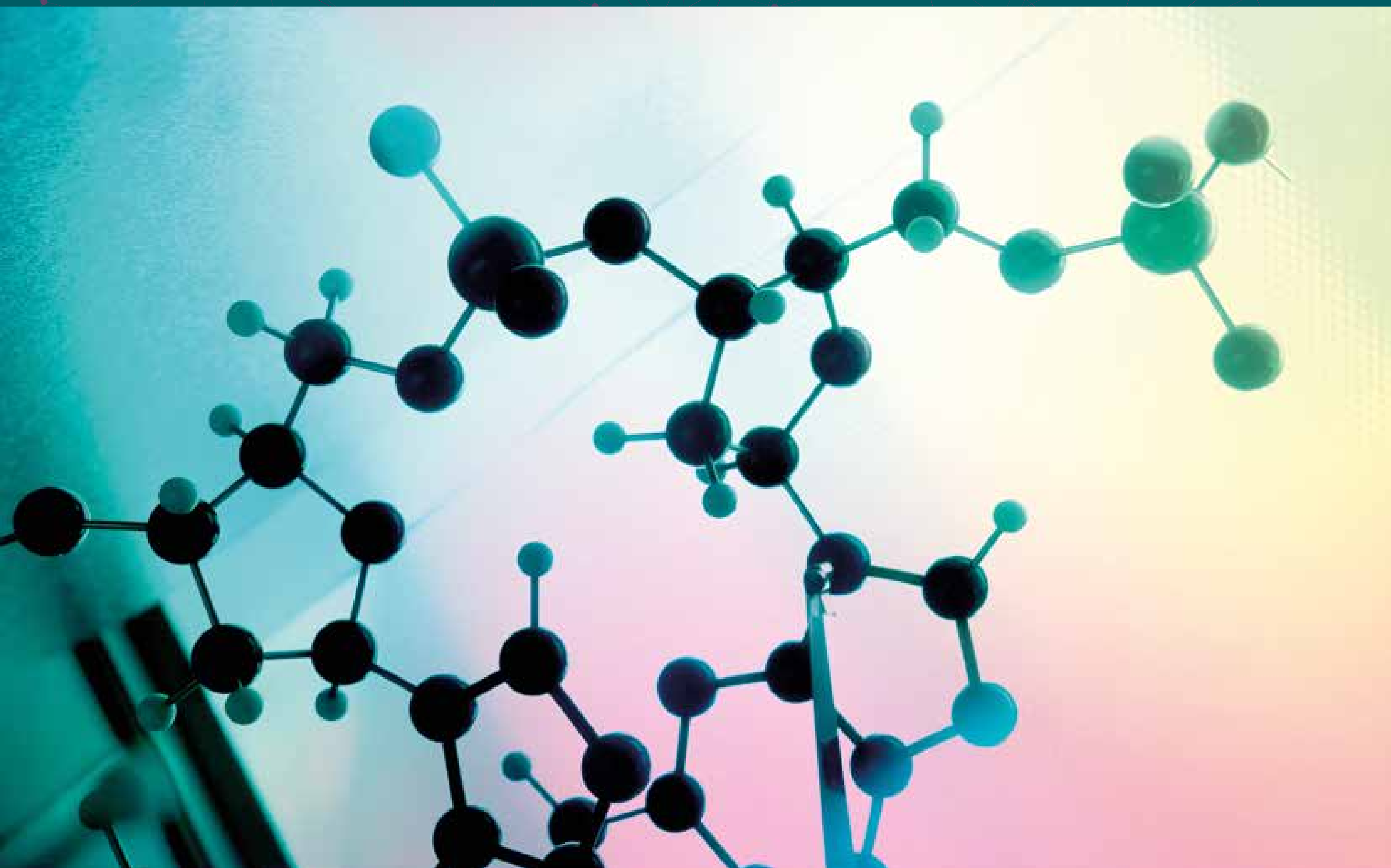
SME COMPETITIVENESS OUTLOOK 2015

Executive Summary

Connect, compete and change for inclusive growth



International Trade Centre

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Printed by ITC Digital Printing Service.

A free pdf is available on ITC's website at: www.intracen.org/publications.

Executive Summary

Connect, compete and change for inclusive growth

Contents

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SMEs are the missing link to inclusive growth. SMEs account for approximately 60-70% of total employment. The wages paid by SMEs are significantly lower than those paid by large firms. This is largely because their productivity lags behind large firm productivity. Addressing the 'productivity gap' is crucial for inclusive growth. This report argues that to increase productivity, firms must connect, compete and change.

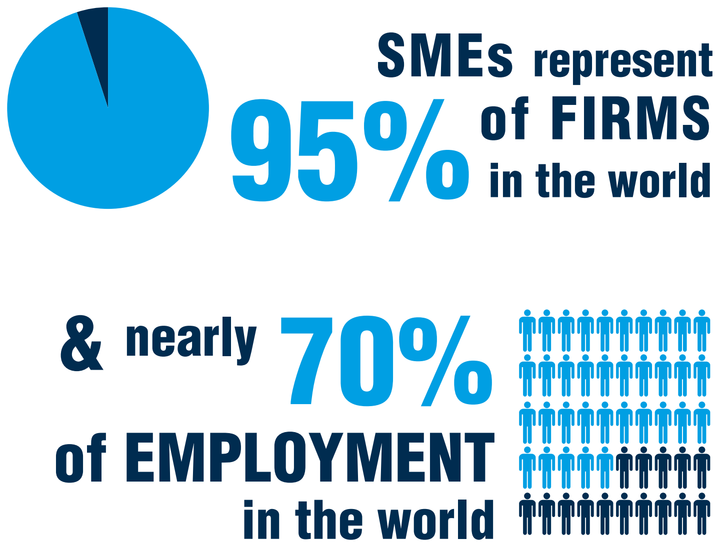
Part I. SMEs and global markets: The missing link for inclusive growth

1. Understanding SMEs

SMEs contribute significantly to employment, GDP and exports

SMEs constitute the overwhelming majority of firms. Globally, SMEs make up over 95% of all firms, account for approximately 50% of GDP and 60%–70% of total employment, when both formal and informal SMEs are taken into account. This amounts to between 420 million and 510 million SMEs, 310 million of which are in emerging markets.

INFOGRAPHIC SMEs are the backbone of the global economy.



Many shapes and sizes

The term 'SME' encompasses a broad range of definitions, which differ according to factors such as country, geographic region, level of development and business culture. Even within countries, definitions may vary or be non-existent. In addition, the definition itself is often linked to national support programmes and other regulations, making the adoption of a single definition difficult.

Firm size and the structural make-up of economies

The importance of the SME sector has changed over time, reflecting the impact of technological change, changing market conditions and rising standards of living.

Before the industrial revolution, production was dominated by what today we might call SMEs. Small workshops and self-employed farmers employed few people and produced bespoke specifications. As the industrial revolution picked up steam, firm sizes began to increase steadily. For example, the median number of workers in cotton firms in Manchester, England more than tripled between 1815 and 1841. This increase was linked to the integration and emergence of national markets, which functioned as important sources of demand, encouraging production of large volumes of goods. Technological innovation and mechanization contributed to radical changes in modes of production. The advent of factories often required high levels of fixed investment, forcing firms to expand to benefit from economies of scale. This reorganization of production, alongside the expansion of firm sizes, grew apace well into the 20^{th} century.

Since the 1970s, the trend has been changing. Increased concentration of employment and value added in large firms reversed in a number of OECD countries, and SMEs began to be viewed as sources of nimble innovation and job creation. Partly fuelled by a desire to outsource non-core competencies, the trend allowed firms to focus on their core competencies – resulting in horizontal (cluster) and vertical (value chain) production systems.

While the historical experience is interesting, it may also be of relevance for the near future. With increased market integration and expansion in recent decades, conditions may once again be in favour of large firms. On the other hand, factors like information and communications technology (ICT) create an environment that may be conducive for the re-emergence of SMEs. The spread of ICTs has led to the phenomenon of 'born globals': SMEs which, from day one of operations, sell or intend to sell to a global client base via e-platforms, blurring the traditional picture of the internationalization process.

2. Why the 'middle' matters

It is hard to grow up

The overwhelming majority of SMEs in the developing world are micro enterprises with fewer than ten employees. In many economies, the private sector is split into two segments: small – often micro – enterprises on the one hand, and a few very large enterprises on the other hand. This phenomenon is called the 'missing middle'. Among the explanations for the 'missing middle' is the central tenet that small firms have few incentives to growth, because they are adversely affected by taxes and access to finance policies once they are medium-sized.

A balanced firm size distribution stimulates competition

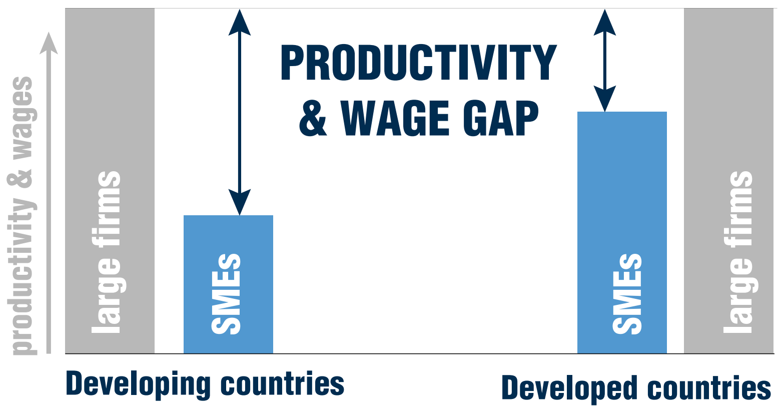
Domination by a few large players with significant market power tends to make economies less dynamic, in particular if small firms are too small to challenge the big players in the market and when lobbying for policy reforms. A balanced firm size distribution instead, stimulates competition within the economy and puts more firms in a position to also compete internationally.

3. SMEs, the missing link for inclusive growth

SMEs tend to be less productive than large firms…

It is well known from the trade literature – both theoretical and empirical – that larger firms are more productive, more likely to export and pay higher wages. What is less well known is that the productivity gap between small and large firms tends to be much more pronounced in developing countries than in industrialized countries. In Germany, productivity of small firms is some 70% that of large firms. In Argentina, by contrast, the productivity of small firms is less than 40% that of large firms; in Brazil, the figure is below 30% (OECD-ECLAC, 2013). In some countries, the productivity gap between small and large companies is even greater: in India, for instance, enterprises with more than 200 employees have been found to be ten times more productive than enterprises with five to 49 employees.

INFOGRAPHIC The productivity and wage gap between small and large firms in developing countries is twice that of developed countries.



…and as a result pay lower wages

SMEs account for a considerable share of total employment. They employ an even larger share of the most vulnerable sections of the workforce, namely less experienced and less educated workers belonging to poorer households. Due to their lower productivity, SMEs also tend to pay lower wages. This is partly a reflection of the sectors SMEs tend to operate in: low value-added, labour intensive, low productivity sectors.

Significant inclusive growth opportunities are possible if the productivity gap can be closed …

Closing the productivity gap between SMEs and larger firms in developing countries is likely to have two direct effects: it would contribute to GDP growth, because of increased SME productivity; and lead to higher wages in the low-wage segment of the economy, with positive and equitable distributional effects.

This latter effect points to the inclusiveness of the growth potential generated by the rise in SME productivity. Those effects are likely to go beyond the immediate income effect on poor households. Higher wages for female employees are likely to have knock-on effects on the wider economy, as women in developing countries are known to have a higher propensity than men to invest in their families and in the community at large, leading to a positive impact for the country as a whole.

… for example via internationalization, as international firms are more productive

It has long been clear that internationally active firms tend to pay higher wages, employ more people and have higher productivity levels. Only the most productive and large firms are able to internationalize, as they are the firms able to afford the costs involved, such as fixed costs related to regulatory compliance or to identifying profitable markets and reliable partners. At the same time, internationalization can increase competitiveness through learning by doing and exposure to increased quality standards, superior technology and superior competition. There are significant gains to be made from internationalization – once firms have the capacity to do so.

4. Being part of international value chains

Stepping stones to internationalization

The potential advantages for SMEs to participate in international value chains (IVCs) are numerous, with some authors writing of a 'laundry list of benefits'. On the macro level, there are opportunities to create jobs, increase income, improve working conditions and diversify production and exports. On the micro level, IVCs can help increase access to finance, shorten lead times, reduce operational disruptions, cut inventory, improve quality and customer service, speed innovation and reduce risk.

SME chances to begin exporting increase when they participate in both local and international production chains. A study on Italian firms found that the probability of exporting for firms employing 1–9, 10–49 and 50–249 persons, increased by 98%, 34% and 34%, respectively, if they were part of a supply chain. This suggests that especially small firms can benefit from the reduced costs of entry and economies of scales by engaging in IVCs.

Importing intermediates also contributes to productivity increases

Furthermore, firms already exporting can benefit from engaging in IVCs, as the access to superior imported intermediate inputs can upgrade the production of outputs and increase the effectiveness of exports. It has, for instance, been shown that the effect of exports on the productivity and profitability of Tunisian firms was magnified if the firms also imported intermediates. This finding is in line with growing empirical firm level evidence: importing intermediates increases the quality and quantity of exports, and therefore magnifies its effect on productivity. Indeed, such imported inputs can be a strong channel for technology diffusion and particularly stimulate product and process innovation. The global lead firms of the chain have an incentive to improve their supplier products and processes.

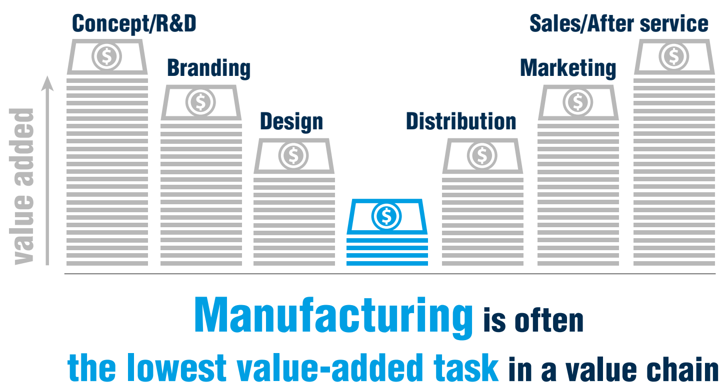
Engaging with IVCs does not guarantee increased economic performance

Engaging with IVCs is by no means a guarantee for increased economic performance. The extent to which firms can reap these benefits will largely depend on their position within the value chain and their potential to move up the value chain. It is conceivable that firms can get stuck in the low value-added activities of the production chain, such as basic assembly activities or the extraction of resources, capturing only a limited fraction of the chains' rents and profits. SMEs in developing countries naturally enter IVCs via such activities. While this can lead to initial static gains in areas such as employment and productivity, it may hinder dynamic gains if firms are unable to move into higher-value added activities. This can be caused by power asymmetries between the chain's global buyers and local suppliers and incentives for the former to maintain the status quo. In other words, global lead firms may obstruct their suppliers from functional upgrading if this interferes with the lead firms' core activities such as marketing, R&D or sales.

How SMEs engage in IVCs depends on their competitiveness

As the inability to move up the value chain is largely due to these power asymmetries, the governance structure of the chain plays a key role in local firms' abilities to move up the chain. In the literature, the distinction between four types of governance structures can be found, which increase in their level of power asymmetry: arm's length relationships, networks, quasi-hierarchy and full hierarchy, or vertical integration. Under

INFOGRAPHIC Manufacturing is often the lowest value added task in a value chain. SMEs should beware of getting stuck at the bottom



the first type of structure, the relationship among firms is not strong enough to facilitate technological spillovers. In fully hierarchical structures, lead firms will try to impede suppliers' upgrading. Relational networks and quasi-hierarchical structures have been found to be most conducive for upgrading, although for developing country suppliers it is difficult to enter relational networks, as they often require significant up front investments and high levels of capacity on the side of suppliers.

5. Internationalizing the elegant way: Competitiveness is critical

What determines whether SMEs manage to export directly or indirectly? What determines the governance structure within a value chain? What determines whether they manage to move up the value chain or gain a profitable and interesting position within a value chain, possibly with potential for upgrading?

Much depends on whether they are globally competitive in their chosen business activity. The recipe for successful SME internationalization is therefore likely to boil down to the determinants of SME competitiveness.

Competitiveness is often expressed in relation to selected 'lines of business'…

Defining competitiveness is complex. Dimensions involved include time (punctual or sustainable), scale (optimal firm size), space (e.g. national or international) and scope (focus only on firm level resources or also on capabilities).

This report expresses competitiveness in relation to 'lines of business', takes a dynamic approach and uses a definition that is applicable to firms acting in an international context:

> *Competitiveness is the demonstrated ability to design, produce and commercialize an offer which fully, uniquely and continuously fulfils the needs of targeted market segments, while connecting with and drawing resources from the business environment, and achieving a sustainable return to the resources employed.*

…with smaller firms having a tendency to be active in fewer lines of business

The 'scale' dimension is not explicit in this definition, which is meant to apply to firms of all size. Firms active in a wider portfolio of businesses tend to be larger and firms transiting from small to medium-sized to large have to remain competitive during the entire process if they wish to survive. SMEs have the particularity that they often are only active in one business, especially the smaller firms in the SME category.

In fast moving, global markets, the dynamic aspect of competitiveness is crucial

The term 'continuously' in this definition reflects the use of a dynamic concept of competitiveness (the time dimension). What is sufficient today to achieve adequate returns for the resources employed may not be sufficient tomorrow if the competitive environment changes. Firms operating in a global environment are constantly exposed to change, and adequate returns can only be achieved in a sustained manner if the firm is able to adjust to, or to embrace change.

Being connected is key for being competitive today

External factors change very rapidly. Competitiveness implies adaptation and resilience. Industry phases, breakthrough or disruptive innovations, increased competition, exchange-rate fluctuations and numerous other events require strategies to adapt. Firms that adapt successfully pre-empt change before external events strike, or follow with changes immediately afterwards, so that change is rapid.

Successful firms are directed by strong managers…

The quality of a company's business strategy is a major determinant of its success. The firm's leadership defines the business strategy and is responsible for executing it. A strong strategy leads to the configuration of an offer that allows the firm to position its goods or services successfully in a specific market segment. A successful offer typically consists of the appropriate combination of a number of aspects: quality and product characteristics, quantity, costs, and timeliness of delivery.

… who base their business strategy on up-to-date market intelligence

Firms do not design their business strategy in a void. They design it in the context of the competitive environment they are operating in. A prerequisite for designing a successful business strategy is therefore to be aware of, and familiar with, the competitive forces shaping a firm's environment. Information about consumer trends, compliance requirements, demographics, trade size and flows, trade agreements, preferential status, barriers to trade, or competition intensity, among others, is highly relevant to determine what can be a successful business strategy.

Meeting quality and sustainability standards is becoming a competitive 'must'

The rise of IVCs has been accompanied by a proliferation of mandatory/regulatory, voluntary and firm-specific standards. Investing in operations that comply with these standards – many of which are private standards – is no longer just an option; it is a major determinant of firms' competitiveness. The successful certification of products and services may facilitate firms' access to finance and new markets, as well as promote higher quality products and services in a sustainable way.

Access to finance determines daily operational efficiency and the ability to make investments for the future

Financing is essential for the implementation of business strategies and is an essential part of operating any business. Different stages of the business life cycle have varying needs for cash, with the start-up, growth and transition stages being particularly important. A firm's ability to grow and strengthen its competitiveness depends highly on its potential to invest in new ventures, innovation, improvements and diversification over time. All of these investments need short- and long-term capital; therefore, access to finance – including for female entrepreneurs – is a central issue. The implementation of transparent financial planning and record-keeping on budgets, purchases, sales, assets and liabilities in combination with a comprehensive business plan does not only promote firms' access to finance but also their potential to integrate into export markets and strengthen their competitiveness.

Access to talent is required at all levels of operations

Skilled employees are not only more likely to deliver high quality inputs into the production process; they are also more likely to be flexible enough to adjust, triggered by changes in the market environment. Access to skilled labour has been shown to increase SMEs' technical efficiency, their capacity to absorb foreign technologies, and enter into more knowledge-intensive activities. Access to skills – including soft skills – increases capabilities to communicate with clients abroad and makes it easier to meet international standards. SMEs that remain below a certain threshold level in terms of their employees' skills are therefore more likely to end up in the low value-added segment of IVCs.

Access to inputs and customers abroad matters for competitiveness...

While firms can do much to improve their competitive position, certain factors remain outside of their control. One major factor affecting firms' ability to access customers abroad is their market access as determined by their home country's or destination country's trade policy. Firms engaged in IVCs are particularly susceptible to the costs imposed by trade policy, as they may be taxed twice if they both import intermediate goods and subsequently export them again after processing. As tariffs have fallen over the last three decades, non-tariff measures (NTMs) are now widely seen to be an equal or bigger impediment to trade than tariffs. Research by OECD indicates that NTM-related costs add up to an average of 15% of total production costs.

… and is notably determined by trade policy and logistics

Serving customers can be a costly undertaking, and depends on the availability and quality of transport infrastructure as well as on the presence of relevant logistics service providers. In particular for time-sensitive products – like perishable goods – logistical aspects are crucial for competitiveness. Increasingly, SMEs follow the examples given by large counterparts and apply sophisticated supply side management and strategic logistic approaches. Yet, as much as SMEs are willing to do so, they will always be subject to their immediate and macro environment, including the nature and quality of processes imposed by border authorities.

Innovative firms are more productive and more likely to export

Innovative firms tend to experience higher levels of productivity and economic growth and are more likely to export – and do this successfully. At the firm level, innovation implies undertaking a series of concrete activities that may improve their innovative capabilities, such as R&D, patenting, spin-offs, incremental innovations, niche market segmentation, standardization, quality up-grading, differentiation, lean manufacturing (the elimination of waste), corporate re-engineering (downsizing, rightsizing, outsourcing, and offshoring). In this context, marketing research and product R&D are critical.

6. Addressing the challenges of internationalization

SMEs face challenges directly related to their size. Many of these challenges are amplified when set in a global context, and as a result, contribute to SME low survival rates. Although these rates vary widely between countries and sectors, studies suggest that around 20% of new firms go out of business after their first year, rising to just over 50% after five years. High failure rates are not in and of themselves a problem. The extent to which market failures cause SMEs to go out of business, when they might have otherwise grown to become export champions, is a cause for concern.

SMEs struggle to gain access to information on export opportunities…

In a recent monitoring survey carried out by ITC for the Fifth Global Review of Aid for Trade, 'access to information about export opportunities' was ranked first out of nine areas in which SMEs would value improvement: 64% of the surveyed SMEs mentioned this factor as one of their top three priorities, while for large firms the figure was 44%. Inadequate provision of business information by public or private associations is a well-recognized market failure, which increases costs and barriers to entry for SMEs.

…adding to other challenges to meet mandatory and voluntary standards…

The need to meet voluntary or mandatory standards and other regulatory requirements affects SME operations at all stages of production and delivery:

- Information: SMEs need to become informed on the details of the requirements.
- Implementation: SMEs may need to adapt products and processes to comply with these requirements.

- Certification: SMEs are required to demonstrate compliance, which typically entails certification of products or processes by recognized bodies.
- Recognition: The final step necessary for exporting SMEs is the recognition of the certificate by customs authorities at home and abroad.

Recent business surveys on NTMs undertaken by ITC reveal that compliance with technical regulations and standards, be it at the implementation or at the demonstration stage, are considered as the dominant problem, especially for smaller firms. On average, 49% of exporting SMEs in 23 surveyed countries report that their business suffers from at least one NTM. This percentage stands at 42.5% for large firms.

…calling for stakeholders to facilitate SME implementation and verification of standards

Various stakeholders play an important role in disseminating information on standards and NTMs, e.g. through the creation of global or national data platforms by international organizations or national trade and investment support institutions; in building capacity to conform to requirements (e.g. training institutes); and in facilitating the verification of standards (e.g. customs authorities). At the national level, government efforts have been oriented towards building quality technical infrastructure in developing countries, including accredited laboratories and certification bodies.

INFOGRAPHIC When asked, SMEs express a strong desire for information about export opportunities.

SMEs still suffer from a lack of funding for working capital and investment needs…

SMEs consistently cite lack of access to finance as a severe constraint. Often, the costs and risks of serving SMEs are perceived to be too high by banks. Because of information asymmetries and the high costs of gathering adequate information to assess the creditworthiness of typical SME borrowers, banks are usually reluctant to extend them unsecured credit, even at high interest rates. Subsequently, many SMEs with economically viable projects, but inadequate collateral, cannot obtain the most needed financing from traditional lenders. Female entrepreneurs are particularly exposed to this problem as lack of collateral, inadequate financial infrastructure and other barriers involving gender-based social and cultural barriers restrict the potential of women-owned SMEs.

The International Finance Corporation (IFC) reports that top banks serving SMEs in non-OECD countries reach only 20% of formal micro enterprises and SMEs, and just 5% in sub-Saharan Africa. Underscoring the scale of problems with access to finance, the Asian Development Bank (ADB) estimates that there is a global gap of US$ 1.9 trillion between the supply and need for trade finance alone. This gap widens especially at the ‘lower end of the market’, where almost half of SMEs requests for trade finance are estimated to be rejected, compared to only 7% for multinational corporations.

… but private and public initiatives can go a long way in closing the SME financing gap

Credit information systems, as well as movable collateral frameworks and registries, can prove particularly effective to facilitate access to finance for SMEs. Other promising solutions include direct assistance to SMEs to meet the requirements of formal financing. These include educating and training SMEs to prepare effective requests for financing and ensuring they have the relevant information to navigate complex loan application procedures. As commercial banks increasingly recognize the untapped and profitable opportunities the SME segment represents, there could be value in supporting the adoption of international best practices to successfully serve this strategic sector. There is scope to encourage cooperation between banks and providers of business development services. Finally, policymakers have placed increasing attention on enabling SMEs to diversify their funding sources beyond conventional bank credit to the non-financial private sector, including trade credit among firms, or through crowdfunding and investing platforms.

SMEs struggle to attract high quality workers due to inadequate market supply…

National skills policies are a major determinant of access to skills for SMEs. The capacity of SMEs to attract good talent with prior education/training and experience will depend on the ability of both relevant education and vocational education and training systems to provide young people with a comprehensive set of readily applicable, job-relevant skills.

… as well as their own limited ability to train their own employees

Skill mismatches are frequently observed in labour markets in both developed and developing countries. They are likely to affect SMEs disproportionately, which do not have the means (both financial and human resources) to invest in training their own workforce. Policy options to facilitate SMEs’ access to skilled labour include training subsidies and support to employer networks that foster SME participation in training initiatives. Such networks can be horizontal networks – with SMEs jointly purchasing training services – as well as vertical – by taking advantage of buyer-supplier linkages.

Limited skills availability extends to the managerial and entrepreneurial level…

Furthermore, the lack of skills at the managerial level may be at the heart of (small) firm failure. Research suggests that firms in emerging markets tend to have poorer management practices than those in developed economies, and has been found to be a significant explanation for low firm productivity. This lack of managerial skills feeds negatively into entrepreneurial capacities, which are further constrained by socio-cultural factors, such as the fear of failure, especially pronounced for young and women entrepreneurs.

… and can be tackled by fostering a strong entrepreneurial culture

Shaping a strong entrepreneurial culture and fostering entrepreneurial skills hinge upon the quality and quantity of entrepreneurship education and training provided. In this context, it seems essential to start entrepreneurship education at young age, encouraging young people to become entrepreneurs driven by opportunity rather than by necessity. There is evidence that policymakers are indeed devoting more resources to stepping up cooperation with the business community, for example by developing entrepreneurship teaching materials and in providing training, incentives and support to teachers involved in entrepreneurship activities.

Technology adoption and scope for innovation are often weak among SMEs

A shortage of skilled labour has further implications: it can impede investments in technology. The benefits of technology are undisputed, and yet many SMEs are not realizing the full potential technology can bring. Their low level of technology engagement is recognized as a serious barrier to improved competitiveness, and they suffer the consequences in terms of inefficiencies and increased costs. In addition to a shortage of skilled manpower (e.g. of technical skills), four other key bottlenecks have been identified that could explain SMEs reluctance to invest in and adopt technology: the high costs of technology, a low awareness of the benefits of technology, data security and privacy issues, and an inadequate core infrastructure.

Finally, logistics costs relative to sales are significantly higher for SMEs than for large firms…

Studies on firms' logistics costs show that they tend to be significantly higher for SMEs than for large firms. For example, logistics costs in Latin America and the Caribbean (LAC) represent 18% to 35% of the final value of goods, compared to 8% in OECD countries. There is evidence that for SMEs this percentage may be over 40%, mainly as a result of high inventory and warehousing costs.

… and to reduce them, both hard and soft aspects of logistics, matter

For a country's logistics operations to function properly there needs to be a modern and efficient transport infrastructure. According to recent research by McKinsey & Company, US$ 57.3 trillion of investments in infrastructure development is needed by 2030. Besides these hard infrastructure investments, soft aspects of logistics are critical to make best use of the existing infrastructure. For instance, trade facilitation measures can assist in creating the right conditions for SMEs to internationalize by seeking to cut red tape related to trade, such as the cost of clearing goods, documentary costs, and border delays.

7. Small but numerous: Pooling resources, creating linkages

Due to small sizes, SMEs have limited political bargaining power…

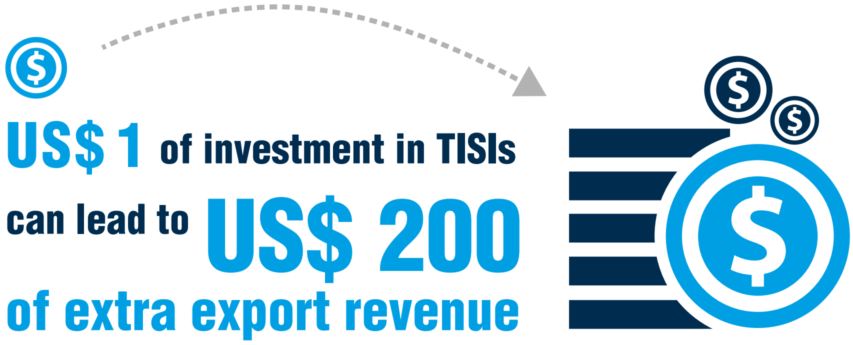
Small firms are at a disadvantage with their limited ability to influence decision-making processes, market outcomes and defend their own interests. Small firms often have less bargaining power than large firms and may therefore only receive a limited portion of the chain's profits. Difficulties of being heard due to their size, extends to policymaking processes, which can end up favouring those with a louder voice. The result is a regulatory environment that systematically disadvantages SMEs.

One way of overcoming small size and isolation is to join forces. Two mechanisms are frequently used: the first consists of institutions that represent SME interests and provide relevant services; the second mechanism facilitates linkages among SMEs through clusters.

…for which they can compensate by working with trade and investment support institutions…

Whether general, sector- or function-specific, trade and investment support institutions (TISIs) cover all aspects of global trade: exporting, importing and investment. Recent economic literature has shown that the impact on trade of TISIs, in particular trade promotion organizations (TPOs), can be significant. According to one study, a US$ 1 increase in TPO budgets can result in an up to US$ 200 increase in exports. Another study showed that assistance directly targeted to individual enterprises is most effective for export generation when targeted to medium-sized firms.

INFOGRAPHIC Investment in trade and investment support institutions can generate export revenue.



…or by forming clusters…

Clusters can help SMEs to improve their productivity, innovation and overall competitiveness. What makes clusters potentially beneficial to SME competitiveness are the opportunities of 'collective efficiency', derived from both positive external economies and joint actions. For policymakers, clusters offer the opportunity to better streamline strategic intervention by providing an essential lever for policymakers to design and implement policies to improve SME competitiveness and their upgrading prospects, and help them overcome some of the barriers to internationalization.

…that can facilitate innovation spillovers

To help overcome coordination failures and support collective actions, cluster development policies can help to develop local competitive factors and strengthen linkages. It has been argued in the literature that cluster policies can address, inter alia, skilled labour shortages, facilitate innovation spillovers (dynamic efficiency), contribute to addressing first-mover-externalities (learning by exporting), and facilitate access to high quality business services.

Yet, although numerous successful clusters exist, it is probably the case that unsuccessful attempts to create sustainable clusters are even more numerous. Cluster policies can be conducive to the creation and sustainability of clusters, but they need to be well designed and are not a panacea for all economic development problems.

8. SMEs and global policy initiatives

Creating conditions in which SMEs can perform better in global markets and contribute to inclusive growth depends on action within countries, as well as international policies and measures.

The role of SMEs is increasingly recognized in global policy debates, especially those taking place in the context of the UN Global Goals, as well as the G20 and B20. The World Trade Organization's Trade Facilitation Agreement (TFA) is also of high relevance for SMEs.

The United Nations Global Goals call for a better leveraging of SMEs

The UN Global Goals established this year by UN Member States is notable for its ambitious reach and cross-cutting approach. In contrast to the Millennium Development Goals (MDGs), the post 2015 UN Global Goals make specific mention of micro, small and medium-sized enterprises (MSMEs).

In particular, Goal 8 promotes '…development-oriented policies that support productive activities, decent job creation, entrepreneurship, creativity and innovation, and encourage the formalization and growth of MSMEs, including through access to financial services'. Goal 8 also acknowledges the need to reduce trade-related costs and red tape for exporters by calling for increased Aid for Trade support for developing countries.

UN Global Goal 9, meanwhile, encompasses two other themes that are key to improving SME competitiveness – getting products to the consumer through improved logistics and being forward-looking through innovation. Goal 9 includes a target to 'increase the access of small-scale industrial and other enterprises, in particular in developing countries, to financial services, including affordable credit, and their integration into value chains and markets.'

The agreement adopted by the Third International Conference on Financing for Development (Addis Ababa, July 2015) is part of the UN Global Goals. It sets out principles and policies needed to deliver the UN Global Goals, with the focus on mobilizing resources and looking in depth at MSMEs.

The agreement's opening overview 'A global framework for financing development post-2015' notes that MSMEs, 'which create the vast majority of jobs in many countries, often lack access to finance'. It commits countries to work 'with private actors and development banks' to promote 'appropriate, affordable and stable access to credit to MSMEs, as well as adequate skills development training for all, including youth and entrepreneurs'. To address constraints in obtaining finance, especially for women entrepreneurs, the accord makes concrete suggestions regarding the design of financial regulations.

SMEs and the B20/G20: a spotlight on SMEs and inclusive growth

In its role as G20 president during 2015, Turkey established three overarching themes: Inclusiveness, Implementation, and Investment for Growth. Within these, Turkey views SMEs as a cross-cutting subject, emphasizing in particular the connection between SMEs and ensuring that 'the benefits of growth and prosperity are shared by all segments of the society' (Turkey's G20 Priorities, 2015).

In designating SMEs as a cross-cutting issue, Turkey has given prominence to SMEs in G20 discussions. Moreover, Turkey launched the World SME Forum in May 2015 to drive the contribution of SMEs to global economic growth, trade and employment.

In tandem with the Turkish presidency, the B20 group of G20 business leaders has sought to highlight the role of SMEs in growth and job creation, reflected in the creation of a B20 SME and Entrepreneurship Taskforce. The Taskforce's report pinpoints five barriers to growth faced by SMEs and entrepreneurs and makes five recommendations: access to international markets; access to finance; access to skills and talent; access to innovation ecosystems and the digital economy; and the ability to comply with business regulations.

The WTO Trade Facilitation Agreement helps SMEs

The WTO TFA establishes binding obligations to improve customs procedures, transparency, predictability, efficiency, and cooperation among border regulatory agencies and the private sector. The TFA can contribute to integrating SMEs into global markets. SMEs suffer disproportionately from fixed trade-related costs, because they cannot offset costs as easily as large firms. They also often lack capacity to comply with complex rules, customs and border procedures. Trade facilitation can cut costs and result in smoother, simpler export and import processes.

The WTO Trade Facilitation Agreement can help foster SME participation in public-private dialogue

Public-private dialogue is particularly suited for identifying policy priorities in the area of reducing trade costs and for building consensus on reforms. The TFA's measures for involving private sector representatives in trade policy formulation offer opportunities for organizations representing SMEs to be active in trade facilitation reforms and implementation. National efforts to include SMEs in public-private dialogue mechanisms should be encouraged.

Trade facilitation can help reduce discrimination against SMEs

The TFA contributes to reducing discrimination against SMEs in trade-related procedures, such as customs clearance. The Agreement specifically forbids the use of criteria that may be discriminatory against SMEs, such as the size of a company or quantity of goods shipped. By looking at areas where SMEs currently suffer discrimination, it is possible to use the process of implementing the TFA to improve trading conditions for SMEs.

Part II. SME competitiveness: A pilot assessment

SME competitiveness matters for SME success in export markets, for the competitiveness of their country, for GDP growth and the inclusiveness of this growth.

Understanding how SME competitiveness compares across countries is interesting for multiple reasons:

- SMEs can assess their strategic position within the lines of business for which they compete.
- Foreign investors can identify SMEs that may become useful partners within IVCs.
- Governments and TISIs will be able to identify where action is needed in order to increase SME competitiveness.

This report presents the 'SME Competitiveness Grid' as basis for conducting a pilot statistical assessment of SME competitiveness.

The SME Competitiveness Grid

Based on three competitiveness pillars – to Connect, Compete and Change – the SME Competitiveness Grid makes it easier to spot strengths and weaknesses of enterprises. It determines whether these are from within the firm, the immediate business environment or the macro level national environment. This helps countries understand their trade potential and address what is stopping them.

FIGURE The SME Competitiveness Grid

		Pillars		
		Capacity to Compete	Capacity to Connect	Capacity to Change
Layers	FIRM LEVEL CAPABILITIES			
	IMMEDIATE BUSINESS ENVIRONMENT			
	NATIONAL ENVIRONMENT			

Source: ITC.

Connect, Compete, Change

The three pillars in the SME Competitiveness Grid capture the time-sensitive nature of competitiveness: Connect, Compete, Change. The quick pace of innovation, the rise of IVCs and the dynamic nature of many markets require a high level of adjustability and flexibility from firms, and SMEs in particular. Firms that are competitive today, need to connect effectively to information channels and world markets to sustain their competitiveness, while retaining the capability to adapt to the new market conditions of tomorrow.

The Capacity to Compete refers to the static dimension of competitiveness. It centres on present operations of firms and their efficiency in terms of cost, time, quality and quantity. The Capacity to Change refers to firms' capacity to execute change in response to, or in anticipation of, dynamic market forces. The Capacity to Connect refers to the capacity to gather and exploit business relevant information and knowledge, including information about consumer trends, compliance requirements, demographics, trade size and flows, trade agreements, preferential status, barriers to trade and competition intensity.

On average, high-income economies perform better along all pillars and layers of SME competiveness

A total of 38 indicators from well-known sources are used as proxies for different determinants of competitiveness within each pillar/layer combination, including 17 indicators with data by firm size. These indicators are normalized and transformed into scores comparable across indicators and countries.

The data shows that, as expected, competitiveness scores are correlated with income group. The higher the GDP per capita in US$, the higher the score. A detailed analysis of different determinants of competitiveness is presented in the profiles of 25 countries (Part III). Geographic and development stage groupings are based on data gathered for 111 countries, and suggest that there are significant cross-country differences regarding the composition of the SME Competitiveness Grid.

Least developed countries and landlocked developing countries perform particularly poorly in the connectivity pillar

Least Developed Countries (LDCs) perform particularly poorly in the Capacity to Connect pillar, reflecting low ICT and cluster development scores. The SME Competitiveness Grid reveals that landlocked developing countries (LLDCs) have more than just a physical challenge with roads and ports. They also have a virtual challenge: e-connectivity rates are among the world's lowest.

Small firms systematically perform worse than large firms …

Large firms systematically outperform medium-sized firms, and medium-sized firms systematically outperform small firms. This holds for all income groups and for all regional groupings examined in this report.

… with the size of the gap being significantly larger in poorer economies

The gap between large and small firm performance is lower in high-income countries than in low-income countries. Taking the score of large firms as a baseline, in low income countries, small firms achieve 42% of the baseline, compared to 67% in high-income countries, based on SME Competitiveness Grid data. This suggests that the determinants used in the pilot assessment correlate well with the productivity differences identified and discussed in Part I.

The biggest gap between small and large firms is in connectivity

The gap between SMEs and large firms is most pronounced in the Capacity to Connect pillar. Small firms and medium-sized firms in developed countries score 64% and 86% of the large firm baseline in with regard to Capacity to Connect. In the same pillar, small firms and medium-sized firms in LDCs only score 22% and 54%, respectively. In three world regions – East Asia and the Pacific, sub-Saharan Africa, and South Asia – the gap between small and large firms is biggest in the connectivity pillar.

In LDCs, access to finance drags down small firms' capacity to compete and to change

In the Capacity to Compete pillar small firms in LDCs score 57% of the score attained by large firms, compared to 74% in developed countries. Dragging LDCs' scores down are the low rates of firms with bank accounts (25% for small firms and 40% for medium-sized firms). The low proportion of investment financed by banks also lowers the Capacity to Change of small firms in LDCs.

In South Asia, small firms' Capacity to Compete suffers due to difficulties to meet quality certifications

Large firms' Capacity to Compete in South Asia is comparable to that of large firms in LAC, and in Europe and Central Asia. Yet, small firms in South Asia are behind on the Capacity to Compete of their counterparts in the other two regions, mainly because they score poorly on quality certification.

In LAC, and in Europe and Central Asia, medium-sized firms outperform the median global firm

When taking the 'median global firm' as the benchmark for competitiveness, medium-sized firms are found to outperform the median global firm in LAC, and in Europe and Central Asia. Small firm performance is also relatively strong in these regions.

Small firm capabilities are strong in Europe and Central Asia, LAC, but weak in South Asia and sub-Saharan Africa

When comparing firm level capabilities across regions, the data reveal that small firm performance is relatively strong in LAC, and in Europe and Central Asia. In contrast, in sub-Saharan Africa and South Asia, small firms' capabilities are very weak. In South Asia, the low use of company e-mail addresses and websites by small firms is particularly striking.

SMEs in LAC: A model for entrepreneurship?

SMEs in LAC are strong entrepreneurial performers. When focusing on firm level capabilities, they outpace average performance in other regions. As assessed in this report, this includes East Asia and the Pacific, and the Middle East and North Africa (MENA). In their capacity to change, they also outperform SMEs in Europe and Central Asia.

Yet, when all layers of determinants are taken into account, LAC SME competitiveness is lower than SME competitiveness in Europe and Central Asia across all three pillars of competitiveness. It is on par with competitiveness in MENA, reflecting that firms in LAC have to struggle with a significantly weaker national environment.

The catch-up potential for SMEs is considerable

The analysis suggests that the 'catch-up' potential for SMEs is considerable. If SMEs in developing countries can increase their productivity and therefore competitiveness in relative terms to the level seen in developed countries, the gain from growth, particularly to vulnerable groups SMEs employ, would be significant. The country profiles in this SME Outlook give a first indication of how this can be accomplished.

Featured in 2015 SME Competitiveness Outlook

Country profiles

1. Bangladesh
2. Burkina Faso
3. Cambodia
4. Colombia
5. Côte d'Ivoire
6. Egypt
7. Guinea
8. Indonesia
9. Jamaica
10. Kazakhstan
11. Kenya
12. Madagascar
13. Malawi
14. Mauritius
15. Morocco
16. Paraguay
17. Peru
18. Rwanda
19. Senegal
20. Sri Lanka
21. Tanzania, United Rep.
22. Thailand
23. Trinidad and Tobago
24. Tunisia
25. Uruguay

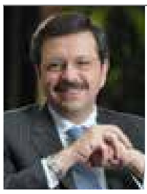
Thought leaders

Axel M. Addy
Why SMEs are the bedrock of the Liberian transformation agenda

Carmen Castillo
In business, David and Goliath should sometimes work together

Victor K. Fung
Risk management and readiness to change within international value chains

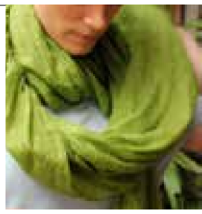
Anabel Gonzalez
Learning to grow: Revitalizing the SME Agenda



Rifat Hisarcıklıoğlu
The World SME Forum and the B20 Agenda

Case studies

First-ever woman coffee exporter in Papua New Guinea secures premium price from major international buyer



Soft to the touch: Cambodian silk producers find new buyers, increase profits

United States safety certificate could quintuple Peru's exports of indigenous food products

Halal certification helps Egyptian dairy group quadruple sales to Malaysia, find new markets

Gaining market intelligence through ITC tools

Benchmarking: Helping TISIs 'AIM' higher

Côte d'Ivoire tackles NTMs with trade obstacles alert

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