitate towards the delivery of services.

3.22. SMEs with greater internationalization tend to report higher turnover and growth (BIS (2010)). Internationally-active SMEs also demonstrate higher employment growth; 7% growth for exporters, and 3% for non-exporters – with a larger difference between importers and non-importers (8% and 2%, respectively) (Edinburgh Group, 2013). In short, SMEs engaged in foreign trade tend to be more productive than non-trading firms.

Figure 3.7 Sector breakdown of small-, medium- and large-sized companies from the African, Caribbean and Pacific (ACP) group of countries



Source: ITC, 2014

3.23. Recent changes in the nature of global business – such as the increased role of GVCs and rise of e-commerce - have arguably made it easier for SMEs to internationalize. Yet, SMEs continue to find it more difficult to internationalize, i.e. expand beyond their domestic markets, than larger firms. There is a large body of qualitative case-study work identifying bottlenecks which lower economic activity. Among the issues identified are: access to finance and technology; lack of investment in foreign market research; lack of adequately trained personnel; and lack of managerial time to deal with internationalization. Research carried out by the OECD ranks some of these barriers (see Figure 3.8). These issues are discussed in more detail in the next section. A sustained effort by policymakers to address these issues will boost SME internationalization and, by extension, an economy's development prospects.

Figure 3.8 Barriers to internationalization ranked by SMEs using the 'top ten' ranking method

Rank-weighted factor	Description of barrier
1	Shortage of working capital to finance exports
2	Identifying foreign business opportunities
3	Limited information for locating/analysing markets
4	Inability to contact potential overseas customers
5	Obtaining reliable foreign representation
6	Lack of managerial time to deal with internationalisation
7	Inadequate quantity of and/or untrained personnel for internationalisation
8	Difficulty in matching competitors' prices
9	Lack of home government assistance/incentives
10	Excessive transportation costs

Source: OECD, 2009

4 BOTTLENECKS TO THE INTERNATIONALIZATION OF SMES

4.1. Small- and medium-sized enterprises (SMEs) face a number of challenges due to their size (see for instance Dinh et al., 2010; ILO, 2013). Some of these challenges are amplified when set in a global context, and, as a result, contribute to the low survival rates observed for SME exporters. The export failure rate has, for instance, been found to average 41% in a sample of 17 LDCs, with a high of 67% in The Gambia and a low of 29% in Bangladesh (ITC, 2014). In addition, most enterprises in Least-Developed Countries (LDCs) export for just one year, implying that SMEs tend to export as a response to opportunistic circumstances rather than because of long-standing relationships with customers (ITC, 2014). This, in combination with the difficulties SMEs face in building long standing relationships, is a problem, as survival rates for intermittent SME exporters are considerably lower than for continuous exporters (WB, 2009).

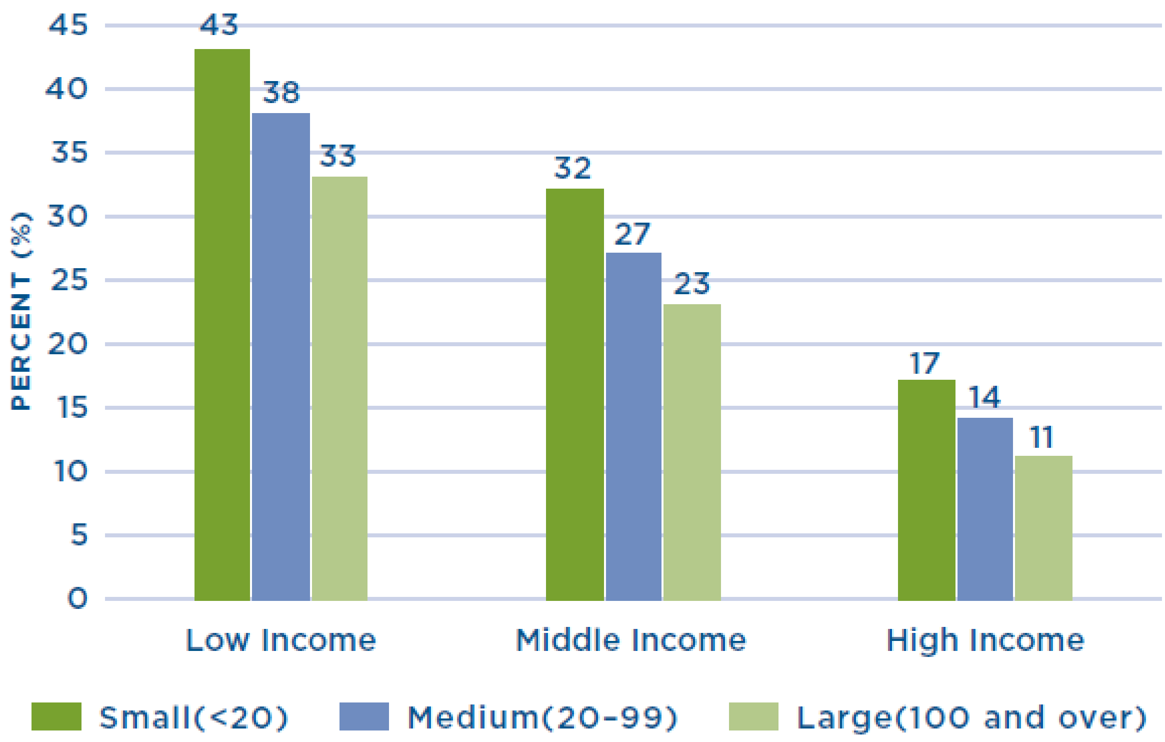
4.2. Firms learn by doing, and the knowledge gained from continuous exporting can be put to use to export the same product to new markets, or new products to established markets (ITC, 2014). It is important to note that SMEs in developing countries are as entrepreneurial as those in richer countries when it comes to exploring new markets, but as alluded to earlier, they are less successful in sustaining trading relationships. Furthermore, globalization may also bring challenges for SMEs mainly active in domestic markets as they become exposed to competition from foreign firms. This competition often leads to losses in market share.

4.3. The challenges SMEs face may be related to both internal factors (e.g. lack of trained personnel, and administrative processes) and external factors (e.g. access to finance, regulatory burden, and infrastructure). A better understanding of the challenges SMEs face when trying to internationalize will help policymakers, notably those active in the area of Aid for Trade, to design appropriate policies.

4.1 Access to finance

4.4. Across the globe, banks perceive SMEs as a large, diverse and complex segment with a broad risk spectrum (Beck and Demiurgic-Kunt, 2003). SMEs notably tend to find it hard to acquire the initial loan which enables the creation of a credit history. Access to finance is perceived as a major obstacle to growth and development for SMEs in low- and middle-income countries. In addition, when banks and other financial institutions start lending to SMEs, they usually provide smaller loans with short tenures as a way of mitigating risk until there is sufficient credit history to warrant larger volumes of lending (IFC, 2010).

Figure 4.1 Percentage of firms viewing access to finance as a major obstacle by firm size and country income group

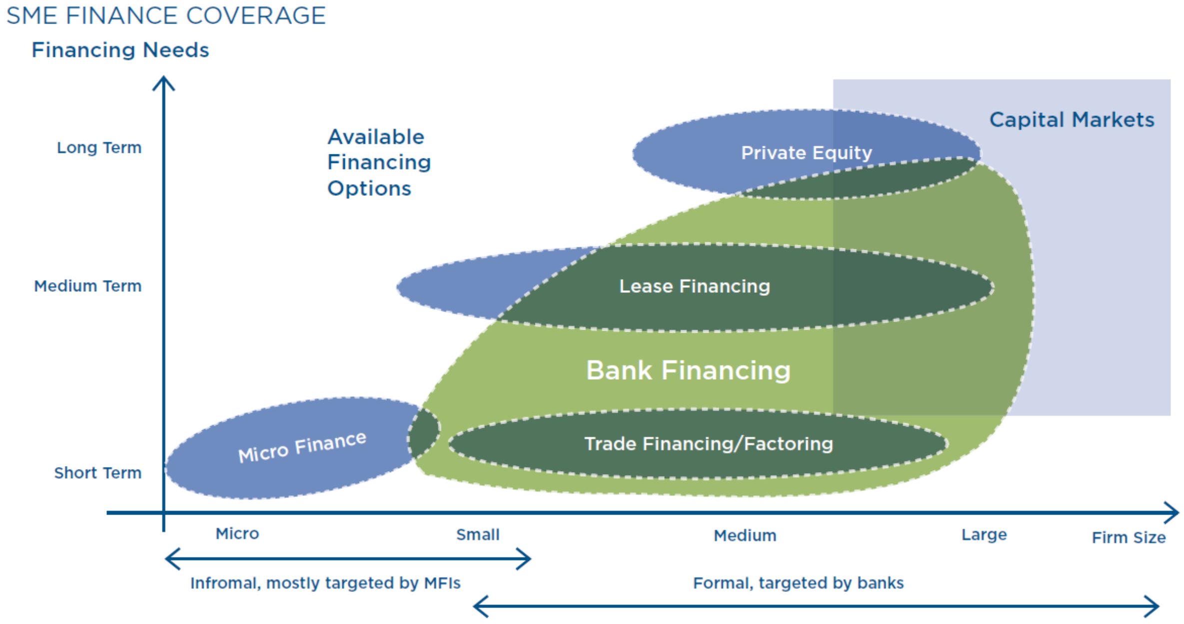


Source: IFC, 2010

4.5. Figure 4.1, which shows the percentage of firms by size and income group viewing access to finance as a major obstacle to growth, illustrates that this is a much greater problem for SMEs located in developing countries. For instance, the data reveals that in low-income countries, on average, 38% of businesses with 20 to 99 employees rate access to finance as a major constraint to current operations. On the contrary, in high-income countries, only 14% of businesses of the same size rate access to finance as a constraint. The WTO's World Trade Report 2012 (WTO, 2012) observes that top banks serving SMEs in non-OECD countries reach only 20% of formal micro enterprises and SMEs. In sub-Saharan Africa this number is even lower, at 5%.

4.6. It is clear that SMEs face a number of challenges when it comes to financing their business activities. One of the central problems is providing SMEs with the right level of financing given their size. Figure 4.2 illustrates how SME finance needs change depending on firm size, and the longevity of the loan they require. Ensuring that all forms of funding are in place, and that the transition from one type of financing to the next is streamlined, is crucial to the growth of the SME sector.

Figure 4.2 SME finance coverage by firm size and by type of financing



Source: IFC, 2010

4.7. A subset of access to finance, which affects exporters, is access to trade finance. Trade finance usually involves the seller, the buyer, and some intermediary (usually a bank) to agree to a contract which enables the flow of goods across borders. Because the involvement of a bank is usually required, it is often difficult for SMEs to leverage the existing trade finance infrastructure to lower risk. Notably, SME managers often lack basic understanding of relevant trade finance instruments or financial business planning. The result is that the participation of small firms in global chains is often diminished by the fact that these firms find it difficult to finance their production cycle, since after goods are delivered most buyers demand 30 to 90 days for payment.

4.8. Specific financial tools (for instance "factoring" and "reverse factoring") have been created to provide financing of working capital to small suppliers, and have gone some way to alleviating the problem (OECD, 2007).

Box 4.1: Accessing affordable trade finance - an on-going challenge for SMEs

Experts have reported on the increasing difficulties faced by low-income countries to access trade finance on affordable terms. Part of these difficulties existed prior to the financial crisis. "Structural" constraints range from the lack of know-how in local banks to mistrust, resulting in traders having to set aside large collateral requirements for a loan in addition to high fees. These problems in accessing affordable trade finance may have worsened somewhat since the 2009 financial crisis. The downsizing of some key global financial industry players since 2009 has certainly contributed to this situation. Capital for lending in low-income countries has become scarcer and the selectivity of risks greater, so negative expectations regarding the cost of doing business in poorly- (or non-) rated countries translated into higher costs for traders locally, or simply in less finance being available. Several global banks have been reducing their network of "correspondent banks" in these countries, thereby limiting the scope of local banks to find suitable counterparties internationally.[5] Emerging countries' banks, while generally gaining market shares, have not filled the gap, because of the "start-up" cost of doing business.

Source: WTO Secretariat (2014)

[5] According to BIS (2014), global banks play a very important role in the market for trade finance. They "*appear to account for a quarter to a third of the global supply of bank-intermediated trade finance, with local and regional banks providing the remainder*". In 2011, such banks provided US$2 trillion of the estimated US$6.5-8 trillion of bank-intermediated, short-term trade finance recorded.

4.9. However, difficulties remain in accessing affordable trade finance, as Box 4.1 above highlights. A 2013 survey by the Centre for Promotion of Imports from Developing Countries (CBI, 2013) reveals that the majority of SME exporters in Africa consider that trade finance costs have increased over the last three years. Furthermore, in most developing economies, the legal and institutional framework to support financial and non-financial schemes is still weak and evolving. There is broad agreement that access to finance, including trade finance, is *the* major bottleneck to SME growth in developing countries.

4.2 Difficulties entering new markets

4.10. Entering new markets typically requires substantial investment in information gathering. It is necessary to acquire relevant market information (e.g. on foreign prices, consumer preferences, standards and testing requirements) and information regarding the establishment of appropriate distribution channels abroad, to lower downside risks when exporting. A CPCCAF[6] survey (Table 4.1) on information constraints shows that in all regions, information on "*trade contacts and business opportunities*" is ranked as the top concern. This is followed by information on "relevant regulations" and on "export support measures".

Table 4.1 Information barriers faced by SMEs by region

When exporting, which are the main types of information you need? (2014, 2 possible answers, CPCCAF)

Information type	Northern Africa (%)	Central Africa (%)	Indian Ocean (%)	Western Africa (%)	Average
Information on trade contacts and business opportunities	69	70	70	66	69
Information on relevant regulations	51	37	28	47	41
Information on export support measures	46	34	43	41	41
Information on target markets	29	43	37	28	34
Other	1	3	0	2	2

Source: ITC calculations based on CPCCAF survey data

4.11. Cash-strapped SMEs find it harder to make the investments needed to plug these information gaps. In addition there may be certain disincentives to be the first mover in these areas, as the information gathered on foreign demand and foreign distribution channels may benefit competing firms (Lattimore et al., 1998).[7] Firms based in countries facing a reputation barrier (because they are unknown to, or have a bad image among, foreign consumers) may also need to make additional investments in branding and marketing that would benefit competing firms. Individual SMEs may therefore be reluctant to make the investments necessary to enter into new markets (Lattimore et al., 1998; Box IV.6 in Bacchetta and Jansen, 2003).

4.12. Institutions that centralize the collection and dissemination of relevant information can play an important role in helping enterprises, and in particular SMEs, to overcome entry barriers related to market intelligence, distribution, and reputation building (Copeland, 2007). Such institutions can take the form of trade support institutions, producer organizations (including Chambers of Commerce) or diplomatic representations. Recent economic literature has shown that the impact on trade of these institutions can be significant. Rose (2007) finds that adding a diplomatic representation can increase exports by 6 to 10 %. Lederman et al. (2006) find that for each US dollar of export promotion, exports increase by US$40 for the median export promotion agency. Volpe Martincus et al. (2009) find that in Latin America, diplomatic missions and other export promotion offices are more successful in promoting new

[6] Conférence Permanente des Chambres Consulaires Africaines et Francophones.

[7] In other words, entering into new markets is an activity characterized by externalities in the form of knowledge spillovers. The result will be underinvestment in market entry.

products for export rather than simply increasing sales of existing ones. This is crucial for export diversification. From these findings, it is clear that trade support institutions, both national and international, have a central role to play in addressing market failures.

4.3 Difficulties defending their interests

4.13. Due to their small size SMEs find it hard to defend their interests. This situation may occur in different contexts including, bargaining with suppliers, bargaining with buyers, and lobbying in favour of policies or regulations that are in the interest of SMEs.

4.14. Concentration of market power is a phenomenon that can be observed in a number of global markets. It can affect the functioning and governance of global value chains (GVCs) as different players within the chain will have different bargaining power. This is, for instance, one of the reasons behind the observation that providers at the bottom of an assembly line or of raw inputs in a food chain sometimes only retain a relatively small share of the final retail price.[8]

4.15. SMEs can also face difficulties defending their interests in the policy arena. Cheong et al. (2013), for instance, report anecdotal evidence on the difficulties smallholders in agriculture face exerting influence on trade policymakers. One way to strengthen the bargaining position of small and medium suppliers within GVCs or at the policy level is to create producer organizations (World Bank, 2008). Such organizations can take different forms such as sector organizations, Chambers of Commerce or other trade support institutions. Examples also exist of situations where SMEs partner with trade unions in order to strengthen their bargaining position on issues of common interest.[9]

4.4 Access to technology and scope for innovation

4.16. SMEs tend to find it harder than large firms to keep up with technological change, notably because they employ fewer technical specialists and because of the financial resources needed to continually purchase new technology. In LDCs, simple information and communications technology (ICT) solutions, such as access to the internet or the creation of a business website, often represent a significant challenge for SMEs. Cluster policies like the creation of special economic zones or innovation hubs try to address such challenges by providing access to relevant business services to those locating in the cluster (McCormick and Maalu, 2011; Chatterji et al., 2013). Geographical vicinity itself can facilitate spillovers of innovation across SMEs, thus representing another advantage of clustering.

4.17. When SMEs are incubators of new technology, they often face new challenges such as protecting their intellectual property. Zhang and Xia (2014), for instance, argues that SMEs face difficulties making use of national intellectual property (IP) systems; systems tend to favour access by larger and financially stronger enterprises with the resources to navigate their way through "cumbersome" processes. To address this challenge, the World Intellectual Property Organization (WIPO) created a division focusing on SMEs in 2000 with a view to increasing awareness among SMEs on IPR related issues, and to strengthen the capacity of relevant public and private institutions to provide IP-related services.

4.5 Availability of skills

4.18. Global production is increasingly characterized by rapid changes in technology and by the need to adjust to changes in consumer demand. Access to a skilled workforce is crucial in such an environment, as skilled workers find it easier to adapt to changes in the working environment. As a consequence, work-force skills are an important asset for both defensive and expansive enterprise strategies in global markets (Jansen and Lanz, 2013).

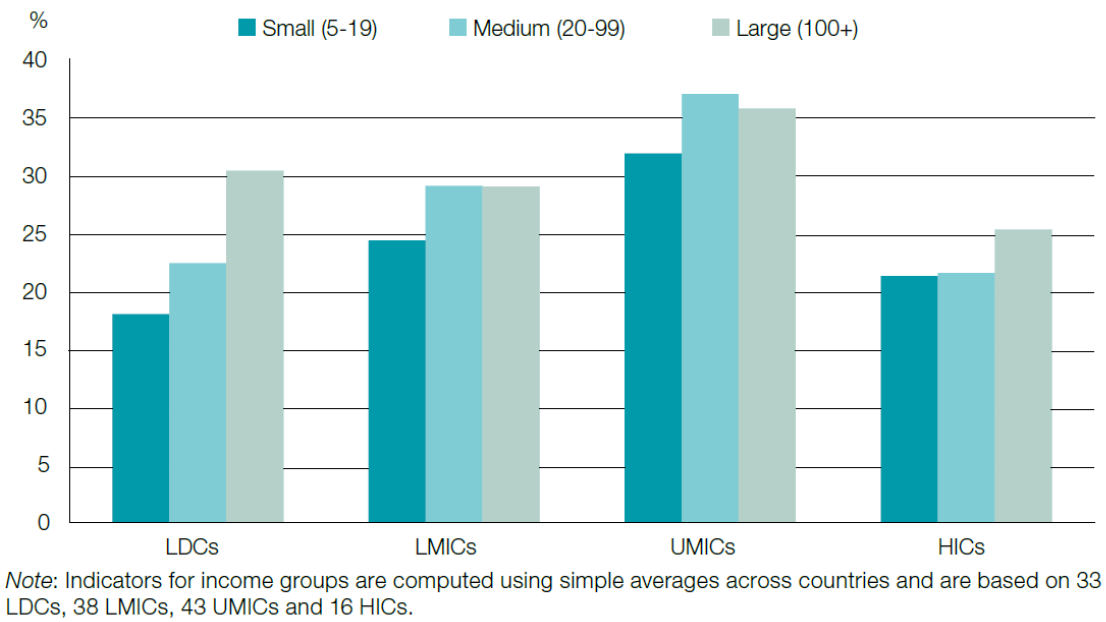
4.19. In an environment of constant change it is difficult for employers to hire workers with the right skills or to regularly adjust skills through in-house training. These challenges are

[8] See, for instance, Nina Pavcnik (2014) on price transmission mechanisms in developing countries.
[9] In Brazil, for instance, CONTAG represents both agricultural wage earners and self-employed farmers (ILO, 2008).

particularly daunting for SMEs that may not have the financial resources to re-train their workforce (see Okada, 2004). SMEs also often lack the resources or the capacity to assess future skills needs, causing them to lose competitiveness over time (Cedefop, 2012).

4.20. Figure 4.3 shows the share of firms by income group identifying an inadequately educated workforce as a major constraint to their operations. Around 20% of small- and medium-sized firms in LDCs identify an inadequately educated workforce as a major constraint. This is low when compared to the other categories shown. This may be explained by the fact that enterprises tend to engage in activities that are not skill intensive. Joining and moving up GVCs often requires a skilled workforce, and it is clear from Figure 4.3 that, as a firm grows, skills shortages becomes a greater problem. Therefore, many SMEs may not consider skills shortages to be an immediate concern. Yet they are a constraint which will need addressing if the SME sector is to grow and thrive.

Figure 4.3 Share of firms by income group identifying an inadequately educated workforce as a major constraint to their operations



Source: Jansen and Lanz, 2013

4.21. In addition, the 2013 OECD-WTO Aid-for-Trade monitoring survey confirmed that skills are a major supply side constraint for SMEs, notably in the ICT sector which is characterized by rapid technological change, and in the tourism sector which is characterized by frequent employee-client contact. In high-tech sectors like ICT, industry clusters sometimes play a role in allowing labour market pooling, thus facilitating access to skilled labour (e.g. McCormick, 1999).

4.6 Trade costs

4.22. In the early 1980s and 1990s many economies undertook trade policy reforms that realised the removal of quantitative restrictions on imports and exports, and the reduction of tariffs. Other barriers to trade, however, continue to exist. They often take the form of non-tariff measures (NTMs) like standards or regulations. They can also take the form of lengthy port-handling or custom procedures.

4.23. SMEs tend to be disproportionally affected by such trade costs. Unlike large companies, most SMEs do not possess in-house trade or international departments with experts who know how to efficiently overcome relevant trade costs. SMEs tend to have limited resources and a lower threshold to absorbing risks, especially when operating in intensely competitive markets (OECD, 2006). In addition, the fact that SMEs tend to trade smaller quantities implies that fixed trade costs often make up a larger share of the unit cost of their goods when compared to rivals exporting larger volumes.[10]

4.7 Business environment

4.24. Much has been written about the importance of the quality of the business environment for international trade (e.g. WEF 2013, Global Competitiveness Index). The quality of the business environment is particularly important for SMEs, because SMEs tend to have less resources (notably in terms of staff) to handle regulatory matters. As a consequence, regulatory matters tend to have a stronger impact on the performance of SMEs than on large firms. Lattimore et al. (1998) cite evidence from Australia indicating that, in 1994-95, SMEs bore around 85% of the regulatory compliance burden, while their share in GDP was only around 30%.

4.25. Proportionate compliance costs can be anywhere from 10 to 30 times greater for SMEs than for larger firms.[11] This highlights the difficulties SMEs face when dealing with government regulations, and in particular, illustrates the disadvantages they must overcome in order to be compeitive. The OECD calculates that reducing these costs by 25% would increase growth by 1% – half the G20 target. This may be achieved by removing superfluous Acts and Regulations, implementing digital reporting and information systems, and rationalizing conflicting regulations.

4.26. There are many indices which measure different aspects of a country's business environment. The World Bank's Logistics Performance Index (LPI, 2014) assesses the transportation infrastructure a country possesses – which is evidently important for trade, while the World Bank's Doing Business series (DB, 2014) looks at a wide variety of indicators in order to provide both quantitative and qualitative assessments of a country's business environment. Other well-known indices and sources of data which contribute to the wide literature on business environment include: the ITC's market access and trade maps, the WEF's Executive Opinion Survey, the International Telecommunications Database, and the UN's e-government survey. However, many of these indices are unable to differentiate between the wider business environment and the business environment faced by SMEs, and in particular, SME exporters.

4.27. When referring to international trade, firms which offer services to trading companies begin to become important to the business environment, even if these firms do not trade themselves. Such firms tend to offer transport, telecommunication, financial, and business services. Total logistics costs (packaging, storage, transport, inventories, administration and management) are estimated on average at 20% of total production costs in OECD countries (WTO, 2004). Integrated transport and communication links are therefore indispensable for cost-efficient transportation networks.

4.28. Logistics services providers can often help trading firms increase transportation efficiency. For example, they can assist clients in finding the best transportation price for their goods alongside an appropriate travel schedule. Efficient logistics may also decrease costs of production, since inefficient production leads to larger inventory stores at each stage of the production chain (i.e. bigger warehouses to store larger inventories). It has been estimated that developing countries could reduce the unit cost of production by as much as 20% by reducing inventory holdings by half (Gaush and Kogan, 2001).

4.29. Telecommunication services consist of wire-based (e.g. fixed-line telephony), wireless (e.g. mobile and satellite services), resale-based (i.e. over leased transport capacity) and a myriad of combinations thereof (WTO, 2004). Since telecommunications is primarily a "network industry", the value and entry level to the industry increases with each additional customer. For these reasons, the industry was considered a natural monopoly in the past, but

[10] This is the mechanism behind the Melitz (2003) finding that only companies of a certain size will be able to export.

[11] Dr Sergio Arzeni, Director of the OECD Centre for Entrepreneurship, SMEs and Local Development, in a keynote address to "The G20 Agenda for Growth: Opportunities for SMEs Conference", Melbourne, 20 June 2014; as quoted in the Conference Report of Proceedings.

recent technological developments have reduced the importance of economies of scale, and promoted vertical disintegration and competition.

4.30. Trade supporting financial services companies also have a pivotal role in the efficient allocation of resources across time and space. The importance of such firms is discussed in sub-section 3.1 "What is an SME". "Business services" consist of a broad range of services, including computing and data processing, professional services, marketing services, technical services, leasing and renting, labour recruitment, and operational services (WTO, 2004).

4.31. The business services sector has both a direct and indirect effect on international trade. The direct impact is the international trade between business services firms. The indirect impact is from business services providers increasing the operational efficiency of currently trading companies. For example, marketing services can help to match producers in one country with customers in another, while technical and management services help producers in countries with shortages of skills to improve productivity and become more competitive (WTO, 2004). Thus, supporting trade growth is inextricably linked to encouraging the development of firms which offer services to currently trading companies.

5 BOTTLENECKS TO SMES INTERNATIONALIZATION IN LDCS: COUNTRY LEVEL EVIDENCE

5.1. The constraints outlined in Section 2 fall heavily on small- and medium-sized enterprise (SMEs) in Least-Developed countries (LDCs). In addition, the contexts in which these constraints are described often depend on purely national factors. Thus, the issues raised in Section 2 may not correlate well with the constraints internationalizing SMEs in LDCs might be facing.

5.2. The Diagnostic Integrated Trade Study (DTIS) represents a unique source of information regarding the constraints SMEs in LDCs may face when trying to internationalize. DTISs identify internal and external constraints of a country’s integration into the global economy, and recommend priority areas where technical assistance and policy actions can help the country overcome these barriers.

5.3. The DTIS is conducted under the Enhanced Integrated Framework (EIF) – a multi-donor programme designed to support LDCs' better integration into the global trading system. Each DTIS is conducted by a specialist team which analyses specific sectors of the economy as well as cross-cutting institutional issues. Towards the end of the process, an "Action Matrix" is created to facilitate discussions with the government, donors, civil society and private sector partners in order to encourage implementation.

5.4. In this section, a study of SME-related issues highlighted in the DTISs is presented. The analysis attempts to identify the number of instances SMEs are mentioned, and in what context. This is followed by an attempt to draw conclusions, at a regional level, about the most important issues facing internationalising SMEs. It is important to note, however, that DTISs were not designed for such SME-specific analysis. The findings presented here should therefore be interpreted with caution.

5.1 References to "SMEs" in the DTISs

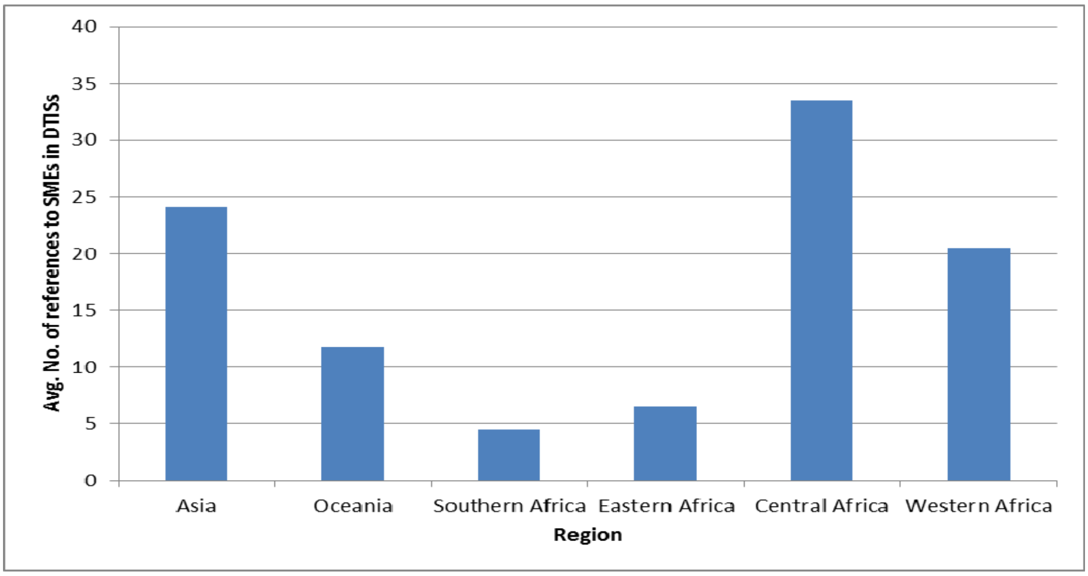
5.5. SMEs are referred to in all the LDC DTISs that were surveyed for the purpose of this study.[12] Figure 5.1 reveals that in the Central African, Asian and West African DTISs, SMEs

[12] The regional distribution of the 23 DTIS is as follows: 5 countries in Asia (Afghanistan, Bhutan, Cambodia, Lao PDR, the Maldives), 4 in Oceania (Kiribati, Samoa, Solomon Islands, Tuvalu), 2 in Southern Africa (Lesotho, Malawi), 4 in Eastern Africa (Burundi, Rwanda, Tanzania and Uganda), 2 in Central Africa (Chad, Democratic Republic of Congo), and 6 in Western Africa (Republic of Cabo Verde, Guinea Bissau, The Gambia, Liberia, Senegal, Sierra Leone, and Togo).

are referred to, on average, more than 20 times. This compares to Southern and Eastern Africa, where SMEs are mentioned, on average, less than 10 times.[13]

5.6. The DTIS for Chad is responsible for the high number of references observed for Central Africa, while in Western Africa, the DTIS of The Gambia and of the Republic of Cabo Verde are responsible for the high number of references observed with dedicated chapters to SMEs. The DTIS for Lao PDR and Cambodia also contribute a significant number for Asia. Both Southern African countries have limited references to SMEs. Lesotho's DTIS has a strong focus on the textiles and garments, and tourism sectors, while Malawi's DTIS focuses on trade costs. Section 4.3 further discusses SME challenges identified in the DTIS by region.

Figure 5.1 Number of text references to SMEs in the DTISs.



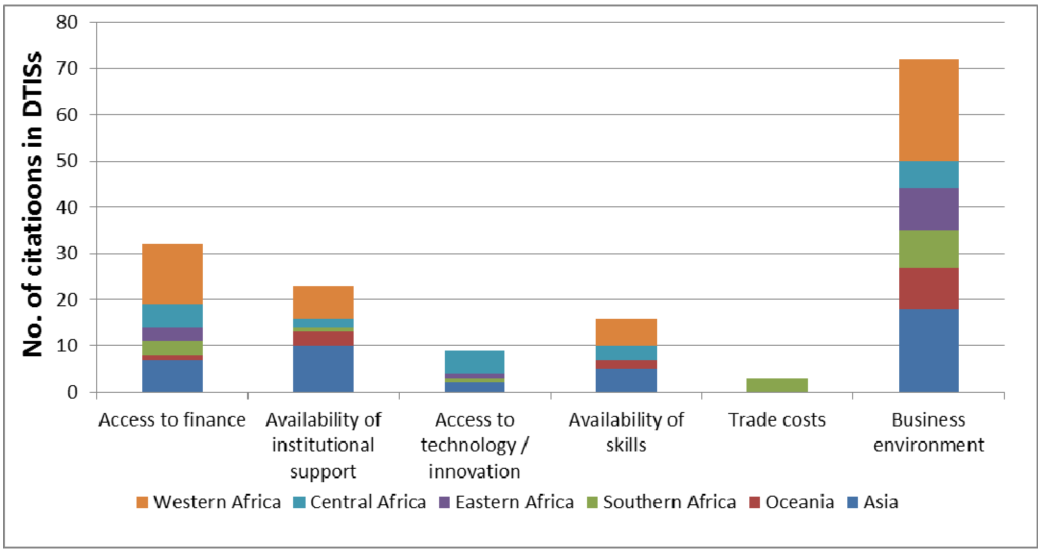
Source: ITC -WTO analysis

5.2 SME constraints highlighted in DTISs

5.7. In addition to simply counting the number of instances SMEs were referred to in the DTISs, the context of the reference was also recorded. Each time SMEs were mentioned, the reference was assigned to one of six categories: access to finance, availability of institutional support, access to technology and innovation, availability of skills, trade costs, and business environment. These categories correspond to the types of bottlenecks discussed in Section 3, with the exception that the category "availability of institutional support" bundles references to support in overcoming difficulties to enter new markets and difficulties to defend SME interests. The results of this categorization process are shown in Figure 5.2.

[13] Figure 5.1 has been established on the basis of a simple word count. This was done by measuring the number of times "SME", or a variation thereof, was mentioned, taking care not to include repetitions (e.g. instances where SMEs are referred to twice in the same sentence).

Figure 5.2 Importance of different SME-specific bottlenecks in DTIS studies



Source: ITC-WTO analysis

5.8. The quality of the business environment is ranked highest among the SME-related challenges discussed in the DTIS observed. This is unsurprising, given that business environment has a very wide definition, and contains within it all other issues not explicitly defined by our remaining categories. Therefore, while accepting that business environment is an important factor to SME development, the focus in the following analysis is on the relative importance of the remaining categories.

5.9. Access to finance (including trade finance) is ranked as the second biggest constraint to SME development. This is in line with the LDC private sector responses surveyed for the 4th Global Review on Aid for Trade: Connecting to Value Chains. Developing country suppliers from agri-food, textiles and apparel, tourism, ICT, and transport and logistics ranked lack of access to finance as their main obstacle preventing them from entering, establishing or moving up value chains, followed by the business environment, trade facilitation and infrastructure (WTO/OECD, 2013). This is confirmed when examining relevant information in the World Bank's Enterprise Surveys, which reveals that in low-income countries, on average 43% of businesses with 20 to 99 employees, rate access to finance or cost of finance as a major constraint to current operations.

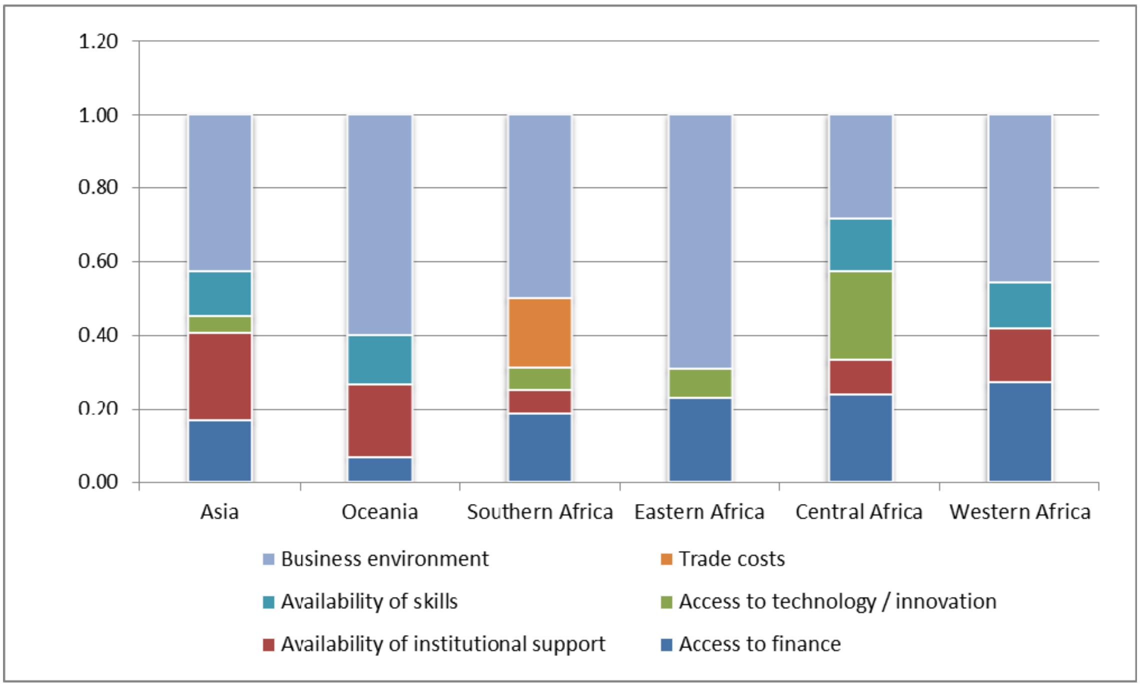
5.10. References to the availability of institutional support is the third largest category of references in the DTISs, and highlights the important role institutions are expected to play in supporting SME development. Some DTISs refer to the importance of building the capacity of ministries and their international partner agencies to support SMEs and increase engagement. Lesotho, for example, plans to establish a new SME department to oversee and coordinate SME policy matters.

5.11. References to trade costs did not factor prominently in DTIS analysis of SME constraints, mainly because most of the DTIS studies examined dealt with trade facilitation issues, which were examined at an economy-wide level, rather than specifically in relation to SMEs. As such, most DTIS include a dedicated chapter on trade facilitation, border and customs procedural issues.

5.3 Constraints faced by SMEs per region

5.12. Figure 5.3 shows the relative importance of SME constraints by region. It is clear that the quality of the business environment is most widely cited, and is therefore the most binding constraint faced by SMEs across all regions, albeit to differing degrees. As discussed in the previous subsection, this is not particularly surprising. In 3 out of 5 regions, the next biggest constraint is access to finance; however, of the remaining two regions, availability of institutional support is ranked second.

Figure 5.3 Relative importance SME-specific constraints in DTIS studies, by region



Source: ITC-WTO analysis

5.3.1 Asia

5.13. The quality of the business environment is identified as the biggest constraint to SMEs in the DTISs of the five Asian LDCs examined (Afghanistan, Bhutan, Cambodia, Lao PDR, and the Maldives). Bhutan identifies SMEs as an engine for green growth, job creation and poverty eradication. Bhutan's DTIS discusses how to improve regulations to support non-polluting, non-harmful industries. Cambodia's DTIS examines how to integrate SMEs into the garment industry and food processing. The DTIS discusses how to assist SMEs in diversification, expansion and sharing of dividends of export-led development. Lao PDR's DTIS discusses how to simplify the taxation regime for SMEs by establishing an SME Tax Unit at the district level.

5.14. Amongst the other categories, availability of institutional support ranked top. In particular, Asian countries are looking to set up business development services and to enhance stakeholder engagements as in the case of Bhutan, Lao PDR, and the Maldives.

5.15. The DTIS of the Maldives identifies inadequate credit finance for SMEs as inhibiting growth; the existing weak credit regime creates uncertainty for financial institutions. This is a problem cited across the five DTISs examined, and steps have been taken to provide more access to financial services for SMEs, but further actions are recommended. Suggestions made include setting up specialized risk sharing facilities or credit facility for SMEs in Lao PDR or providing lower, more competitive rates in the Maldives.

5.3.2 Oceania

5.16. The quality of the business environment is cited as the major constraint in the Pacific region – a region characterized by relatively low SME density. The importance for SMEs of an improved business and investment climate has been stressed in the DTIS of Kiribati. Institutional support is considered the second largest constraint. There is a general finding that ministries of trade are not well prepared to support SMEs. The DTIS for Solomon Islands highlights the thriving non-governmental business services sector for SMEs, and calls for a strengthening of the capacity of the Ministry of Commerce, Industry and Employment to support SMEs.

5.17. Access to start up and development financing for SMEs due to difficulties in preparing business plans is highlighted in the DTIS for Tuvalu. Lack of access to finance was the subject of a joint IFC-McKinsey 2010 study, which mapped the finance gap experienced by SMEs. That study reports that access to financial services in the SME sector remains low across the pacific region. In addition, a substantial portion of SMEs who have access to basic financial services still remain underserved given the gaps in the product range offered to SMEs in the formal sector.[14]

5.18. The DTIS of Kiribati, Samoa, Solomon Islands, and Tuvalu highlight the tourism sector as generating significant income and employment opportunities. The sector is currently dominated by a small number of resort-style hotels. SMEs are identified by the DTIS as offering the potential to grow the community-based and eco-tourism segment of the tourism market, whilst also safeguarding local culture and environmental preservation.

5.3.3 Southern Africa

5.19. Trade costs are identified as a particularly serious constraint to SME internationalization in the DTIS of Malawi and Lesotho – both landlocked LDCs. Both DTISs recommend streamlining customs documentation and rules of origin to bring SMEs more into foreign trade. Lesotho's trade facilitation environment is identified as a key constraint for its SMEs and simplifying these processes is key to diversifying the country's exports.

5.20. Quality of the business environment and access to finance are also identified as constraints. Lesotho’s DTIS states that SMEs face a lack of physical facilities to ensure quality and hygiene, internet facilitates for logistics services and linkages with supermarket chains. In Malawi, formalizing the informal SMEs is considered crucial.

5.3.4 Eastern Africa

5.21. The quality of the business environment is considered the main constraint for SMEs in four East African DTISs (Burundi, Rwanda, Tanzania, and Uganda), together with access to finance and access to technology/innovation. The DTISs also recognize steps being taken to create an enabling environment for SMEs. For example, Tanzania's Small and Medium Enterprise policy which is aimed at fostering job creation and improving the performance and participation of existing small enterprises – a policy which the DTIS recommends mainstreaming into the Tanzanian National Development Plan.

5.22. In Rwanda, awareness campaigns and programmes on financial support to provide exporters credit and raising awareness to SMEs on existing trade financing schemes, are being rolled out. Rwanda’s DTIS also recommends setting up a special financing scheme for SMEs. For Uganda, the Ugandan Revenue Authority is recommended to provide training on trade facilitation measures to small economic operators. A Directorate of Small and Medium Enterprises is now in place under the Uganda Investment Authority as a One-Stop Centre to oversee coordination and implementation of SME support through the SME National Policy and Strategy.

5.23. The DTIS for Burundi notes that efforts need to be made to engage SMEs and informal traders in regional integration processes. Rwanda's DTIS suggests the development of quantifiable indicators on SMEs so as to move towards an inclusive export strategy.

5.3.5 Central Africa

5.24. SME challenges identified in the DTISs for Chad and for the Democratic Republic of Congo focus on access to finance, access to technology, and the quality of the business environment. Chadian SMEs are struggling to formalise due to absence of an enabling infrastructure (especially in the ICT sector) which facilitates economic activity. The government is addressing SME challenges through a number of policy and institutional reforms; with a strong focus on increasing ICT penetration to SMEs as a tool to foster

[14] The informal sector is estimated to be three times the size of the formal registered businesses in the Pacific region according to the same study.

economic activity. These include the elimination of all taxes on all ICT import products and creating awareness and improving incentives for SMEs to invest in ICT.

5.25. In the Democratic Republic of Congo, power cuts and access to finance are identified as key constraints to SMEs. The DTIS recommends offering a loan fund to SMEs. The price and availability of power for example, is highly dependent on a business's size and negotiating power; SMEs are therefore at a disadvantage.

5.26. Chad's DTIS also makes specific reference to strengthening the institutional framework to support the development of SMEs and improving their technical, financial and economic performance. Furthermore, access to market information is considered crucial in enhancing SME competitiveness.

5.3.6 Western Africa

5.27. The quality of the business environment and access to finance emerges as the largest constraints to SMEs in the seven Western African DTIS (Republic of Cabo Verde, Guinea Bissau, The Gambia, Liberia, Senegal, Sierra Leone, and Togo).

5.28. Regarding the business environment, many of the DTISs highlight that a majority of SMEs remain in the informal sector. Formalizing SMEs so as to expand the tax base is therefore a priority measure. Togo has adopted a tax framework to promote SMEs and formalize micro-enterprises. The DTIS for The Gambia is dedicated to fostering SME development and has prioritized the streamlining of business registration and the establishment of a help desk for SMEs. The Gambia Investment and Export Promotion Agency has been mandated to support SMEs and micro-businesses in their export promotion initiatives.

5.29. Senegal’s DTIS claims that 65% of SME start-ups currently fail in less than a year mainly due to the high cost of credit and lack of access to capital markets. Senegal adopted a Charter of SMEs which plans to facilitate access to finance by implementing agencies or line venture capital, with new products of the Regional Stock Exchange. Financing SME activities have also recently been put through sovereign wealth funds. The Liberian Central Bank has also launched a Credit Stimulus Initiative for Liberian-owned SMEs.

5.30. A number of analysed DTISs in this region acknowledge the importance of and made recommendations regarding institutional support. The Republic of Cabo Verde's DTIS recommended support to the Agency for Business Development and Innovation to increase its ability to support a pipeline of strong SMEs with export potential. Liberia's suggests that the Ministry of Commerce and Industry shall continue institutional support to SMEs through the Bureau of Small Business Services.

5.4 EIF support to alleviate SMEs' bottlenecks

5.31. Building on in-country partnership, outreach and advocacy, the EIF focuses on mainstreaming trade into national development plans, strengthening trade institutions and building capacity needed to roll out coordinated trade and development assistance. The EIF works to support catalyst projects to overcome supply-side constraints to trade and help develop a sustainable basis for export growth. Tier 2 projects fund Action Matrix priority projects to build up trade-related and supply-side capacities. This phase is supported by the EIF Trust Fund for priority small-scale projects to build up trade-related and supply-side capacities.

5.32. The EIF Trust Fund portfolio of US$251 million is being used across 50 poorest countries to fund catalytic initiatives addressing trade-related challenges inclusive of SMEs constraints facing the LDCs and three graduated countries. The EIF Trust Fund resources are also used to coordinate and further leverage additional resources from domestic and external partners to address national priorities identified in the DTIS and the DTIS Update including on SMEs. Box 5.1 below provides some examples of the EIF's support for SMEs.

Box 5.1: Examples of EIF support to address SME constraints

- In Cambodia the EIF is supporting a project to strengthen and diversify export supply capacity in milled rice focusing on SMEs.
- In Nepal, the EIF medicinal herbs and aromatic plants project is working to develop value chains and helping products through marketing for stronger exports. It will help SMEs build a competitive edge, supporting people across the country whose livelihoods depend on agriculture (currently 77% of the total).
- In Burundi, the EIF is supporting the Ministry of Trade, Industry, Posts and Tourism to take public-private sector partnerships forward, with the Federal Chamber of Commerce and Industry linking up SMEs across regions and offering micro-finance.
- In The Gambia, the EIF support is going to 14 sub-grants to improve productivity for fisheries, horticulture, ports, cashew and the SMEs Association
- In the Republic of Cabo Verde, the EIF has supported training to 39 SMEs to strengthen their capacities and knowledge in labour laws, food safety and hygiene.
- In Uganda, 25 districts nationwide are being networked as part of the EIF Tier 2 project on providing decentralized business services to rural clients, including farmers, producers, businessmen, cooperatives, local tourism agencies and SMEs. The European Union is supporting additional districts, while the Government is supporting an additional 15 districts and plans to increase its annual support to new districts in order to provide market information at grassroots level, linking the farmers to producers and the producers to the market.

Source: EIF Secretariat

6 SMES, DEVELOPMENT FINANCE AND AID FOR TRADE

6.1. Assistance to small- and medium-sized enterprises (SMEs) has a long tradition in national policymaking and international development assistance. The impact of the economic crisis, greater understanding of the role of value chains in trade and a desire on the part of the development community to promote inclusive, sustainable models of development, have stirred renewed interest in SMEs and how to support their internationalization.

6.2. Classic capacity building approaches are being mixed with innovative financing vehicles and new commercial thinking. Innovative approaches are being complemented with new actors, notably South-South partners, with their own ideas and instruments. Companies are also taking up the challenge, recognizing both the possibilities in underserved markets, and the possibilities for innovation and expansion offered by integrating new supplier into value chains.

6.3. Emerging practice tells us much about how private sector development is seeking to leverage other financial resources and work with the private sector, notably as regards issues of financial inclusion and broad-based inclusive economic growth.

6.4. This section begins with an analysis of approaches used in development finance to address the financing gap faced by SMEs. It presents SME-specific Aid-for-Trade activities and in this context discusses how established approaches to capacity building are being allied to financing mechanisms. The section ends with an examination of lessons from recent evaluations and poses the question of how to achieve scale in SME development without loss of focus and spreading programmes too thinly, together with the on-going challenge of how to mainstream the trade dimension into programming and reporting – a dimension currently neglected in evaluation approaches.

6.1 Development finance and SMEs

6.5. While commercial financing is substantial and growing, work by the International Finance Corporation (IFC) suggests that SMEs still face a significant financing gap. Some 55–68% of formal SMEs (14–18.6 million enterprises) in developing economies are either un-served or under-served in terms of their access to financing (IFC, 2011). The gap widens considerably further when the financing needs of informal enterprises are considered.

6.6. Lack of collateral and insufficient banking history can make formal sector SMEs a "credit risk" for poorly-capitalized and thinly-spread banking sectors. Electronic payment systems and mobile banking services are offering new approaches to meet the un-served banking needs of SMEs (see Box 6.1). These new approaches, combined with development financing vehicles such as micro-credit and venture capital funds, offer opportunities to advance financial inclusion – if the appropriate regulatory regimes can be put in place.

Box 6.1: Mind the gap: empowering Kenya's SMEs through alternative lending

A series of companies, including Kopo Kopo, PayPal, and Square are seeking to fill the financing gap of SMEs in Kenya. Through electronic payment platforms, these companies can track electronic receivables and use these as the basis to offer financing products. This payment platform transforms a customer's transaction history into a form of credit history. To repay loans or other financing, the company automatically deducts a mutually-agreed percentage of the customer's daily sales over an assigned period. For Kopo Kopo, customers on average borrow as little as US$2,400 and repay their advances within 2-3 months. Of those that have completely repaid, nearly 70% have taken another (and often larger) cash advance, indicating a continuous need to smooth the ebbs and flows of daily business.[15]

6.7. Development financing is intended as catalytic; it cannot close the funding gap for SMEs by itself. This funding seeks to expand the stock of private investment and private sector activity in developing countries. Development finance support for SMEs aims at "additionality" – addressing market failures (i.e. such as insufficient bank credit lines or the regulatory environment) or a development objective (economic, environmental or social). Box 6.2 provides some examples of development finance institution (DFI) projects that aim to address the funding gap faced by SMEs.

Box 6.2: Plugging the SME funding gap - examples from around the world

Deutsche Investitions-und Entwicklungsgesellschaft mbH (DEG - a subsidiary of KFW) has partnered with the International Finance Corporation and the Dutch development finance institution (FMO) to make a US$80 million investment to improve the range of financial services available to SMEs in Papua New Guinea offered by Bank South Pacific (BSP). BSP is the leading bank in Papua New Guinea with more than 50% market share. The joint investment expands BSP's credit line, thereby allowing it to extending its SME business. (Source: DEG website)[16]

The Central American Small Enterprise Investment Fund (CASEIF) is a private equity fund totaling US$35 million for SMEs in the Central American region. It provides long-term capital needs, provides technical services, and aims to improve transparency and governance within its investees. CASEIF is a joint venture of the Multilateral Investment Fund of the Inter-American Development Bank, the Norwegian Investment Fund for Developing Countries, the Swiss Investment Fund for Emerging Markets (SIFEM), the Finnish Fund for Industrial Cooperation (Finnfund), the Andean Investment Corporation (CAF), and Latin American Financial Services (LAFISE). (Source: CASEIF)[17]

Fanisi Venture Capital Fund is a joint initiative of IFC, NORFUND and Amani Capital that makes privately negotiated equity and quasi-equity investments in start-ups, early stage and growth orientated small- and medium-sized enterprises primarily in the East African region. The Fund (US$55 million in total) will target investments of between US$0.5 and US$3 million in the Agri-business, Retail, ICT/Technology, Financial Services, Manufacturing, Media, Transportation, Logistics/Distribution, Tourism and Housing sectors. FANISI also offers a Business Advisory Services Facility funded by grants from Norfund.

(Source: IFC website)[18]

6.8. An important characteristic of much of the work of DFIs engaged in this area is that these projects seek to catalyze financing from a range of other sources, including private

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[15] Adapted from Mind the gap: empowering Kenya's SMEs through alternative lending *Benjamin Lyon, Director of Special Projects at Kopo Kopo* Source: http://smefinanceforum.org/post/mind-the-gap-empowering-kenya%E2%80%99s-smes-through-alternative-lending.

[16] See: https://www.deginvest.de/International-financing/DEG/Die-DEG/Was-wir-tun/.

[17] See: http://www.lafiseinvestment.com/lafise-lim/default_e.aspx.

[18] See: http://ifcext.ifc.org/ifcext/spiwebsite1.nsf/ProjectDisplay/SPI_DP27776.

investors, other DFIs, governments, non-government organizations (NGOs) and private companies. Most international DFIs limit their participation in project investment to well under 50% of the total project value. As such, the intention is to expand the volume of financing offered, and not to crowd out commercial financing.

6.9. Another important feature of investments is that there is a high degree of collaboration and cooperation between different DFIs in projects and programming.

6.10. CGAP research suggests that some 300 SME investment vehicles are currently being run by DFI-investment vehicles that committed at least US$20 billion to developing countries in 2010. Table 6.1 below provides an indicative list of the DFIs active in this area.

Table 6.1 Indicative list of Development Finance Institutions active in SME development through their private sector development programmes

Multilateral Development Banks or Finance Institutions with Private Sector Operations	Examples of Bilateral Private Sector Development Finance Institutions
African Development Bank (AfDB)	Belgian Corporation for International Investment (SBI-BMI)
Asian Development Bank (AsDB)	Belgian Investment Company for Developing Countries (BIO)
Black Sea Trade and Development Bank (BSTDB)	CDC Group (British Development Finance Institution)
Development Bank of Latin America (CAF)	COFIDES (Spanish Development Finance Institution)
European Bank for Reconstruction and Development (EBRD)	Danish Industrialization Fund for Developing Countries (IFU)
European Investment Bank (EIB)	DEG (German Development Finance Institution)
Inter-American Development Bank (IaDB)	Development Bank of Austria (OeEB)
Inter-American Investment Corporation (IIC)	Entrepreneurial Development Bank of the Netherlands (FMO)
International Finance Corporation (IFC)	Finnish Fund for Industrial Cooperation (Finnfund)
Islamic Corporation for Development of the Private Sector (ICD)	French Investment and Promotions Company for Economic Cooperation (Proparco)
Multilateral Investment Fund (MIF)	Japan Bank for International Cooperation (JBIC)
Multilateral Investment Guarantee Agency (MIGA)	Norwegian Investment Fund for Developing Countries (Norfund)
Nordic Investment Bank (NIB)	Overseas Private Investment Corporation (OPIC, US)
OPEC Fund for International Development (OFID)	SIMEST (Italian Development Finance Institution)
	SOFID (Portuguese Development Finance Institution)
	Swedfund
	Swiss Investment Fund for Emerging Markets (Sifem)

Source: International Finance Institutions and Development through the Private Sector (IFC, 2013)

6.11. Work in the G20 in the aftermath of the financial crisis has sought to scale up successful models of SME support, notably through an SME Finance Challenge. At the G20 Seoul Summit, 14 winners were announced and an SME Finance Innovation Trust Fund was created, with funding of US$28 million, contributed by Canada, Korea, the Netherlands, the United Kingdom, and the United States. Concurrently, the G20 SME Finance Framework channelled US$119.7 million in additional funding from DFIs and bilateral donors directly to individual challenge winners.[19]

[19] Saint Petersburg Accountability Report on G20 Development Commitments. https://www.g20.org/sites/default/files/g20_resources/library/Saint%20Petersburg%20Accountability%20Report%20on%20G20%20Development%20Commitments_0.pdf.

6.12. Another area of finance taken up through the G20 and other bodies has been that of trade finance. The WTO, together with the International Chamber of Commerce, the World Bank Group, and other international financial institutions have sought to promote action on trade finance through such initiatives as the Global Trade Liquidity Programme, the IaDB Trade Finance Reactivation Programme, and other programmes offered by regional development banks which have sought to resolve issues of access to trade finance, notably for SMEs (see Box 6.3). Since 2007, the Director-General of the WTO has convened regular meetings of an Expert Group on Trade Finance to report on market developments and possible steps to address market gaps and failures.

Box 6.3: Trade finance support: facilitating US$30 billion in trade in 2013

The Asian Development Bank (AsDB), the European Bank for Reconstruction and Development (EBRD), the Inter-American Development Bank (IaDB), the Islamic Development Bank Group (ITFC), and the International Finance Corporation (IFC) are all operating similar trade finance programmes. In early 2013, the African Development Bank (AfDB) opened a permanent programme and has already financed close to US$1 billion in trade transactions in Africa and expects to support more than US$10 billion over the next four years. Trade finance facilitation programmes from multilateral institutions helped facilitate around US$30 billion in trade in 2013. Almost a third of IFC's total operations took place in sub-Saharan Africa and the AsDB's risk-mitigation support mainly caters for the poorest regions in Asia, inter-alia, Pakistan, Bangladesh, Viet Nam, Sri Lanka, Nepal, and Uzbekistan.

(WTO, 2014)

6.2 Aid for Trade and SMEs

6.13. Development financing for SMEs passes through three main channels:

- Official development assistance (ODA) provided by national aid agencies that provide concessional funding support (mostly in the form of grants);
- Multilateral development banks' public sector arms that provide concessional financing (with a combination of grants and loans, both concessional and non-concessional);
- Bilateral development finance institutions and the private sector arms of multilateral development banks, which provide financial products and related advisory services to the private sector (mostly on non-concessional or commercial terms).

6.14. Monitoring of Aid-for-Trade flows captures assistance provided in ODA-form by development agencies (bilateral and multilateral). Although small in financial terms, as compared to the work of DFIs, the Aid-for-Trade activities captured by OECD and WTO monitoring nevertheless play an important role. Projects addressing a variety of different SME constraints (e.g. access to electricity, business support services, development of the banking sector, information and communication technology, trade policy, industrial development), are reported to the OECD's Creditor Reporting System (CRS).

6.15. Given the range of support that benefits SMEs, it is not possible to quantify Aid-for-Trade support to SMEs. Many projects benefit SMEs (e.g. business environment reforms or infrastructure development – as suppliers and final users) either directly or indirectly even if they may not be the main target of an intervention. Assistance, though, is significant. For example, an Independent Evaluation Group study estimated World Bank Group support at around US$3 billion per annum in commitments, expenditures, and gross exposure for SMEs over the period 2006–2012.[20] Many of the activities undertaken by the World Bank Group, such as investment climate reform, may be best considered as a form of public good – establishing conducive conditions for others, notably DFIs, to operate.

[20] The Big Business of Small Enterprises, Evaluation of the World Bank Group Experience with Targeted Support to SMEs, 2006–12, Independent Evaluation Group, 2014.

6.16. Table 6.2, provides an overview of the funding reported to the CRS with the specific aim of supporting SME development.

Table 6.2 Assistance reported to the OECD for SME development (US$ millions)

Year			2008	2009	2010	2011	2012
All Donors, Total			**1099**	**1008**	**1051**	**1477**	**569**
All Donors, Total	**DAC Countries, Total**		**751**	**685**	**637**	**1252**	**306**
	DAC Countries, Total	Australia	11.3	13.2	2.5	1.7	5.3
		Austria	3.6	3.4	9.8	..	0.9
		Belgium	25.8	41.5	10.7	9.0	0.9
		Canada	13.6	20	39.0	39.7	29.7
		Czech Republic	..	..	..	0.01	..
		Denmark	31.4	37.2	132.1	56.7	21.5
		Finland	1.45	3.08	9.27	2.42	0.31
		France	..	122.7	75.7	9.33	22.3
		Germany	17.8	74	19.3	57	32.8
		Greece	0.08	0.2	..	..	..
		Iceland	..	..	..	..	0.18
		Ireland	0.07	1.8	0.01	..	0.02
		Italy	126	6.1	44	0.9	1.0
		Japan	292	186	57	479	31
		Korea	4.1	0.5	0.49	0.72	4.5
		Luxembourg	0.4	..	0.5	0.4	0.18
		Netherlands	18.3	1.9	0.5	12	63
		New Zealand	4.1	0.3	2.4	1.3	1.6
		Norway	12.8	6.8	14.6	8.4	4.1
		Spain	13.5	6.8	19.9	458.5	4.68
		Sweden	7.2	0.8	11.9	9.3	18.1
		Switzerland	22.8	20	24.7	18.9	13.2
		UK	32	42	37	20	6
		USA	112	95	124	65.2	43
	Multilateral, Total		**347**	**323**	**414**	**224**	**263**
	Multilateral Total	AsDB Special Funds	..	83	40	..	5.01
		BADEA	..	..	..	0.1	..
		EU Institutions	116	169	167	104	227
		GEF	..	..	..	..	0.99
		IDA	221	27	151	58	12
		IDB Sp.Fund	..	4.6	25.7	11.4	11
		IFAD	9.7	11.8	27.4	48.7	6.7
		OFID	..	25	..	..	..
		UNDP	0.2	1.4	1.1	0.7	..
		UNPBF	..	..	..	..	0.0

Source: OECD Creditor Reporting System

6.17. A total of 34 donors reported over 3,400 projects worth US$5.2 billion to the OECD CRS in activities supporting SME development over the period 2008-2012. LDCs received on average 22% of this support over this period – assistance provided in the form of grants and concessional loans.

6.18. Table 6.3 below provides indicative examples of the type of activities funded. Examples given include multi-donor programmes, projects with a specific thematic focus (e.g. gender empowerment), and initiatives with a sectoral focus (e.g. agricultural or tourist sector development). A diverse range of donors are engaged in this area. Examples also exist of SME-targeted projects trying to engage multinational private sector players as illustrated in Box 6.4.

Box 6.4: Involving multinational enterprises in trade-related technical assistance

The ILO-IFC's Better Work Program and the International Trade Centre's Ethical Fashion initiative are two initiatives that combine capacity building of developing country producers with a direct involvement of global private sector players. The set-up of the programmes has been influenced by the on-going debate on the functioning of global value chains (GVCs) that highlights the important role intermediaries can play in linking local SME producers to global players. Technical assistance projects can play such a role, whereby the ultimate objective should be to make the programmes self-sustainable, in the sense that developing country producers run sustainably profitable businesses with the implementing agency's role being reduced in the long run to certifying quality standards.

6.19. South-South partnerships are also playing an increasingly important role in this area. Accelerating India-Africa cooperation in support of SME development was one of the topics discussed at the 2014 Confederation of Indian Industry-Exim Bank Conclave on India Africa Project Partnership. China is also active in SME development support. For example, the China Development Bank has signed an Agreement on Development Financing Cooperation with the Development Bank of Southern Africa, and an agreement to loan €60 million to the West African Development Bank for the development of SMEs in countries belonging to the West African Economic and Monetary Union. The Export-Import Bank of China and the Agricultural Bank of China have both signed cooperation framework agreements with the African Development Bank to cooperate on infrastructure project financing and the development of SMEs. Developing countries are also taking their own actions at regional level to support SMEs. A good example here is the ASEAN Strategic Action Plan for SMEs for the period 2010-2015.

Table 6.3 Examples of Aid-for-Trade projects providing for SME development

Area of thematic focus	Examples of projects and programmes
Business environment for SMEs	• Competitiveness and Private Sector Development – Mozambique (World Bank IDA) • SME revitalizations and Governance – Côte d'Ivoire (World Bank IDA) • Investment Climate Advisory Services – IFC • Central Asia Invest – European Union • Trade Mainstreaming in LDCs – Enhanced Integrated Framework (through Tier 1)
SME training: market research, business plans, vocational training, business education and mentoring, trade meetings	• ITC online tools – Trade Map, Market Access Map, Investment Map, Trade Competitiveness Map and Standards Map – that enable companies and trade support institutions to identify export/import opportunities and compare market-access requirements. • Business-to-Business IT training centre, Nicaragua – Denmark • "One Village-One Product", Japan International Corporation Agency • Micro Enterprise Development Programme in Nepal – multi-donor programme including Australia, Belgium, UNDP) • SMEs newsletter, SME guides and manuals, training and free legal advice for SMEs – World Intellectual Property Organization • Empretec and Business Linkages Programme – UNCTAD • ITC's Enterprise Competitiveness Diagnostic Model to

	evaluate SMEs vis-à-vis all internal factors driving operational excellence and long term competitiveness. • SME development programmes – IFAD • Jordan SME training programme – France
Regional training centres/strategies for SMEs	• SME innovation centre – APEC and KOICA • CARICOM Education for Employment – Canada and CARICOM • Compete Caribbean – Inter-American Development Bank, Caribbean Development Bank, Canada, UK
Exporter/importer pairing, promotion of joint ventures, development of business to business services	• ITC's Certified Trade Advisers Programme (CTAP) is a certification programme that builds the capacities of Trade Support Institutions for designing and delivering export management development and direct assistance programmes to SMEs • Trade Americas & Connect Americas Expo, Inter-American Development Bank
Sustainability, fair trade, certification, quality standards	• Portfolio of 164 debt and equity projects with focus on sustainable development – Belgian Investment Company for Developing Countries (BIO) • Capital Access for Renewable Energy Enterprises, East Africa – SIDA
Funding for business start-up and working capital	• Microenterprise programs – USAID • Global SME finance facility – IFC • Small and Medium Enterprises Program – African Development Bank • Impact Fund (Africa and South Asia), UK
Promoting women-owned SMEs	• Women in trade – ITC • Training for women micro entrepreneurs in Peru – Spain • Rural SME support services, Bolivia – Switzerland • Women in tourism empowerment programme – UNWTO

Source: OECD Creditor Reporting System

6.3 Strengthening the delivery of SME support programmes

6.20. Ever greater attention is being paid to the "results agenda" in aid programming. Development financing for SMEs and targeted Aid-for-Trade assistance to SMEs is no exception. An oft-repeated conclusion of evaluations is the need for more robust results measurement frameworks, the use of impact assessments, and greater attention to baselines and indicators. For example, an evaluation by the Independent Evaluation Group (IEG) of World Bank Group support to SME concluded that the Bank's support "needs to be firmly rooted in a clear, evidence-based understanding of how the proposed support will sustainably remove the problems that constrain SMEs' ability to contribute to employment, growth and economic opportunity".[21]

6.21. One difficulty faced by project designers in Aid-for-Trade programming is the small size of many project interventions. Table 6.4 examines project size using data reported to the OECD CRS. From the table it is clear that 2,100 (or 60%) of the 3,400 activities reported were under US$200,000 in value. From the data, a median project size of US$110,800 can be estimated. Given the small size of projects, evaluations have tended to focus on the performance of the delivery institutions or programme reviews.

Table 6.4 SME development projects by value 2008-2012 (in US$)

Less than 50,000	50,000-100,000	100,000-200,000	200,000-500,000	0.5 million to 1 million	1-2 million	More than 2 million
1,181	415	505	491	336	172	293

[21] The Big Business of Small Enterprises, Evaluation of the World Bank Group Experience with Targeted Support to SMEs, 2006–12, IEG, 2014.

6.22. One challenge facing private sector development institutions is how to achieve operational scale when providing support to SMEs in developing countries, which by their nature are small, diffuse and numerous. Supporting SMEs carries with it the inherent risk of itself becoming too diffuse as highlighted in a number of recent evaluations of development assistance to SMEs as illustrated in Table 6.5. One way through which institutions seek to increase the scale of impact of trade-related SME support is to focus on strengthening intermediary organizations – such as trade support institutions, as highlighted in a recent evaluation (ITC, 2013).

Table 6.5 Overview of messages from recent evaluations

Programme	Key messages
DANIDA - Business Development Services (2009)	Business sector interventions need to take account of the enabling environment as well as provide scope for interventions at firm level. Interventions at multiple levels are interdependent and support each other and create scope for more relevant and effective programmes.
	While it would be naïve to say that donor agencies' business sector programmes triggered growth, one could point to a measure of contribution – both in terms of creating an enabling environment for the business sector as well as for more direct forms of support, and some evaluations actually claim that interventions had such an effect
	The supplies of investment capital through the multilateral financial institutions and bilateral donor programmes, and the technology transfer through various projects fit into an overall picture of competitive business sector performance.
EU – Private Sector Development (2004-2010) (2013)	The contribution made by the EU to the development of the private sector showed particular strengths in middle-income countries as compared to low-income countries, across a range of different criteria. Notable strengths were observed regarding policy dialogue, alignment and the clarity of the EU's role in private sector development.
	The EU has generally aligned its support with the beneficiary countries' priorities but has also, on good grounds, reserved for itself the right not to so align when confronted with specific drawbacks to alignment.
	Ensuring that the expected results are clear and targeted, baselines defined, and evaluations conducted, including for cross-cutting issues.
	Enhancing the inclusiveness of the Private Sector Development (PSD) enabling environment support.
AsDB – Private Sector Development (2013)	*Improving business registration*: ADB support was effective in increasing the number of business registrations.
	AsDB actively promoted secured transactions legislation and the establishment of collateral registries. Insufficient collateral is seen by SMEs as being among the top reasons for their difficulty in accessing finance.
	Investment support needs to be carefully sequenced with enabling environment support, particularly for SME development and public-private partnerships.
UK- Private Sector Development (2013)	DFID should clearly define where it can add most value in PSD relative to other stakeholders.
	Micro-level interventions are achieving pro-poor impact and mid-level and Markets for Poor approaches show signs of impact and sustainability
	DFID needs to appreciate the barriers and business imperatives faced by the private sector in participating in development.
	Impact evaluations should be applied to all pilot programs to decide whether to scale-up or not.
ITC-SAANA (2014)	Impressed by the "special relevance, quality and thoughtful delivery" of its expertise, in an environment crowded by larger, better funded organizations.
	Thinly spread, only intermittently present in countries, and with deserving requests being unmet.
3IE-	To understand results, focus should go beyond outcomes and examine

Business Development Services (2013)	impact.
	Participation levels during trainings, and the extent of formal training and cognitive skills affected outcomes.
	Clarify approaches to target support to SMEs.
World Bank - Independent Evaluation Group (2014)	Enhance relevance and additionality of SME support.
	Institute a tailored research agenda.
	Strengthen guidance and quality control.

Source: WTO Secretariat analysis

6.23. Trade metrics are also largely absent from the diagnostics and results measurements being used in SME support. The IEG report 2014 evaluation of World Bank Group support to SMEs includes only limited textual references to trade – and no substantive analysis of trade effects. Other evaluations have similar shortcomings. Given the increased and increasing exposure of SMEs to global markets, both through exports and imports, there appears to be a need to integrate trade metrics and indicators more systematically into the design of projects.

6.24. The need to bolster monitoring of trade effects is not however to suggest that programmes do not have positive trade effects. The 3rd Global Review of Aid for Trade collected a wealth of information on project and programme outcomes and impacts, with direct impacts on exports, employment and poverty reduction. More than 20 of the 275 case stories submitted cited examples of SME export development programmes and their impacts.

6.25. Action is being taken by the aid community to integrate the results agenda into programming and reporting. A number of trends are emerging from the ongoing discussions as reflected in initiatives like the OECD's (2013) "Management Framework for Aid for Trade and Development Results", the Donor Committee for Enterprise Development common standard for results measurement, and the ITC's new approach to impact assessment.

6.26. Although targeted SME projects are often relatively small on the funding side, many of them involve significant numbers of beneficiaries. As a consequence, the use of quantitative impact assessments is in theory possible and is increasingly applied in targeted SME projects.

6.27. Quantitative, research-based impact assessments – such as those based on random control trials or quasi-experimental approaches – need to be integrated into projects from the design phase. In order to be applicable, baselines need to be established and expected results need to be defined clearly and from the start of the project.

6.28. The cost factor of such impact assessments is significant (Cadot and de Melo, 2014) and effective application of such assessments requires support from donors, implementing agencies and beneficiaries. If well-implemented such assessments could provide very valuable insights into the effectiveness of different aid projects, which may explain the increased use of these approaches in targeted SME assistance.

7 CONCLUSIONS

7.1. Small-and medium-sized enterprises (SMEs), though small in size, are large in number and represent the overwhelming majority of enterprises in most economies. This report has sought to synthesize key issues facing SMEs in developing countries, and in particular Least-Developed Countries (LDCs). In tandem, the report has attempted to survey the support being offered by a broad array of development actors.

7.2. This report does not claim to be exhaustive, and rather aims at stimulating dialogue on SME competitiveness constraints and how best to address them. In this respect, the report is timely. A message that emanates clearly from the report is that SME development is integral to the vision of inclusive, sustainable growth that is being debated in New York in the context of the post-2015 Development Agenda.

7.3. The evidence surveyed in this report points to the central role that SMEs play in economic growth, job creation, and women's economic empowerment. The expansion of global and regional value chains, together with the expansion of electronic commerce, offers new opportunities for SMEs in developing countries and LDCs to internationalize and to increase their contribution to sustainable development.

7.4. Experience suggests that SMEs offer an important route for economic diversification, the gravitation of SMEs towards the services sector being an important trend in this regard – not least in the context of what has been termed the "servicification" of global and regional value chains. Evidence suggests that SMEs engaged in trade enjoy higher productivity, but only if they are able to survive and thrive. Herein lies the challenge: failure and exit rates for SMEs in trade operations are high.

7.5. The range of constraints that burden SMEs (poor business environment, limited access to finance (including trade finance), poor labour skills, lack of bargaining power, restricted access to market data, high trade costs and difficulty accessing technology) are sometimes amplified when SMEs try to internationalize. This may particularly be the case in developing countries, notably because many SMEs operate in the informal sector there and because of the often higher incidence of fixed costs and market failures relevant for trade.

7.6. In 23 LDCs surveyed for the purpose of this report, the quality of the business environment ranked as the most pressing concern for SMEs, with access to finance close behind. Availability of institutional support – notably to enter new markets or to defend SME interests – also ranks highly among the SME-specific challenges.

7.7. The economic crisis has prompted a resurgence of interest in private sector development support aimed at the SME sector – both in developed and developing economies. Bridging the financing gap faced by SMEs has attracted a high level of attention, notably in the context of the G20's work on financial inclusion. It has also stirred renewed interest in the work of a broad array of development finance institutions and their work.

7.8. Important to note here is that the work of development partners aims not at trying to fill the financing gaps faced by SMEs themselves, but instead at seeking to address the market failures that give rise to this situation. Public-private partnerships are an integral part of many of the approaches taken. Furthermore, commercial financial institutions are looking at new business approaches (such as base of the pyramid models, and electronic payment systems) that can seek to un-tap economic value. South-South partners are also entering this area with their own approaches and institutions.

7.9. Support to SME development and internationalization is a dynamic area, but it is also an area characterized by a number of inherent pitfalls for development agencies. Support to SME development by definition involves working with a relatively large number of small beneficiaries. The danger for agencies is that their programmes become too diffuse to have appreciable, measurable impact. A second phenomenon highlighted in this report is that the trade dimension to SME development programmes is often not adequately captured, at a programming, implementation or evaluation stage. The prevalence of value chains and the trade exposure of SMEs is growing; in this context, better perhaps that internationalization happens by design, not default.

7.10. Lastly, the study highlights that the constraints of SMEs, particularly related to internationalization, remain a pressing concern. The potential which SMEs offer in the context of inclusive, sustainable growth underlines that support for private sector development, with a specific focus on SMEs in LDCs, needs to continue. Furthermore, evaluations conducted to date of SME development suggest that these programmes have measurable and beneficial impacts for SMEs in developing countries.

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