Typology of Small and Medium Enterprise Needs and Interventions
## Contents

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I. Introduction and Summary

1. Small and medium enterprises (SMEs) make a substantial contribution to economic activity, job creation and economic growth in all countries. In developed economies, they account for approximately 50–60 percent of gross domestic product (GDP) and 60 percent of jobs. SMEs’ contributions in some developing economies can approximate these numbers, while elsewhere their contribution is more minor. Governments facing a challenge of stimulating job creation, diversification, and other economic goals frequently turn to SME policy and programs to bring about these changes.

2. However, the category of “SMEs” captures a very heterogeneous universe of companies. Not all SMEs have the desire or ability to grow, and they face a range of different market, systems and capabilities failures. They have potentially different policy needs and economic impacts depending on their size, their age and capacity for growth. Most SMEs do not grow significantly after their establishment, and a large proportion actually fail in their first few years of operation. Although most SMEs are not going to be drivers of economic growth, improving their efficiency can have a positive economic benefit because SMEs provide a substantial baseload of economic activity and employment.

3. A much smaller proportion of SMEs can and will grow, but it is very difficult to identify in advance which firms will grow. Given this, it is useful to have a framework for characterizing types of SMEs. This paper presents a typology for categorizing firms and their growth orientations:

   a. New or young firms:
      i. New subsistence micro-businesses, which are unlikely to ever grow
      ii. New, competency-based micro, small, and medium enterprises (MSMEs), whose growth trajectory depends on the capabilities within the business and market conditions
      iii. Start-ups, which are engineered to grow quickly and significantly.

   b. Established MSMEs:
      i. Micro-businesses, which generally have little potential for growth, but this can vary
      ii. Established SMEs, which most likely do not have growth aspirations but may develop them
      iii. Established, growth-focused SMEs, which generally have growth intent and grow through new products and market entry, through mergers and acquisitions, or a combination

4. The ability and likelihood of SMEs growing is affected by their own capabilities (and their ability to add and grow these capabilities); their ability to access and compete in new markets and find customers through supply chains, global value chains (GVCs), government procurement, and other channels; their access to finance to fund operations and investment for growth; and the business environment they operate in. Several types of market and systems failures may constrain enterprise development and growth, including limited competition in an economy; the existence of positive
externalities and spillovers; asymmetric information; uncertainty of returns to innovative and improvement activities (market failures); and limited absorptive capacity, infrastructure failures, and institutional failures (systems failures).

5. Due to their size and lack of scale, SMEs face many challenges to their growth, and governments on occasion choose to intervene to directly support firms. These interventions can be grouped into four broad areas—capabilities, markets, finance, and environment. This paper describes each type of intervention and the relevant needs and types of firms for each intervention. The main interventions are as follows: ¹

<table>
<thead>
<tr>
<th><strong>SME Interventions Mapped to Areas of Need</strong></th>
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<tbody>
<tr>
<td><strong>Capabilities:</strong></td>
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<tr>
<td>• Management and entrepreneurship training</td>
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<td>• Acceleration and investment readiness programs</td>
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<tr>
<td>• Dissemination of information on financing options</td>
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<tr>
<td>• Mentoring</td>
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<tr>
<td>• Incentives for business services and other productivity-enhancing activities</td>
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<tr>
<td>• Research and development (R&amp;D) and innovation support programs</td>
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<td>• Technology extension services</td>
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<td>• Technology transfer programs</td>
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<tr>
<td>• Upgrading and competitiveness programs</td>
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<tr>
<td><strong>Finance:</strong></td>
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<tr>
<td>• Microfinance</td>
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<tr>
<td>• Innovation funds</td>
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<tr>
<td>• Business angels</td>
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<tr>
<td>• Platforms for crowdfunding</td>
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<tr>
<td>• Commercial bank lending</td>
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<tr>
<td>• Investment funds</td>
</tr>
<tr>
<td>• Financial infrastructure</td>
</tr>
<tr>
<td>• Credit guarantee scheme (CGS)</td>
</tr>
<tr>
<td>• Export-Import (EXIM) Bank Support</td>
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<tr>
<td><strong>Markets:</strong></td>
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<tr>
<td>• Market information and research</td>
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<tr>
<td>• Exporter training and “How to” guides</td>
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<tr>
<td>• Support to establish business leads in foreign markets</td>
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<td>• Supplier development programs</td>
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<tr>
<td>• Value chain or export competitiveness initiatives</td>
</tr>
<tr>
<td>• Access to government procurement</td>
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<tr>
<td><strong>Environment/infrastructure:</strong></td>
</tr>
<tr>
<td>• SME support centers</td>
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<tr>
<td>• Business incubators</td>
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<tr>
<td>• Industrial parks, technoparks, etc.</td>
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<tr>
<td>• Cluster and network initiatives</td>
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<tr>
<td>• National quality infrastructure</td>
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</table>

Note: These interventions all take effect at the firm level. There are many additional measures at the business environment level which can also have an impact on SMEs (see paragraph 9).

6. The wide variety of SME challenges, drivers of these challenges and interventions can make it difficult for governments to choose suitable policy tools and in the right combination. Policy makers need to be selective in identifying and targeting the challenges which are most likely to stimulate SME capacity building, to focus scarce public resources and policies on the activities that will have the most impact. This ‘policy mix’ is discussed further in the paper.

7. Many governments instinctively believe in supporting SMEs because they ‘are small and need help’, but this is not a policy approach that is likely to deliver a positive economic outcome. Such an approach may have other political benefits (e.g. if SMEs are a significant political constituency). However, support to SMEs needs to trigger improvement in SME capabilities that is then used by the SME to improve efficiency and growth. Otherwise, the support subsidizes ‘business

¹ As some types of interventions may include aspects of others, some judgment calls were made when categorizing interventions into the four types of needs.
as usual’ and does not bring about changes within the firm, and as such would not be impactful. Therefore, support to SMEs should trigger capability building within beneficiary SMEs, which then leads to improved efficiency and productivity, and hopefully also into growth and a sustained higher level of performance.

8. **Given that most SMEs do not grow, an important additional government focus should be on the dynamics of SME entry and exit.** This means encouraging new firms to enter the market and existing poor performers to exit. Firm exit enables resources (human resources and capital) to be reallocated (through market mechanisms) to better performing businesses. Thus, policy should encourage new firms bringing fresh business models and products to enter the market through entrepreneurship (making business entry as easy and seamless as possible, and entrepreneurship a viable economic and social option), and should enable failing firms to exit the market through effective and non-punitive business closure mechanisms.

9. **In this context, this paper provides a reference for governments and private sector development practitioners when considering how (and whether) to support SMEs.** This paper does not cover each type of challenge or instrument comprehensively or make specific recommendations on instruments that a client government should implement. Rather, it aims to describe the different types of SMEs and their range of needs and to illustrate instruments that have been used around the world to address some of those needs and facilitate enterprise growth. This paper also limits its focus to interventions that provide direct assistance to SMEs; thus, broader business environment issues such as inspections, trade facilitation, tax administration, regulatory reform and others are not covered.
II. The Role of Small and Medium Enterprises in Economic Growth

10. The growth of a country’s economy is at least partially dependent on how well its firms absorb knowledge, developing new products and business models, and upgrading their capacity to compete in domestic and international markets. Indeed, a country’s GDP growth is determined by the aggregate performance of the different types of firms that operate within the economy. Growing business activity increases an economy’s ability to create more jobs and entrepreneurial opportunities, helps build firm and industry specialization, fosters adoption and adaptation of technologies by more firms in an economy (through demonstration effects and knowledge sharing), contributes to building human capital and physical infrastructure, generates public revenue, and increases welfare as a whole. The environment in which the firms operate is fundamental to firms’ growth and therefore to an economy’s growth.

11. Macroeconomic stability is key to a conducive operating environment for private firms. However, a strong macroeconomic framework alone is not necessarily adequate for sustainable and inclusive private sector development. An adequate macroeconomic framework needs to be complemented by a transparent and predictable investment climate. While investment climate is a broad term, the 2005 World Development Report frames it as factors that shape the opportunities and incentives for firms to invest productively, create jobs, and expand. Following this description, empirical evidence suggests that if the conditions (that is, the investment climate) do not provide an environment in which entrepreneurs are motivated to start new businesses and existing firms are motivated to invest and scale up, it is reasonable to expect that the economy will exhibit lower growth.

12. Factors that affect firms’ motivation to invest and grow include the level of economic returns that the firm expects to generate and the extent to which the operating environment is predictable enough for firms to have reasonable certainty regarding the returns they can expect from investing. This operating environment includes aspects such as taxes, inspections, licenses and permits, trade facilitation, and the availability of reliable and affordable infrastructure such as energy, transport, and information and communication technologies (ICTs). Good governance, transparency, and the rule of law are critical foundations of a good business environment. Thus, improving the investment climate by making it more transparent and predictable will improve conditions for growth across firms in the economy. Another key element is the nature and level of competition: firms may not invest if they face steep barriers to entering new markets or to gaining scale or cannot appropriate returns from investments they make (for example, because they cannot protect their intellectual property, cannot retain trained staff, or because the enterprise ‘playing field’ is not even—that is, their competitors benefit from some form of protection or state support).

13. In addition to a favorable investment climate, a specific focus on meeting the needs of SMEs may be warranted. In most countries around the world, SMEs constitute the bulk of the private sector and account for the majority of employment. According to the World Bank survey of 50,000 firms in 104 countries, SMEs provide approximately two-thirds of total employment, with small firms

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contributing more to employment in low-income countries than high-income countries. SMEs represent approximately 50–60 percent of GDP in advanced economies (United States and European Union) and 99 percent of the number of enterprises.

14. **Countries and regions characterized by higher entrepreneurial activity tend to have higher growth rates and job creation, the main pathways through which the poor can escape poverty and join the global middle class.** The evidence from both developed and developing countries indicates that young companies, in particular, contribute significantly to net employment growth and help enhance competitiveness and productivity by introducing new products, developing novel business models, and opening new markets.³

15. **A key feature of a healthy investment climate is that there is a constant entry of new firms, bringing competition and new ideas, and creating new markets.** New research shows that this ‘churning cycle’, in which firms are constantly dying and being recreated amid competition, plays an important role in net job creation attributable to SMEs. The churning process helps reallocate scarce resources toward more efficient firms and sectors, raising overall productivity and speeding up structural transformation.⁴ The effectiveness of this process relies on the ease with which new firms can enter the market and also whether they can efficiently exit, because nearly a third of new SMEs close down in less than two years.⁵ There is also evidence that the labor market can affect entrepreneurship—particularly subsistence entrepreneurship. If formal employment markets are strong and flexible, then they are likely to offer better returns than self-employment, except for people with few skills. Formal employment is likely to be more productive than self-employment.⁶

16. **SMEs also exhibit varied levels of growth.** There is evidence that a quite small number of high-growth firms have a disproportionate impact on productivity and on private sector employment growth. Only 5 to 10 percent of SMEs become high-growth firms, yet these firms appear to create 40 to 45 percent of net job gains.⁷ The formal Organization for Economic Co-operation and Development (OECD) definition of a high-growth firm is one which grows 20 percent per year for three consecutive years, another term used is that of a ‘gazelle’ (which is a high-growth firm that is also less than 5 years old). For most SMEs that do exhibit growth, however, it occurs in bursts rather than in a linear manner and most firms do not actually have multiple growth episodes.

17. **The extraordinary ‘hockey stick’ growth (rapid exponential growth over a period), seen in well-known Silicon Valley start-ups, is, in reality, a rare event especially in small markets.**⁸ These ‘hockey stick’ growth models are also designed to produce high returns for investors when they sell their holdings, and even after rapid growth these companies are often remain unprofitable and potentially unsustainable.

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⁷ Global Entrepreneurship Monitor, five-year study of 800,000 entrepreneurs; analysis of enterprise survey data for 925 firms in Colombia, NESTA research on U.K. firms.
18. **SMEs that do grow have a number of particular features.** These high growth firms are generally young (although not necessarily small). Although some older firms experience growth spurts, younger firms are generally more dynamic. High-growth firms are found in economies of all income ranges, in all major sectors of activity, and geographies – and their share tends to be relatively stable across these dimensions. In many instances, high-growth firms are more productive, innovative, integrated more tightly with global markets, and attract higher-quality workers and managers than low growth peers. However, in some cases, high growth may not reflect a capable company, but may be an outcome of distortions (e.g. corruption) or idiosyncratic demand shocks (e.g. a new regional airport, mine or hospital is opened which suddenly increases supply opportunities for local SMEs).

19. **There are no robust predictors of high firm growth** despite years of research on business plan competitions and socio-economic traits of entrepreneurs and the insights of investors. Firms that have grown in the past generally do not sustain this growth over long periods of time. However, high-growth firms do seem to engage in particular activities more than their low-growth counterparts. Growth firms in general invest in innovation, invest in upgrading management, are involved in exporting and/or indirectly supplying export markets (through supply chains), are involved in networks as this exposes them to new ideas/contacts/opportunities, and have CEOs with employment experience in large companies.⁹

20. **There are various reasons why the large majority of SMEs grow slowly or do not grow at all.** For some SMEs, this is a deliberate strategy in which the owners make a conscious decision that their current size meets their professional and lifestyle needs; that growing larger will entail more competition; or that the costs of being more visible to tax, inspection, and other authorities outweigh the benefits of formalization (can apply both to currently informal or small formalized businesses) and growth. For many other SMEs who want to grow, they could be constrained by a lack of market opportunities, lack of skills to pursue this growth, obstacles that make investing in growth risky, lack of access to finance, or a number of other constraints driven by market failures discussed in the next section. There is also a difference between SMEs and entrepreneurs who actively seek growth (and may establish businesses with the express aim to grow quickly) and those who may only seek growth if the opportunity presents itself.

21. **A wide range of policy instruments are available to strengthen the enterprise development ecosystem, from horizontal measures to targeted policy interventions.** Horizontal measures that help foster competition, facilitate firm entry and exit, and improve the functioning of product and factor markets are extremely important to ease resource reallocation and ensure incentives and market signals are working appropriately. Targeted interventions encompass programs to strengthen firm capabilities and build networks, including accelerators, innovation centers, incubators, and clusters. They also include interventions to support access to markets, including access to GVCs

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and increasing exporters’ capacity and ability to compete in international markets; to offer technology extension services; and to provide financing.

22. While SMEs face a range of challenges, this does not mean that government should try to intervene directly to address them all. Governments need to undertake a process in which they identify the underlying problem(s) and the nature, cost, and impact of the market or systems failure that may be causing them and also the opportunities that policy intervention may open up. Many impediments that SMEs face are caused by their size, which means they cannot draw on all the internal resources that large companies have (lack of information, finance, capability, talent). But governments cannot address this size constraint for every SME; there needs to be an additional rationale. At the same time, SMEs present some advantages for driving economic growth—for instance, they are more nimble than large firms and may be able to change and innovate more quickly. As governments cannot support all SMEs, further clarity is needed on the government’s objectives and how these might be achieved, to prioritize areas for analysis and potential interventions.

23. Once the problem(s) and their root causes are clearly identified, the policy assessment process needs to consider the range of potential interventions available to address them and whether existing interventions can be utilized. If new interventions are desired, the first question will be whether a proposed intervention will actually address the root cause of the problem. The cost of any potential intervention needs to be considered, as well as the likelihood of success (and over what period), what the explicit benefits (economic, societal) are likely to be, and any risks that incentives could be distortionary and may prop up unproductive firms. The complexity of delivery and the risk factors also need to be considered, along with the relationship of a potential intervention to other policy initiatives, because SMEs grow within an ecosystem and policy measures are inevitably interconnected.

24. If a decision is made to develop an intervention, then various design questions need to be worked through. These include the organization/level of government that is best placed to deliver the intervention; the level of demand for the intervention that exists among the target population of enterprises; the estimated scale (that is, in number of beneficiaries and in total cost); and the implementation arrangements (that is, participation of the private sector, level of centralization/decentralization, and so on), having regard for ease and efficiency of delivery. Also important to consider is how complex the intervention would be to deliver and whether there is capacity to deliver it—or how such capacity would be built and sustained—and the proposed intervention’s relationship with existing programs and entities. Clear and measurable key performance indicators should be defined and reporting and data collection requirements established. The intervention should be supported by monitoring and review processes that evaluate its performance on an ongoing basis, generate lessons, and enable such lessons to be applied as the intervention is implemented over time.

25. A critical aspect of success is to ensure that government initiatives do not crowd out the private sector—that on the contrary, they stimulate markets in which the private sector is able to provide solutions to problems where feasible and foster growth and competition in the market of private providers of the desired services. Delivery mechanisms for government-supported initiatives can do
this by facilitating or encouraging access to private sector providers—for instance, matching grants for SMEs to access business development services or training from private providers or credit guarantee schemes to foster increased SME access to finance through commercial banks rather than direct provision of credit through government entities. This principle can be applied across the types of interventions presented in this paper.

26. Lastly, for firm level SME support to be effective, design and delivery need to ensure that SME users are engaged in upgrading and the support is not just subsidizing ‘business as usual’, that their initiatives are ‘teaching SMEs to fish – not just giving them fish’. This applies to all SME support mechanisms, but in particular to instruments that involve direct funding as these tend to have a higher budget cost. It potentially impacts both the type of support (as noted above encouraging innovation, networking, management improvement and linkages to new markets seem to be associated with SME growth) and how it is delivered, as SME support instruments need to be as targeted as possible and able to identify whether clients are effectively upgrading.
III. Typology of Firms and Their Needs

A. SME Definitions and Categorization

27. There are different ways to categorize SMEs. One is the formal legal definition which usually defines SMEs by size (turnover and/or number of employees). Some countries formally break down these categories into subcategories of micro, small, and medium-size firms. Although it is essential for collecting statistics, this definition is not so useful for identifying the particular needs of SMEs because within size and age categories, there are different types of firms.

28. Distinguishing between the different types of SMEs is important for policy makers as these firms can have different needs but also different potential economic impacts that should be recognized when allocating scarce resources. A more informed categorization of MSMEs reflects their capabilities, possible growth trajectories, and their age. Table 1 below presents a way to categorize MSMEs more specifically. While it is nearly impossible to identify a specific firm’s growth potential ex ante, the categorization can be useful conceptually when examining the universe of SMEs in a country and as a starting point for developing further targeting mechanisms.

<table>
<thead>
<tr>
<th>New or Young MSMEs</th>
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<tbody>
<tr>
<td><strong>New subsistence micro-businesses</strong> - Youth, marginalized, unemployed, and/or underemployed individuals who start micro-businesses generally for reasons of self-employment. The businesses are usually low skill, they may be engaged in simple retail activities, and they are likely to stay informal.</td>
<td></td>
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<tr>
<td><strong>Growth trajectory</strong>: Unlikely to ever grow.</td>
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<tr>
<td><strong>New competency-based MSMEs</strong> - The establishment of small businesses by entrepreneurs who have a skillset—a technical trade, profession, or work experience—around which the business is formed. Such enterprises are found in all sectors and generally do not involve a new business model or innovation.</td>
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<tr>
<td><strong>Growth trajectory</strong>: Can potentially grow significantly if they have an entrepreneurial owner and/or right market conditions, although the owner may lack broad skillset to manage this growth.</td>
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<tr>
<td><strong>Start-ups</strong> - New, innovation-based businesses that aim to scale quickly and utilize new technologies and business models to do so.</td>
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<tr>
<td><strong>Growth trajectory</strong>: Start-ups are engineered to grow quickly and significantly. Successful start-ups will be ‘gazelles’.</td>
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<thead>
<tr>
<th>Established MSMEs</th>
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<tr>
<td><strong>Micro-businesses</strong> - Micro-businesses that have been operating for some time and have often remained informal. Also increasingly includes skilled individuals often working from home, either producing and trading products through online platforms (for example, creative businesses) or providing business services (for example, coding, design) sourced through ‘gig’ economy.</td>
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<tr>
<td><strong>Growth trajectory</strong>: Potential for growth varies, some home-based businesses can be scaled, and networked individuals can be aggregated.</td>
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<tr>
<td><strong>Established SMEs</strong> - Existing SMEs older than 3–5 years with some scale, usually mature ‘competency-based MSME’. They are found across the economy in all sectors, and are often family businesses.</td>
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<tr>
<td><strong>Growth trajectory</strong>: Most probably do not have growth aspirations, either because they provide a sufficient lifestyle to their owners or because of limited capabilities and market opportunities. Others will grow</td>
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10 A firm that grows 20 percent per year for 3 consecutive years and is also less than 5 years old, per the OECD definition.
opportunistically but are not actively strategizing for it. However, their interest in growth can change, for example, when there is generational change in family business.

| Established, growth-focused SME - Existing SMEs older than 3–5 years with some scale, with growth aspirations and business model based (at least partially) on new product, business model development, or new market entry. |

*Growth trajectory:* Generally have growth intent and hence they may invest in innovation. Growth can occur organically (for example, through new products/new market entry) or through mergers and acquisitions or a combination.

29. **In relation to ownership, the large majority of SMEs will be family or founder owned.** A subset will have a more diversified ownership (for example, owned by management). Some SMEs (as defined by size or turnover) will be the local arms of multinational enterprises (MNEs) or may be spin-offs or affiliates of local large firms. Typically, SME interventions are directed at SMEs that are family or founder owned, as they are not able to access the financial and nonfinancial resources that larger businesses have.

**B. The SME Ecosystem**

30. **As Table 1 indicates, SMEs can be divided into new and existing businesses, and policy interventions may be different for each.** This is because the potential impediments to SME growth are many and varied—so when trying to identify and classify these, it is sensible to recognize that SME success depends not just on their own talents and activities, but on their business ecosystem. In nature, ecosystems are a biological community of interacting organisms and their physical environment. This is a good analogy for the ecosystem in which SMEs operate, which includes a multitude of specialized, diverse entities that feed off of, support, and interact with one another in support of the businesses that drive economic growth. Figure 1 presents the enterprise ecosystem in terms of four broad areas of policy that most affect businesses (firm capability, markets, finance, and environment) and what specific aspects of these are relevant in various stages of the firm life cycle (new firm/initial growth cycle or developed/established SME).
31. **An SME’s performance is impacted by its own capabilities**, including knowledge and information to increase productivity and ability to compete; its ability to access and compete in new markets and find customers through supply chains, global value chains, government procurement; and other channels; its access to finance to fund operations and investment for growth; and the SME-specific environment they operate in. Several types of market and systems failures may constrain enterprises in these areas, and governments may choose to interven to try to address these failures if they believe they can successfully do so, and if the benefit significantly outweighs the cost.

32. **SME capabilities improvement is especially important and should be a core target of SME interventions, particularly given the difficulty in identifying ‘growth’ potential SMEs.** For firms to grow, or even stay competitive, they need to have a sound set of core capabilities that allow them to compete. Only SMEs that are constantly improving and also adding new capabilities will be able to increase productivity, grow, and retain this growth (rather than just flaring and then dying). Government policies just providing inputs (e.g. cheap loans, machinery) without improving the firm’s ability to use them will often not result in any real change in SME capabilities.
33. Although there is no fixed definition of these capabilities, management tools like Balanced Scorecard typically encompass financial, business process, learning and growth, and customer related capabilities all based on a cogent strategy.\(^\text{11}\) In practice, this means:

a. **People management:** moving from the founding owner or partners controlling every aspect of the business directly to a situation in which tasks are delegated to employees and people have to be managed. This includes issues like delegation, leadership, recruitment and training, compensation, workloads, and job descriptions and roles. As SMEs grow, these become crucial when there are too many people to be managed directly by the founder, when geographically distinct offices are set up, and/or when different product or functional teams are established.

b. **Strategy:** moving from an opportunistic approach of accepting whatever work is available to a focused strategy of targeting and accepting certain specified types of work and client or developing a brand and market position. This point may be repeated when new products are developed, new markets entered, and/or new competition or business models arise.

c. **Formalized systems:** moving from an informal approach to acquiring customers, storing information, controlling expenses, etc. to formalized business systems that ensure consistency and reduce the risks of things going unexpectedly wrong.

d. **New market entry:** either selling to new customers, new geographic areas, or selling new products. This includes understanding new customer needs, adapting or replicating the existing business model to the new market, and scaling up the business.

e. **Obtaining finance:** getting funds to grow. This firstly means financial management and accounting – understanding the basic costs and revenues and managing them. It means moving from reliance on initial funders to outside finance providers, and the pressures and constraints they will place on the firm. This point is repeated at each significant growth spurt.

f. **Operational improvement:** moving from an “if it isn’t broken, don’t fix it” attitude toward understanding and implementing process capabilities and best practices – for instance, in marketing and sales, product development, operations management, distribution, and supplier relations.

What underpins a firm’s ability to maintain, and hopefully build, their capabilities is a concept called absorptive capacity – the firm’s capacity to recognize, acquire, assimilate, transform, and exploit knowledge from both internal and external sources.

34. **Firm capabilities are linked to finance, market and environment.** As indicated above, accessing finance and new markets represent areas of particular capability that SMEs need to work on. From the supply side, SME finance is a typical area of policy activity, and SMEs usually

\(^{11}\) Additional literature on the importance of management capabilities can be found here: [https://worldmanagementsurvey.org/academic-research/manufacturing-2/](https://worldmanagementsurvey.org/academic-research/manufacturing-2/)
rate a lack of finance as one of their main impediments to growth. However, the impediments are usually not just on the supply side, in many cases SMEs fail to raise finance because they cannot provide a coherent business case. On market access, SMEs can struggle to enter new markets because they lack the quality standards or IT systems to interact with larger companies, or even if initially successful in entering new markets they lack the systems to sustain quality and consistency of supply over time, and drop out of these markets. Environment related policy interventions are usually directed at building institutions and initiatives that then provide SMEs with capability building support (e.g. incubators, science and technology parks, quality and standards providers).

**Why do governments need to intervene to support the ecosystem?**

35. **The ecosystem approach indicates that there are many different factors within that can potentially have an impact on SME success.** In policy development, it is important to identify what the issues are and whether there are tools available to government to effectively address these issues and then tailor a response.

36. **Several types of market and systems failures may constrain enterprise development and growth.** Interventions should be designed to help firms overcome the market failures present in a given setting. Without understanding the underlying market failures, any initiative is not likely to resolve the true constraints to SME growth.

37. **Types of market failures that affect the ability of SMEs to grow include the following:**

   a. **Direct violation of perfect competition.** Some firms exert excessive market power or key markets may be missing. In the first instance, dominant firms elevate prices and/or provide services of poor quality but face little competition. In the second instance, weak markets result from lack of demand for specialized skills and information asymmetries between SMEs and service providers on the quality of their services (which makes SMEs unable to judge their quality and unwilling to pay for them).

   b. **Existence of positive externalities and spillovers.** The development of market knowledge, enabling technologies, etc. can have spillovers such that their benefits to a sector or firms across the economy as a whole are greater than the benefits to the firm that may develop them. Examples include basic information on market trends and opportunities, market entry requirements (such as certifications required to be competitive in a certain market or sector), the development of a new organizational process that increases efficiency, etc.

   c. **Asymmetric information.** This type of market failure arises from the inability of one party to monitor the performance of the other party. For instance, financial institutions lack the capacity to know ex ante what the true capabilities of an entrepreneur are or what the market demand for a new product may be, so they may overprice the risk associated with providing a loan, guarantee, or other financial service. Asymmetric information on the capability of a service provider may also lead to underutilization of business services or collaboration for innovation activities. Asymmetric information on the trustworthiness or
capabilities of a partner may result in less-than-optimal cooperation among actors in a value chain or missed opportunities to exploit interactions and co-creation of new products and technologies with other firms.

d. **Uncertainty of returns to innovative and improvement activities.** Firm upgrading requires different forms of innovation—developing new management capabilities, developing and adopting new internal processes, developing new products, exploring new markets, implementing new technologies, etc. The level of returns and the likelihood of success from these activities are often unknown by firm managers and owners, especially if they have not undertaken this type of change before. Therefore, firms may underinvest in upgrading and productivity-enhancing activities. Further, smaller firms have less margin for error should change go wrong.

38. **In addition to market failures, certain system failures may also limit SMEs’ development and growth.** These are related to market failures but involve gaps and weaknesses at the level of the ecosystem rather than at the firm level.

   a. **Limited absorptive capacity.** Firms’ ability to engage in upgrading and implementing good practices is limited due to size, lack of awareness of good practices, lack of experience in innovation, path dependency, and other cognitive biases. For example, the results from the World Management Survey shows that firm managers systematically overestimate their managerial abilities and rarely know how their firm performs relative to peers.\(^\text{12}\)

   b. **Infrastructure failures.** Firms operating in emerging markets often face insufficient infrastructure (human and physical) and limited levels of technology in peers, suppliers, and customers. They may lack research centers, national quality infrastructure (metrology, standards, accreditation); specialized logistics (such as cold chain); and specialist training centers. The underlying depth and breadth of education and skills in the economy may also be low.

   c. **Institutional failures.** There may also be insufficient institutional quality or capacity and poor regulations that distort and constrain firm innovation activities. For example, when the business environment is characterized by a lack of predictability and transparency, firms may perceive that they may not be able to appropriate all/most of the returns to their investment, whether through changing tax codes, increased inspections, bribery or other acts of corruption, etc. This is most relevant in contexts in which the institutional setup or weaknesses encourage capture, rather than facilitation, of returns to private sector growth.

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Table 2 presents in greater detail the nature of the different elements of the enterprise ecosystem and why governments may need to intervene.

Table 2: Enterprise Needs and Constraints within the Ecosystem

<table>
<thead>
<tr>
<th>SME needs</th>
<th>Potential impediments to SMEs fulfilling these needs</th>
</tr>
</thead>
</table>
| **FIRM CAPABILITY** | • Demand side: SMEs lack internal capabilities to build on; lack information on market trends and demand, how to improve, and which new technologies to adopt; find the cost and risk of investment in innovation and productivity too high; face risk of competitors quickly copying improvements and new products; and do not trust provider market of potential expert providers.  
• Supply side: There may be a limited supply in quality and quantity of expert advisers, particularly for new areas and in start-up support. |
| • Management capabilities - strategy, internal systems, HR and skills development, financial management (and ability to raise finance), marketing and branding, etc.  
• Productivity - efficiency of production and support operations  
• New product development - ability to develop and take to market new products |  
| **MARKETS** | • Demand side: SMEs lack information and intelligence on markets, trade logistics, how to interact with multinational companies (MNCs), and how to deal with government procurement.  
• Supply side: There may be weaknesses in government procurement systems that discriminate against SMEs; MNCs and large companies may not be interested in supplier development and/or may take a predatory approach to suppliers. |
| • New market entry - ability to enter new markets and find new customers through supply chains, GVCs, exports, government procurement markets, or new markets using new online business-to-business (B2B) and business-to-consumer (B2C) techniques |  
| **FINANCE** | • Demand side: SMEs lack the skill and knowledge to develop compelling business strategies and effectively seek debt finance or pitch to investors. SMEs’ financial records may also be of a poor quality and not enable financiers to understand the level of risk they would take on when lending to or investing in such firms.  
• Supply side: For debt providers, SMEs may be a less attractive market segment due to size and transaction costs, or there may only be a narrow range of products or only short-term lending available. For equity providers and potential providers, there may be a lack of experience in equity investment and information about potential investees. |
| • Access to debt finance - (loans, supply chain finance, factoring, leasing and so on)  
• Access to equity finance - angel investment, early and late stage venture capital, private equity |  
| **ENVIRONMENT** | • Demand side: SMEs are limited in articulating their knowledge needs and can lack understanding of technical areas like intellectual property. They rarely will initiate clustering or networking as most of the benefits will accrue to others, and many are too small to invest in processing plant and equipment or capabilities like testing, which may not be used regularly.  
• Supply side: Weaknesses and gaps in reliable, affordable accessible transport/ICT/energy/land/ buildings, shared production or R&D facilities. Weaknesses in education and training system. |
| • Infrastructure - hard, the provision of key physical transport, information and communications technologies (ICT), business, and innovation infrastructure  
• Infrastructure - soft, the provision of key support services including innovation, trade, and skills development |
Given the breadth of potential issues faced by SMEs and the market failures that affect them, there are also a wide range of interventions that can address each of the areas of the ecosystem. As noted in paragraph 6, these instruments are all primarily used to support SME development. There are many other areas of intervention (that broadly relate to the business) involving business regulation, competition, infrastructure (ICT, transport, education), taxation, and so on, which are relevant to the SMEs’ business environment but whose main impact is much broader than SME development. Table 3 places many of the instruments used by governments around the world into the four broad areas as discussed above: firm capability, finance, markets, and environment, but is not exhaustive. In practice, there are many overlaps in how these interventions are delivered; for instance, a competitive industry program may provide training and export development and may be housed in an SME center. Thus, the placement of each type of intervention within these four categories is indicative.
Table 3: SME Support Interventions that Address Various Needs

<table>
<thead>
<tr>
<th>FIRM CAPABILITY</th>
<th>FINANCE</th>
<th>MARKETS</th>
<th>ENVIRONMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Support for training</strong></td>
<td><strong>Direct information, advice, and funding support for projects</strong></td>
<td><strong>Equity finance</strong></td>
<td><strong>DEMAND-SIDE POLICIES</strong></td>
</tr>
<tr>
<td>Basic business training (for example, business edge)</td>
<td>Basic business advice (one-stop shops)</td>
<td>Angel investor support</td>
<td>Government procurement for SMEs</td>
</tr>
<tr>
<td>Entrepreneurship training (including pre-entrepreneurship)</td>
<td>Business plan competitions, acceleration programs</td>
<td>Seed co-investment funds</td>
<td>Incentives for SME procurement by private sector</td>
</tr>
<tr>
<td>Tailored courses for firms</td>
<td>Business advisory services</td>
<td>Co-investment funds</td>
<td>Value chain competitiveness initiatives</td>
</tr>
<tr>
<td>Workforce training</td>
<td>Technology extension services</td>
<td>Government venture funds</td>
<td>Industrial parks</td>
</tr>
<tr>
<td>Implanting scientists and engineers in industry</td>
<td>Innovation project grants and subsidies</td>
<td>Export credit</td>
<td>Intellectual property system</td>
</tr>
<tr>
<td>Tax incentives/ subsidies for training/ workforce improvement</td>
<td>Tax incentives for R&amp;D</td>
<td>Tax incentives for young businesses</td>
<td>Science and technology parks</td>
</tr>
<tr>
<td><strong>Support for technology transfer offices</strong></td>
<td><strong>Support infrastructure - hard</strong></td>
<td><strong>Support infrastructure - soft</strong></td>
<td>National quality infrastructure (standards, accreditation)</td>
</tr>
<tr>
<td>Tax incentives/ subsidies for upgrading plant and equipment</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- **FIRM CAPABILITY**: Various business support interventions for improving firm capabilities.
- **FINANCE**: Financial support such as loans, equity, and debt.
- **MARKETS**: Market development and entry support.
- **ENVIRONMENT**: Support for infrastructure and technology transfer.

Note: The table outlines specific interventions that address various needs for small and medium-sized enterprises (SMEs).
The interventions in Table 3 are of different types:

a. *Training and courses.* Support for the development and provision of structured training to SMEs, owner-managers, and their workforce. This training varies widely in length and focus, from short (for example, half day) and covering a specific topic to long (for example, 12 months) and covering a combination of topics. These are often combined with a financial subsidy to encourage uptake of the training. It is a cross-cutting measure, and can often form part of other SME assistance (for example, training for the introduction of new technologies, training for exports). The role of government can be to build both the supply side and demand side of business training market.

b. *Advisory services.* Support for provision of advice to SMEs by external experts. This comes in many different forms and modalities (for example, short diagnosis and recommendations for improvement, to structured three-year business improvement program, individualized mentoring to owner, to ‘whole of enterprise’ benchmarking). The service is often combined with a financial subsidy (for example, a matching grant) to encourage uptake of the advisory services, so the role of government can be to build both the supply side and demand side of advisory service market.

c. *Tax incentives.* Reduction/elimination in taxes to encourage specific activities (for example, R&D, technology upgrading, and exports) or to support SME development generally (for example, lower/no tax for start-ups).

d. *Grants and subsidies.* Financial support through grants, subsidies, and so on to encourage a wide range of capability improvement and market development activities. These vary widely in size (for example, a small voucher to purchase simple business advisory services through to large grants for new plant and equipment) and modality (for example, non-matching, matching, repayable grants).

e. *Debt finance instruments.* Various instruments to reduce the cost and increase the availability of debt finance and access to it. Generally delivered by financial institutions which may or may not be government owned and may or may not have specific mandates to target SMEs.

f. *Equity finance instruments.* Support for the providers of equity finance (for example, angel investors, funds), usually by providing matching investment capital through co-investment funds and venture capital fund instruments.

g. *Collaboration instruments.* Support for bringing SMEs together to collaborate on innovation, skills development, access to markets, or other economic development goals. Various models include working with clusters (geographically concentrated), networks (which need not be geographically concentrated), or collaborative platforms. These collaboration instruments are often combined with other instruments to aggregate groups of SMEs (and other actors) to deliver capability-building support and/or tackle new markets.
h. **SME support infrastructure.** Support for the development and provision of hard and soft infrastructure used directly to support capability development and market access. This comes in many different forms, including support for the infrastructure in which SMEs are physically located (for example, industry parks) or centers relevant to particular activities (for example, exporting, production, industry-specific knowledge). This intersects with advisory services and grants and can include government building and running this infrastructure (for instance, an SME center or export promotion agency) or subsidies to nongovernment providers.

42. **Given the range of potential markets and, in particular systems, failures that may exist, policy makers will need to take a systems approach not only in diagnosis but also in developing solutions.** This may mean that several interventions are needed in what is called a ‘policy mix’. For instance, in improving the export performance of SMEs it may be identified that poor quality of financial statements perpetuates information asymmetries that make them unable to access finance; poor information flows, market analysis skills, and a low level of networking limit their market knowledge; and knowledge of relevant information and communications technologies (ICT); and unavailability of hard and soft infrastructure (e.g. testing facilities or specialized storage) limits their business model. In addition, there may be a raft of business environment issues. Addressing just one or two of these issues alone may not be effective because the SMEs will remain fundamentally constrained by the others. Similarly, policies aimed at stimulating start-ups may typically need to cover finance (at different stages so that firms have access to capital as they grow), mentoring and advisory support, physical space (e.g. in an incubator) and access to potential customers.

43. **Thus, policy makers should take a systems approach in their diagnostic phase and carefully consider the main impediments to having healthy markets.** This means looking at supply issues (for example, impediments to new companies starting or new companies being able to grow); demand issues (how easy local, national, and international markets are to access); the information flows and links that help SMEs access knowledge and build scale (for example, networks); and the infrastructure that supports this. If capability and/or funding is limited, careful sequencing of measures is needed, along with dedicated and planned capacity building within the SME policy and delivery functions (which may be government or external, such as industry associations) to ensure that as the SME ecosystem grows capacity, so does the support structure around it.

44. **Another aspect of SME policy making is to ensure policy mixes are appropriate for the particular governance structures and business culture of a country.** Although it is good to learn from best practice in other countries, it is usually difficult to transplant successful models (for example, Silicon Valley, Shenzhen) as these have evolved organically under unique circumstances, fashionable sectors (for example, biotechnology) which may require many existing elements to succeed, and fashionable instruments (for example, clusters, venture capital) which again have been developed within particular industrial contexts. Again, policies need to fit the local context, assets, business culture, and delivery capacity.
45.** Countries can often place too much focus on physical interventions and funding instruments as the main stimulants to SME growth and avoid SME capability and broader business environment reform.** Although physical infrastructure such as incubators, industry and science parks, and technology centers are tangible and can address market failures, they rarely also address SME capability issues which are often a key binding constraint. Similarly, finance is just fuel for growth—it does not help with SME capability or with SMEs’ market access. Also, business environment reform almost always should be part of the policy mix but often involves taking on vested interests either within government (for example, corruption) or in the private sector (for example, monopolies), and so they are more difficult than direct interventions.

46. **On a final note, taking a systems approach is also important in addressing the particular barriers faced by women entrepreneurs and women-owned/-led SMEs.** Programs that have shown success have utilized combinations of business training with technical assistance, access to grants or finance, and non-cognitive skills training. To help women access markets, initiatives which assist women in crossing over into traditionally male-dominated sectors have been successful by providing information about profits in different sectors, engaging positive male and female role models for young women, providing mentoring, and building the managerial capacity of female entrepreneurs.

47. **Again, business environment issues also need to be in this particular policy mix.** There can be targeted laws and regulations that limit women’s economic rights. Policies that strengthen the rule of law by reducing corruption, such as bribery payments, or those that encourage the formalization of businesses and increased trade benefit all, including women. Policy reforms that specifically target women’s employment and entrepreneurship can also be effective. This includes reforming discriminatory legislation which gives women the opportunity to invest in, start, and manage a business; simplifying business registration procedures; and addressing sexual harassment by officials.
IV. Interventions in Detail

48. There is a broad range of possible interventions to address SME needs in the areas of capabilities, markets, finance, and environment. The most appropriate intervention varies by need and context but can also vary by age of firm.

49. New, young enterprises usually have limited internal capabilities, and their founders may not have experience in establishing and running a business. They can potentially benefit from training to improve their core management skills—mentoring from experienced businesspeople to provide an external perspective on the various challenges the business may face. New firms usually begin serving a particular market that presented the business opportunity around which the founder established the enterprise. They may not have been in business before, so young firms can also benefit from advisory support that helps develop their management capacity and business planning, support market R&D of marketing plans, and improve financial management and other core functions.

50. New enterprises will also need establishment financing. Entrepreneurs usually initially use their own sources of funding, typically from their own savings, friends, and/or family. They may access debt if they have some assets to be used for collateral and have a business model that is easily understood by lending institutions and for which lending institutions’ existing risk assessment models are applicable.

51. Established SMEs and growth-focused SMEs have a range of challenges that in some cases are similar to those of young companies but in some cases are different or reflect the greater level of maturity. The needs at this stage can be improving internal systems to drive productivity, adopting and upgrading technology (for example, ICTs), and developing new products and taking them into new markets. Moreover, at this stage, firms hire more staff with different skills and adapt their production to match standard quality requirements, including investing in equipment, which would require knowledge and finance.

52. Business environment issues affecting firms may also vary by age and size of firm. A new or young formal firm may need to register a business, obtain licenses and other permissions to conduct business, and learn about the various tax and business regulations (for example, employment, environment and so on) that may be relevant to its operations. A more established firm may deal with more onerous tax administration or inspections as it grows (many countries have simplified tax regimes for the smallest companies, and anecdotal evidence suggests that somewhat larger companies face more difficulties with inspections). A firm that exports or imports would need to deal with trading across borders and supply chain/logistics issues; if it opens multiple premises, its needs for plant and equipment may become more complex; and it may need to manage operations in multiple locations potentially with different business environments.

53. That said, there is no clear-cut division of when one intervention may cease to be relevant and another may become more relevant. Some young enterprises may be ‘born global’ to take advantage of a specific business opportunity in a foreign market, for instance. The interventions for fostering MSME growth are presented in the following sections in sequence of interventions that tend
to be more relevant as a firm gets older or grows more. Annex 1 summarizes the types of interventions that tend to be more relevant to each of the six types of MSMEs presented in Table 1.13

A. Instruments to Increase Firm’s Capabilities 14

54. **Management training** is a traditional and common tool that aims to increase an entrepreneur’s ability to manage a business and identify and pursue commercial opportunities. Typical topics in management training include financial management and accounting, general management and operations, marketing, human resource management, personal productivity skills, business planning, and governance. These are the training topics included in the widely used Business Edge training methodology of the International Finance Corporation (IFC), as well as IFC’s SME Toolkit,15 an online training platform that provides SMEs with free online key business management information, interactive tools, and training resources. These types of trainings are applicable to all new companies, although the level of sophistication may differ according to the target market.

55. **Entrepreneurship training** aims both to increase the capacity of entrepreneurs as well as to foster a culture of entrepreneurship in future or potential entrepreneurs. Entrepreneurship training may include idea generation; obtaining of financing and pitching to investors (which may be through investment readiness training); legal and regulatory issues; and approaches to foster creativity, flexibility, and entrepreneurial ingenuity and improvisation, among others. Such training is generally most relevant to start-ups and is a component of acceleration programs, although competency-based SMEs may also benefit.

56. **Business plan competitions** are a widely used tool to find and encourage new entrepreneurs. They typically target new entrepreneurs (which can potentially be subsistence, competency based, or start-ups) in a competition in which the entrepreneur develops a potential business plan which is judged. Plans that are most meritorious are selected for a package of support, which can include both

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13 While the team that developed this paper recognizes that it would be useful to have a World Bank Group example for each type of initiative, cataloguing the initiatives based on current information systems is quite difficult. The paper “How to Make Grants a Better Match for Private Sector Development” catalogues interventions in World Bank Group projects that use matching grants—many of which are used to deliver interventions of the type described in this paper. This is the most comprehensive review of interventions by type that has been conducted (http://documents.worldbank.org/curated/en/693731491973004765/pdf/ACS20984-WP-P155294-PUBLIC.pdf).

14 The level of “managerial capital” (managerial capacity), in addition to quantities of labor and capital, can affect productivity, in turn affecting firm growth. Further, business practices vary widely across countries and across firms within a country. Firms with better practices (especially accounting, marketing, financial planning) tend to perform better.

Sources:

funding and training, mentoring, specialized advice, or a combination of these for a period after the venture is launched.

57. For start-ups, there can be **specialized acceleration and investment readiness programs**.\(^{16}\) Acceleration programs are a relatively new model which aims to test the viability of a business model over an intense, short period (12 weeks or so), by providing groups of entrepreneurs and their teams with mentoring, specialized advice on building of businesses, connections to markets, and potentially a small amount of funding. There is also extensive peer interaction and learning. A related type of program is **investment readiness training**,\(^{17}\) which is aimed at positioning entrepreneurs to be able to access capital by making their venture investible. This training can be included in an acceleration service or can be separate.

58. Another type of support that can be provided to all types of new entrepreneurs is **mentoring**. Mentors are typically experienced entrepreneurs who can help new entrepreneurs define their business model, connect with customers and investors, and generally provide an external perspective against which to bounce ideas and assist with problem solving. Mentoring is also often integrated into other types of support.

59. **Professional advisory/consulting services** also help SMEs improve their performance and tend to be tailored to the specific needs of the business. These services can be holistic, for example, by assessing and benchmarking the performance of the SME and providing assistance to implement change, or they can focus on a particular area such as production, marketing, logistics, HR, or exporting. These services can be offered by government organizations (for example, technology extension services or technology centers); by private business consulting companies, through business incubators; or a mix. Many programs that aim to support SME development attempt to make access to these services easier by providing a matching grant (subsidy) and in some cases by maintaining a register of qualified consultants.

60. To increase access to the **professional advisory/consulting services**, a government may offer a support program to fund a portion of the cost of a business service such as a market study, certification, product or label design, and strategy development, among many others, aiming to **overcome information asymmetries regarding the value of such services**. This support attempts to overcome capacity challenges in SMEs by bringing in external, specialized knowledge to address a specific issue. The support is usually provided by external experts, and access to it is commonly supported through a matching grant (that is where the company ‘matches’ funding from the government, to ensure company buy-in) or a voucher.\(^{18}\) The rationale behind government support to the use of these services is that firms under-utilize them because they are not aware of the benefit that

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\(^{16}\) One resource on accelerator programs is the following: https://www.nesta.org.uk/toolkit/startup-accelerator-programmes-a-practice-guide.

\(^{17}\) One resource on investment readiness programs is the following: http://www.oecd.org/globalrelations/45324336.pdf.

\(^{18}\) A voucher scheme usually involves giving an SME an amount of money up front, which the SME can use to purchase services from a list of prequalified consultants. A matching grant may provide money up front or may partially reimburse expenses that an SME incurs. In any case, the intervention is provided after the SME applies for the program, is screened, and signs an agreement with the entity providing the funding that specifies the requirements for use of the funding.
they can provide until after the service is delivered—and thus are not willing to pay the full cost or find the cost prohibitive—and that SMEs are uncertain about the quality of the providers. Governments can also seek to improve the quality of the supplier market by providing specialist training and then accrediting providers, thus reducing the risk of using these services for SMEs.

61. **Programs to increase firms’ use of such services should aim to foster the use of such services on a commercial basis after the initial period in which the subsidy is provided and should require a matching contribution from the enterprise.** Types of services that have been included in such programs are the following (not exhaustive):

   g. *Market knowledge and planning*: Development of business plan (including plans for expansion or scaling-up), market research, planning and promotion studies, market research skills, market knowledge and information

   h. *Marketing and promotion tools*: Development of brand and corporate identity, product brand and marketing, product catalogue, website, etc.

   i. *New technologies*: Identification and capacity building for the implementation of new technologies and the development and rollout of new products

   j. *Business process improvement*, to help companies improve their business processes and productivity

62. Thus, this type of intervention can address needs related to capabilities and markets. In some cases, an initial diagnostic of firm capability is provided to identify the key constraints and opportunities, and an improvement plan is developed around which services are then provided. This may also involve formal benchmarking in which SMEs’ performance is measured and compared to peers, and improvements target areas of particular weakness.¹⁹

63. **Activities that increase firm capability are not limited to those described above.** They may also include support for R&D and creation of intellectual property and others. To incentivize this type of innovation and productivity improvements, governments may provide cash incentives, interest-reduced loans, matching grants, public guarantees, or tax incentives. Activities that have been the focus of such instruments include design (fashion, furniture, graphic, and industrial design) tax credits; labor-related incentives (for hiring, training, and so on); R&D tax credits; and technological development subsidies for machinery, equipment, and intellectual property. In the implementation of such programs, the following are key: objective and transparent eligibility criteria, time-bound nature of support, and complementary efforts to strengthen firms’ capacity and promote firms carrying out such activities on a market basis in the longer term.²⁰


²⁰ The paper available [here](#) summarizes various instruments available to governments to support innovation in SMEs. The forthcoming innovation flagship from the World Bank Group Trade and Competitiveness Global Practice will also provide more detail.
In some cases, advisory services to improve firm productivity are provided by technology or management extension services from specialized institutions. Examples include the U.S. Manufacturing Extension Partnership, the Japanese Kosetsushi SME network, or Colombia’s National Productivity Center. Such programs typically provide advice to businesses on production technologies and help disseminate novel technologies and know-how along entire value chains or to firms that meet eligibility criteria. They may also conduct a diagnostic of the enterprise to detect weaknesses in other areas related to capabilities and technology such as financial management, human resource management, plant layout, and so on. They provide benchmarking and tailored advice on how to upgrade and can also assist SMEs with the implementation of this advice. They are also the source of information on new technological changes and cutting-edge developments in the relevant industry from around the world and interpreting the implications that these may have for local SMEs (for example, digital manufacturing, 3D printing, and mass customization).21

Technology transfer programs and offices generally refer to the commercialization of technology or the provision of consulting services by public research sector to industry. Such initiatives and offices are established because the commercialization process can be complex and resource intensive, and individual researchers may not have the entrepreneurial drive or skills to take their innovations to market. Research organizations and industry also often have different cultures and timelines, and having an intermediary who understands both assists in the process.22

Furthermore, international experience has shown that it is useful to include a firm-level diagnostic as a first step in an intervention to improve firm capabilities. Managers tend to overstate their capabilities, as well as overestimate their capabilities in some areas and underestimate their capabilities in others.23 A firm-level diagnostic that addresses the principal business functions of leadership and strategy; human resources; marketing, sales and business development; operations/production management and technologies; and financial management (or a similar typology) identifies the bottlenecks that a firm would need to address in one area in order to advance across the board. For instance, a firm’s manager might be particularly focused on implementing a new production process in order to increase sales, but the firm’s financial management also needs improvement to manage the expected volume of new sales. A diagnostic based on a proven methodology can ensure a coherent and informed approach to helping a firm upgrade.24 Such an approach is also relevant in increasing firms’ access to markets (see section B).

21 The following document provides a useful overview of technology extension services:
22 For resources on technology transfer, see https://www.innovationpolicyplatform.org/content/technology-transfer-offices.
Table 4 summarizes the interventions discussed in this section, the potential role for government intervention, and the type/age of firm to which the intervention is usually best suited.

<table>
<thead>
<tr>
<th>Type of Program</th>
<th>Needs It Targets</th>
<th>Potential Role for Government</th>
<th>Typical Age of Firm</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management and entrepreneurship training (for example, IFC’s SME Toolkit)</td>
<td>Management capacity</td>
<td>• Public funding of training may be justified to develop a pool of qualified managers and prepare entrepreneurs to create firms and jobs. Government can also seek to improve quality and breadth of the supply market of training institutions. • Public funding of training may be justified as young companies can lack the resources to afford these services or may not be aware of their value.</td>
<td>New/young firms</td>
</tr>
<tr>
<td>Business plan competitions</td>
<td>Encouraging entrepreneurship; entrepreneurship training</td>
<td>• Support the establishment and subsidize the provision of competitions, especially in regions or institutions where entrepreneurship is weak.</td>
<td>New/young firms</td>
</tr>
<tr>
<td>Acceleration and investment readiness programs</td>
<td>Encouraging entrepreneurship; entrepreneurship training</td>
<td>• Support the establishment and subsidize the provision of these programs which may not have been offered before and which new entrepreneurs may not be able to afford without subsidy.</td>
<td>New/young firms</td>
</tr>
<tr>
<td>Dissemination of information on financing options</td>
<td>Capacity to access financing</td>
<td>• Coordination and co-funding provision of investment readiness training, to prepare firms to establish relationships with sources of debt and equity financing (banks, business angels, venture capitalists, etc.) may be justified.</td>
<td>New/young firms</td>
</tr>
<tr>
<td>Mentoring</td>
<td>Management capacity</td>
<td>• Supporting mentoring programs can be justified as entrepreneurs may not understand the value of mentoring, and the market may not coordinate and effectively match mentors with mentees without assistance.</td>
<td>New/young firms or established SMEs looking to change</td>
</tr>
<tr>
<td>Incentives for business services and other productivity-enhancing activities</td>
<td>Financing access to professional advisory/consulting services (capacity and markets)</td>
<td>• Provide basic information on importance of productivity. • Support the provision of services by providing funding and information (for example, benchmarking). • Accredit suppliers to improve quality to build market for business services and SME capability improvement.</td>
<td>Established SMEs</td>
</tr>
<tr>
<td>R&amp;D and innovation support programs</td>
<td>Innovation capacity</td>
<td>• Provide funding and advisory support to address risks and knowledge gaps in undertaking innovation.</td>
<td>Established SMEs</td>
</tr>
<tr>
<td>Technology or management extension services</td>
<td>Transfer of know-how; access to technology; information on market demand</td>
<td>• Develop and manage technology extension services to fill market gap and knowledge gaps within SMEs.</td>
<td>Established SMEs</td>
</tr>
<tr>
<td>Technology transfer programs</td>
<td>Innovation; access to technology;</td>
<td>• Establish legal/regulatory framework, particularly an effective intellectual property regime.</td>
<td>Established SMEs</td>
</tr>
<tr>
<td>Type of Program</td>
<td>Needs It Targets</td>
<td>Potential Role for Government</td>
<td>Typical Age of Firm</td>
</tr>
<tr>
<td>-----------------</td>
<td>----------------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------------------------------</td>
<td>---------------------</td>
</tr>
<tr>
<td></td>
<td>links between research/universities and businesses</td>
<td>• Support initiatives to overcome coordination failures among companies domestically and with external partners.</td>
<td></td>
</tr>
</tbody>
</table>
B. Instruments to Increase Access to Markets

68. Most new SMEs are focused on servicing their immediate local markets, although a minority are also interested in wider markets (and may be born to cater to such markets). Policies to support building the capabilities of the firm are usually also directly relevant to increasing their market penetration (for example, basic marketing skills). For start-ups, an important component of acceleration and incubation services is to link entrepreneurs with prospective customers, and mentors and angel investors often support this activity. Young SMEs may also benefit from initiatives that link them with domestic supply chains or, in some cases, exports. One specific area of capacity-building support is training/advisory services for online trading and B2B (business-to-business) and B2C (business-to-consumer) commerce, which can open up access to non-local markets to SMEs that provide tradeable products.

69. Many SMEs have difficulty marketing their products or services effectively in international markets—this is partly due to lack of knowledge about marketing channels as well as failure to establish marketing networks. Assistance with marketing and branding can help SMEs create a brand image, tailor their product based on consumer preferences, and achieve competitiveness in existing and new markets. Enterprises may also need assistance with export strategy and planning and information regarding international trade documentation. Fostering use of business services as described in the section on capabilities (section IV A) remains relevant to helping companies access markets, with a focus geared toward international markets. This may include, for instance, developing a new product for a new market, increasing sales of existing products in new markets, and ensuring product quality can be maintained and new markets can be supported in case of large orders from these new orders.

70. Market information and research is critical to firms’ success in exporting and even accessing large markets in their own country. Firms will ultimately need and want to conduct market research that is very specific to the products that they offer and the factors they use (or can use) to differentiate themselves from the competition. However, providing information and research on priority markets and products on a broader scale can be useful and have positive spillovers. Market studies may be

25 There has been some debate in the literature as to why more productive firms export: do exporting firms learn and thereby become more productive and competitive, or is it the case that only the most productive firms end up being those who succeed at exporting? Literature points to the existence of ‘learning by exporting’. Blalock and Gertler (2004) find that Indonesian firms experience a 3 to 5 percent jump in productivity following the initiation of exporting, which does not disappear if the manufacturer stops exporting. The timing of the performance improvement suggests causality and supports the learning by exporting hypothesis. Van Biesebroeck (2003) also finds evidence of learning in nine Sub-Saharan countries where firms increase their productivity after entering export markets and scale economies are shown to be an important channel for productivity growth. Atkin, Khandelval, and Osman (2016) conduct a randomized experiment of small rug manufacturers in Egypt and also find evidence of learning by exporting, whereby exporting improves technical efficiency. Sources:

26 Priority products and markets may include products in which a country or region already has a comparative advantage (has shown some export success)—countries that are nearby, close trade partners, and/or that have a large market of consumers for the
published that give enterprises a basic understanding of the opportunities and trends in priority countries/markets for priority products. Such studies could include different market segments in an industry (for example, high-value, low-volume or high-volume, low-cost); what types of products are in highest demand and what factors (cost, quality) firms usually compete on; what the channels for reaching and competing in those markets are (that is, is the supply chain dominated by national intermediaries, global intermediaries; are there niche markets where firms can sell more directly into the market; etc.); and data on sales and competition (for example, by source market).

71. **Exporter training and ‘How to export’ guides** are also useful for companies as they prepare and explore opportunities. The training or guide can cover the basics of how to export—paperwork required; trade facilitation and logistics firms that can assist (for example, the role of customs brokers, and so on); how to conduct market research and where to get market information; requirements for entering certain major relevant markets (for example, food safety and consumer product standards in a large, nearby market); competitive elements to keep in mind (voluntary standards, certifications, etc.); how and where to find buyers—how the GVC for a certain industry works; and others. This type of intervention combines capability building with the ability to access markets.

72. **Support to establish business leads in foreign markets** is a common service provided by export promotion agencies. This may be through supporting firms to attend trade fairs; organizing and carrying out trade missions—on which companies meet a series of pre-screened, potential buyers tailored to their needs; providing customized contact lists in a certain market; assisting individual companies with a business agenda in a foreign market (again, to meet pre-screened, potential buyers); and similar services. The keys to success in such initiatives are to

   a. *Ensure that the enterprise is prepared* - that they are aware of market trends, competitive landscape, market segments, what buyers are looking for in that market, whether the buyer is a good match for them, and whether there is any need to first upgrade their production before pursuing business leads, and

   b. *Ensure that the enterprise follows up* on leads generated and opportunities identified.

73. Additionally, supporting enterprises to attend trade fairs and missions (again, with adequate preparation) may also be instrumental in helping firms identify technologies, explore the competitive landscape, better understand market demand, and gather other market information so that they can upgrade their products and services. In some cases, helping groups of SMEs to form networks and provide an integrated service offering (where each individual SME may produce a component but may lack the capacity to pull together an integrated package) is a role supported by these types of initiatives.

74. **Many of the interventions discussed typically fall into the scope of work of a dedicated export promotion agency (EPA).** EPAs provide programs and information that has a spillover effect to firms with similar characteristics. Export promotion functions include support with marketing,
image-building (country and/or industry), market research and information dissemination, and exporter support services. Sector upgrading and exporter finance are complementary approaches, implemented by specialized institutions. These activities are described in Figure 2.

Figure 2: Typology of Export Promotion and Development Functions

<table>
<thead>
<tr>
<th>Strategy Development</th>
<th>Sector Upgrading</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Determining the country’s export targets and the suite of service offerings necessary to reach goals)</td>
<td>Should be done through financial institutions</td>
</tr>
<tr>
<td>Linking the service offerings, obtaining buy-in and bringing together companies, associations, and partner organizations</td>
<td>Typically done through complementary programs</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Marketing</th>
<th>Image Building</th>
<th>Market Research and Information Dissemination</th>
<th>Exporter Support Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Helping companies to generate leads that could potentially result in a sale</td>
<td>Promoting the image of the country, or a specific industry, to interest international buyers</td>
<td>Providing information to companies which will help drive decisions on entering and maintaining export markets</td>
<td>Increasing companies capacity to develop and sustain export businesses</td>
</tr>
<tr>
<td>Typical activities include:</td>
<td>Typical activities include:</td>
<td>Typical activities include:</td>
<td>Typical activities include:</td>
</tr>
<tr>
<td>- Trade fairs</td>
<td>- Country-image / country-brand</td>
<td>- Market opportunities and overviews</td>
<td>- General education (e.g. seminars and workshops)</td>
</tr>
<tr>
<td>- Trade missions</td>
<td>- Industry-specific branding (e.g. New Zealand wool, Wines of Chile)</td>
<td>- Information on how to enter a specific market</td>
<td>- “How-to” guides</td>
</tr>
<tr>
<td>- Identification of high-level opportunities</td>
<td>- Direct marketing</td>
<td>- Information on industry-specific standards</td>
<td>- Customized training</td>
</tr>
<tr>
<td>- Customized contact lists</td>
<td>- International trade analysis</td>
<td>- One-on-one consultancy and mentoring</td>
<td>- One-on-one consultancy and mentoring</td>
</tr>
<tr>
<td>- Lead generation</td>
<td>- Highlighting successful experiences</td>
<td>Topics include:</td>
<td>Topics include:</td>
</tr>
<tr>
<td>- Business meeting agendas</td>
<td></td>
<td>- Regulatory compliance</td>
<td>- Technology transfer</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Customs, logistics</td>
<td>- Linkages with global value chains</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Certifications</td>
<td>- Innovation programs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Packaging / labeling</td>
<td>- Upgrading quality, logistics, supply chains, etc. within value chains</td>
</tr>
</tbody>
</table>

Global value chains and industry upgrading

75. When a firm is ready or interested in entering into new markets, initiatives to facilitate enterprise growth should explore opportunities from global value chains (GVCs). Firms no longer just trade products; they work together to make things. GVCs bring together the know-how of lead firms with suppliers of components along all stages of production in multiple companies and locations. Box 1 discusses opportunities and challenges presented by GVCs.

76. Enterprises may enter and compete in GVCs by selling to GVC-linked enterprises in their home market and/or by exporting directly. One clear area of opportunity would be to sell to foreign investors that have established operations in an enterprise’s home country. Many countries are interested in developing more ‘backward linkages’ from these operations to the enterprises in the domestic economy. Supplier development programs are a way to foster such linkages.
Box 1: The Role of GVCs in Enterprise Development

Building stronger linkages with GVCs can support economies at different levels of development and in all sectors (across agriculture, manufacturing, and services) by empowering production with more technology, know-how, and a richer skill set. Integration within GVCs can increase investment, create jobs, provide greater opportunities for domestic suppliers, increase exports, and improve productivity. The question is how to identify and remove binding constraints, including at the policy and regulatory level, industry level, and firm level. This includes diverse elements that range from infrastructure to trade policy, investment incentives to capacity building, and many other areas. Industry-specific interventions are also relevant at the scaling-up and internationalization stage, when firms may shift from exporting indirectly to exporting directly.

With GVC-driven development, countries generate growth and higher value added by process, product, and functional upgrading. These types of upgrading are likely to be achieved by embedding more technology, more know-how, or both, in all stages of production. Specialized production should be seen therefore as an opportunity for countries to develop comparative advantages in particular segments of international value chains and to raise technological sophistication, as was the case of Chinese and Indian exports.

GVCs create specific challenges arising from the high standards of productivity, efficiency, sophistication, and timeliness required to serve the global markets. Improving connectivity to international markets, cost competitiveness, the drivers of domestic and foreign investment, quality of the domestic supply chain, infrastructure, and related services are all important for GVC entry. Meanwhile, expanding and strengthening participation is best achieved by fostering innovation, building capacity (for example, increasing the supply of appropriate types of labor and skills), and maximizing the absorptive capacity of firms. The policies to achieve such objectives are wide-ranging. At the same time, entering and upgrading in GVCs presents risks of becoming more vulnerable to external shocks, especially if the supply chains that a firm or industry is integrated into are not diversified. Further, entering or upgrading in GVCs may require substantial investment, especially if a country is on the periphery of GVCs. At the same time, international markets are ever changing, and opportunities that an economy may invest in pursuing may look quite different several years in the future. Thus, firms and policy makers should remain informed about market trends to course correct and take advantage of opportunities to innovate.


Supplier development programs aim to facilitate increased linkages between domestic SMEs/suppliers and large (often multinational) companies. They aim to increase an SME’s performance and/or capabilities so that it is able to meet a buyer’s supply needs more effectively and reliably. These programs are typically found in contexts in which (a) there is a substantial pool of foreign investors present in the SMEs’ home market, in a manufacturing industry, and at least some of them seek to increase local sourcing and (b) the value chains in which those foreign investors operate are characterized by the original equipment manufacturer (OEM, the final producer) and they have significant power over the value chain—in other words, the value chain is producer driven,27 requiring

27 The understanding of governance in value chains has evolved from a simple ‘producer-driven’ versus ‘supplier-driven’ model to five different types of governance: market-based governance, modular governance, relational governance, captive governance, and hierarchy (integrated firm). Relevant literature includes:
suppliers to produce a product to a buyer’s exact specifications, on time, and to a high degree of quality. Over time, as the relationship with the buyer grows, the supplier may propose/develop innovations; however, the commercial relationship is first established through a rigorous process of supplier qualification. The majority of the examples of supplier development programs cited in the literature are in the automotive sector. Other sectors mentioned include smartphones/computers, office equipment (copiers, and so on), and agricultural packaging equipment. For instance, in automotive and aerospace industries, OEMs such as BMW, Mercedes-Benz, Peugeot, Boeing, and Airbus dictate the specifications that their inputs need to follow down to the strictest detail. Each OEM, or Tier-1 supplier (defined as a direct supplier to an OEM), has a process that firms need to follow to supply key inputs into their production process.

78. **Implementation of a supplier development program** involves understanding buyers’ requirements, transmitting those to SMEs, conducting diagnostic assessments of SMEs’ production and management, recommending improvement plans to SMEs, supporting SMEs to implement the improvement plans, and facilitating business with buyers once the SMEs have reached the standards required by the buyer. These programs usually involve a team of facilitators to liaise with potential buyers and suppliers to participate in the program, to manage the firm-level assessments and support provided, to ‘certify’ to buyers that SMEs have reached the appropriate standards, and to facilitate business between buyers and SMEs. Developing and maintaining a database of suppliers is also useful. The SME improvement processes are usually supported through business advisory services which can be general improvement (for example, acquiring ISO 9000 accreditation) or involve specific training (such as tendering).28

79. **Value chain**29 or industry-specific competitiveness initiatives are beneficial because they can help firms identify and better compete in their end markets. Value chain competitiveness programs typically help firms link into export markets. They help companies understand how the GVC they operate in works and how to best reach and compete in their end markets (selling to regional intermediaries or intermediaries in the final market, finding niche opportunities, and so on). These types of initiatives also examine how enterprises at various stages in the value chain can add more value and what producers should do to better respond to consumer demand. The purpose is to remove constraints to growth and facilitate market linkages so that firms are better positioned to take advantage of opportunities in GVCs. As value chain competitiveness initiatives tend to focus on helping firms reach export markets, supplier development programs have not been included under this heading. In essence, supplier development programs are one type of value chain competitiveness initiative—focused on value chain linkages between firms operating in the same country and linked to global markets.

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80. To make a sustainable impact on the market competitiveness of an industry, value chain or industry-specific initiatives should:

   a. Focus on removing constraints to industries that have already shown a degree of commercial success (‘following winners’ instead of picking them) and

   b. Avoid any approaches that would lead to subsidizing uncompetitive firms.

Any initiative that does not follow this approach risks wasting public funds on uncompetitive sectors. Further, it risks distorting incentives that may lead to an inefficient allocation of capital, leading the private sector to invest in sectors that are less productive and provide lower economic returns.

81. Value chain or export competitiveness programs aim to increase the export competitiveness of SMEs by upgrading production capabilities (for example, quality, standards, efficiency, new product development) to meet demand in export markets. These programs provide firms with market information, identify promising market segments where firms can add value, help firms upgrade their production to better compete, and provide direct assistance with making contacts and finalizing deals in export markets. They may include other export promotion and/or development activities. These programs may also seek to connect SMEs with buyers domestically; however, most of the programs focus on export-driven development to increase economic growth by seizing opportunities in larger or more developed markets. These programs are more commonly found in value chains with buyer-driven governance. In these value chains, products may compete on differentiation—quality, standards, design, and so on—that would stand out in final consumer markets. While there certainly are major global buyers in these value chains, market segments exist that provide more niche opportunities. Examples of niche or more specialized market segments include organic and non-GMO30 food products; ‘fair trade’ food, handicrafts, and textiles; fast-fashion brands; and others. Service sectors such as information technology and tourism also allow for differentiation based on various factors and market segments.

82. Additional interventions, beyond the firm-level activities described above, are likely needed to increase SMEs’ competitiveness in the particular value chains. National quality infrastructure (standards and laboratories) may need to be upgraded and international recognition of certificates issued domestically achieved. Specific regulatory constraints may need to be eased, streamlined, or adjusted (that is, through ‘smart’ regulation). Logistics may need to be improved, including through contractual arrangements with a private provider when appropriate (for example, ensuring cold chain management from the primary producer through to the end market). Attracting and retaining foreign direct investment and strengthening the full investment life cycle (attraction, establishment, retention, links, and regional integration) may be a relevant goal in the sector and economy as a whole. Labor force skills may need to be improved, supply chain and other types of finance may be required, the industry’s innovation ecosystem may need to be strengthened, and many

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30 GMO stands for ‘genetically modified organisms’.
others. Thus, firm-level interventions are a part of the policy mix, but the whole system for industry/value chain competitiveness should be considered.

83. **Activities addressed by programs to fill gaps in the value chain must be informed by prior analysis and consultations:** analysis of opportunities and risks of specialization in different GVCs; understanding of productivity, quality, standards, skills and jobs, and market linkages; and public-private dialogue around these issues and the strategic direction of the industry. Then, recommendations are made at the firm, industry, and policy levels for increasing competitiveness. Such action plans serve as comprehensive road maps for reforms and initiatives to remove constraints to growth and better prepare firms, employees, and entrepreneurs to take advantage of opportunities for growth.

84. **Thus, value chain or export competitiveness initiatives combine elements of multiple types of programs covered in this paper:** firm capability (for example, upgrading production, skills); access to markets (for example, promotion of links into GVCs); finance (for example, supply chain finance); and environment (for example, quality infrastructure, regulations, trade facilitation, and organizational structures that are created to serve the industry). As the goal is to better link enterprises with market opportunities and increase their competitiveness in those markets, these interventions have been included under the ‘access to markets’ heading.

85. **Access to government procurement.** In most countries, the government is a significant and major consumer of goods and services within the domestic economy. However, SMEs face particular challenges in public contracts—a process that involves governments purchasing goods and services from private companies. Often, SMEs face critical challenges to participate and secure public contracts. These include onerous supplier and contractor registration requirements, detailed bid information and documentary requirements, costs of supplying a performance bond or guarantee, and lengthy payment intervals after contract award that require significant interim cash flows and financing costs. Governments also tend to be more risk averse when dealing with SMEs (particularly new SMEs or providers of innovative products), requiring stringent financial or experience requirements that exclude newer and financially weaker SMEs. An efficient public procurement system that provides equal and fair access to opportunities can play a vital role in improving SMEs’ competitiveness and efficiency.

86. **SMEs also face knowledge gaps and may lack the technical know-how to prepare competitive bids, while public procurement officials may lack awareness of the benefits and procedures for including SMEs in public procurement proceedings.** There are various levers to improve SME access to procurement opportunities. Examples of programs to support increased SME participation in public procurement can include measures such as annual set-asides; bid price preferences; and independent small business agencies that provide training, advice, and access to finance on government procurement to SMEs and also provide training and advice to officials who manage the procurement processes within government. Some governments have also explicit policies to purchase locally developed technology and innovations and develop lists of approved technologies for potential use by government organizations.
Table 5 summarizes the interventions discussed in this section.

Table 5: Needs and Types of Programs for Accessing and Competing in Markets

<table>
<thead>
<tr>
<th>Type of Program</th>
<th>Needs It Targets</th>
<th>Potential Role for Government</th>
<th>Typical Age of Firm</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market information and research</td>
<td>• Information and intelligence on markets</td>
<td>• Provide information on priority markets for priority products that benefit a range of firms (spillover).</td>
<td>All</td>
</tr>
<tr>
<td>Exporter training and ‘How to’ guides</td>
<td>• Management capabilities for export</td>
<td>• May provide basic training. • May support associations to provide training. • Provide basic resource for exporters, including information on procedures and paperwork, etc. • Encourage firms to develop more capacity through specialized training programs offered by associations, private providers, etc.</td>
<td>All</td>
</tr>
<tr>
<td>Support to establish business leads in foreign markets</td>
<td>• Marketing networks • Market development</td>
<td>• Support directly or indirectly firms’ contact with international markets through trade fairs, missions, etc. • May support industry associations (which may have better-developed contacts) to carry out these activities or participate jointly with them.</td>
<td>Established SMEs</td>
</tr>
<tr>
<td>Supplier development programs</td>
<td>• Information on customer needs/demand • Capacity to produce to those standards</td>
<td>• Facilitate linkages to overcome coordination failures between large buyers and small suppliers</td>
<td>Established SMEs</td>
</tr>
<tr>
<td>Value chain/export competitiveness initiatives</td>
<td>• Information on customer needs/demand • Building firm-level capacity, access to finance, and environment for firms to compete</td>
<td>• Government has a direct role to provide a sound enabling environment for businesses. • May support industry associations or private sector efforts to get more information on market demand, industry trends, etc. • Provide enabling environment for supply chain finance. • May establish a unit or secretariat to coordinate value chain competitiveness initiatives (overcome coordination failures).</td>
<td>Established SMEs</td>
</tr>
<tr>
<td>Access to government procurement</td>
<td>• Information on market opportunities with government • Capacity to prepare bids • Systems for government to contract with SMEs</td>
<td>• Act directly to make procurement more open and easier for SMEs. • May provide capacity building directly or support an association or private provider to deliver it.</td>
<td>Established SMEs</td>
</tr>
</tbody>
</table>
C. Instruments to Increase Access to Finance

88. Two broad types of financing are relevant to firms along the firm life cycle: debt finance and equity finance. SMEs generally may have issues securing debt finance due to collateral requirements (for example, banks require a high level of collateral relative to the amount of money that is being borrowed and accept only a mortgage in a capital or large city as collateral); tenor of the loan (for example, loans may only be available at a rather short term, say 2–4 years, and this may not be consistent with the expected timing of returns from the investment); the level of interest rates (particularly in situations of macroeconomic instability); and other aspects, including paperwork, application process, lack of project financing, etc.

89. Equity finance comprises more specialized instruments applicable at various stages of the firm life cycle, is a much newer set of instruments, and is far less widely used. It can range from seed capital through to venture capital and then to private equity. Some of these instruments may be lacking in particular emerging markets, either due to underdeveloped legal and regulatory frameworks, a lack of deal flow to interest investors, or a lack of familiarity with this type of investing and the potential risks and time frames involved. When these instruments are available, SMEs may be unfamiliar with them and often do not wish to sell equity, the degree of control they are comfortable giving to an investor, do not know how to package an attractive proposal and sell it, and other issues. Equity finance is predominantly relevant for riskier companies that do not have the assets, established business model, or revenues to gain debt finance.

90. The instruments described in this section include those that provide finance directly to SMEs. However, there is a large agenda on the regulatory and business environment side as well. Many banks do not lend—not because of lack of collateral but because lenders cannot easily access (seize) collateral through the judicial system. Therefore, improving collateral registries, insolvency regimes, and the judicial system are also important approaches for improving enterprise access to finance.

91. Bank debt is the most common source of external finance for SMEs (beyond the own sources of funding addressed in paragraph 40). Banks typically provide at least two forms of debt financing: bank loans and credit lines. A loan is a type of debt provided with the expectation of repayment of the principal with interest according to a determined payment schedule. A credit line, such as an overdraft, gives bank clients access to additional funding at any time, as long as it does not exceed the maximum amount agreed on with the bank, and usually with no interest payment required on the unused portion of the credit line (even if at a fee). Many other types of debt finance also exist, some of which may be provided by specialist finance providers. Distinctions are also made between working capital and longer-term loans. Many governments have designed special policies to increase bank lending to SMEs and mitigate the market failure caused by asymmetric information.

92. Microfinance institutions also offer debt finance, targeted toward the smallest companies. Microfinance institutions use specialized lending methodologies to manage the risk of small, first-time,
and high-risk borrowers (for example, a new enterprise with unproven track record).\textsuperscript{31} These methodologies may involve group approaches to harness social capital to improve repayment rates—for instance, borrowers in a group can take a second loan only if everyone in the group pays back the first loan. They also tend to involve a hands-on approach by the loan officer—for example, visiting borrowers frequently. Many microfinance programs target women entrepreneurs. Microfinance is typically used by low-income entrepreneurs that may not have other sources of seed capital. Loan amounts tend to be very small and may not be sufficient for start-ups who aim to grow.

93. Typical equity interventions often have multiple purposes: to provide finance and associated advice and mentoring to young companies and also to grow the pool of early-stage investors. Instruments for providing such funding to new and young companies include innovation funds of various designs and targeting stages of development (which may be nonprofit or for-profit) support for business angels (which operate on a commercial basis).

94. Innovation funds may be used to provide these types of financing and usually require a matching contribution from the beneficiary. Seed financing is funding attained for research, assessment, and initial development of a product or business concept. One model increasingly being used is seed co-investment schemes that match private sector investors with government funding on a deal-by-deal basis, utilizing the due diligence of the private investor.\textsuperscript{32} Start-up financing is provided for product development and initial marketing to firms that are in the process of formation or that have been in business for a short time but have not yet sold their product commercially.\textsuperscript{33} Venture capital co-investment funds bring together public and private sector investment within a fund structure, run by private fund managers, to support this stage. In some cases where there is little private investment, governments may establish pure public funds, although managed by external professionals.

95. Funding at the start-up stage may also be provided on a commercial basis, through business angels. Government may facilitate the development of business angel networks and linkages between entrepreneurs and interested investors. A business angel is a high-net-worth individual, usually with business experience, who directly invests his/her own time and money in new and growing businesses with the goal of profiting from their long-term growth.\textsuperscript{34} Business angels can invest individually or as part of a syndicate where angels pool their capital to make larger investments. In addition to the financing, business angels are an important source of strategic and operational expertise to the entrepreneur. As angel investors are usually former successful entrepreneurs, their insights and expertise are valuable for an entrepreneur. In this way, business angels provide both funding and capacity development for entrepreneurs.

\textsuperscript{31} There is much literature on microfinance, including the following:


\textsuperscript{33} infoDev. 2008. \textit{Financing Technology Entrepreneurs & SMEs in Developing Countries: Challenges and Opportunities}.

\textsuperscript{34} infoDev. 2014. \textit{Creating Your Own Angel Investor Group: A Guide for Emerging and Frontier Markets}. 
96. **Angel investing is especially crucial at the seed stage.** Funds gathered from friends and family may not be enough to generate sufficient revenues, and banks are usually not willing to lend at this high-risk stage. Private equity firms and venture capitals generally do not invest less than US$1 million. Therefore, angel funds play a significant role in filling this financing gap. In line with this role, business angel networks are being formed to match the entrepreneurs with business angels. National angel associations are also emerging as trade bodies to support the development of angel capital market within the country and to provide a collective voice for angel investors to policy makers.35

97. **Crowdfunding has emerged as an alternative tool to traditional funding tools such as bank loans or angel or venture capital investments for financing SMEs.** Crowdfunding is an Internet-based means for businesses to raise money (typically from about US$1,000 to US$1 million) in the form of donations or investments from multiple individuals, which can be through debt (for example, peer-to-peer lending), equity, and royalty-based models, as well as non-securitized types, such as charitable donations and rewards crowdfunding. So far, the main role of government is to ensure that crowdfunding is possible within its jurisdiction, which means ensuring the right regulatory structures are in place, including electronic payments.

98. **The financial needs of established SMEs can become more complex as they grow, and they may be more likely to have revenues and assets against which to raise debt finance.** Various approaches exist for facilitating access to finance, including facilitating development of and access to credit bureaus so that firms develop credit histories that can mitigate information asymmetries between firms and financial institutions, developing mechanisms for secured transactions (using moveable assets as collateral), fostering the development of the venture capital industry and linkages with venture capital fund, and others.

99. **In relation to debt finance, one tool used by governments is the provision of subsidized public loans to SMEs; however, this approach can be problematic.** Funding for such loans is typically channeled by governments to development banks or through on lending government funds to specialized financial institutions (including commercial banks). However, such instruments tend to create complex issues: they tend to be captured by enterprises with the best access to information on such programs and who may be clients of financial institutions already instead of firms who might present the best-quality business plans or investment projects or those whose access to finance is the most problematic. Subsidized interest rates may create distortions in the financial sector, as they may then reduce margins and rates for savers and they may be implemented by institutions that do not have the most appropriate capabilities to assess credit risk and conduct lending programs (in cases in which lending does not go through commercial banks). Further, such programs do not address the underlying market failures that limit SMEs’ access to finance and thus do not provide long-term solutions. Another rationale for governments to provide funds for banks to onlend to SMEs may be to extend the tenor of loans to enable investments that generate returns over longer terms. This may be a sounder approach than subsidizing interest rates, although governments should still complement this with reforms that

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would lengthen the term of deposits and thus result in a closer match between assets and liabilities for banks to lend for longer terms.

100. **For the reasons described in the preceding paragraph, governments should work to address the underlying market failures that inhibit SMEs’ access to finance.** This may include instituting policies that encourage financial institutions to develop/implement specialized lending methodologies and risk assessment tools for SMEs; addressing SMEs’ lack of collateral by providing credit guarantee facilities and developing secured transactions frameworks (ability to use moveable assets as collateral); addressing SMEs’ lack of credit histories by creating the framework for credit bureaus; and fostering development of new financial instruments such as factoring, leasing, and supply chain finance discussed in paragraph 99.

101. **Governments can also put into place mediation services to which SMEs can refer in case of a loan rejection.** Credit mediators aim to improve the communication and exchange of information between entrepreneurs and loan officers, as well as advising on how to improve business plans.

102. **CGSs are another common instrument and provide third-party credit risk mitigation to lenders with the aim of increasing access to credit for SMEs.** The lender recovers the value of the guarantee, when there is a default by the borrower. Guarantees are generally provided against a fee. CGSs could be public or private; however, public schemes are the most commonly used type in developing countries. In terms of scope, public CGSs could be national, regional, or local. The rationale for this is to extend access to credit for those firms which the commercial bank may have seen as too risky but which have sound business models and also to overcome the constraint that many MSMEs do not have the type or amount of collateral typically required by banks.37

103. **Other types of debt finance include factoring, leasing, and supply chain finance.** As with credit guarantees, these are all generally provided through financial institutions to their clients; however, governments need to ensure the legal and regulatory environment allows for these to occur. **Factoring and invoice discounting** allows businesses to release the funds tied up in unpaid invoices with the help of specialist finance providers. They can sell their accounts receivable to a third party that will collect the outstanding credit (factoring) or advance the money until the business receivables are paid (invoice discounting). **Leasing** provides an alternative to purchasing an asset as a leasing agreement lets the firm pay a rental price for the use of equipment, machinery, or vehicles provided by a third party. Under **supply chain finance**, finance providers use the long-term relationships and history that have developed within existing supply chains (for example, between farmers and processors) as key intelligence when undertaking due diligence rather than just relying on assets and revenue history.

104. **EXIM banks provide different tools necessary for SMEs during their internalization stage.** Export credit insurance, working capital loan guarantees, supply chain finance guarantees,

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finance lease guarantees, and direct loan are examples of tools used by EXIM banks. Exporter SMEs could obtain funding from commercial banks at favorable terms through an export credit insurance program. Commercial and political risks may be covered within these programs.

105. Later-stage equity finance will generally involve later-stage venture capital and potentially private equity if the SME is sufficiently large and has growth prospects. In both cases, the risk profile tends to be lower than with earlier stage finance supporting younger companies, and prospective investees will be more established and have a business record more easily understood by investors. A typical instrument is venture capital co-investment funds, which bring together public and private sector investment within a fund structure run by private fund managers. This model has the advantage of using the public sector funding to ‘crowd in’ private capital, thus increasing the investment pool while also ensuring investment decisions are made by the fund managers on commercial basis and are divorced from government. In some cases where there is little private investment, governments may establish public venture capital funds that only have public money, although these should be managed by external fund management professionals whose investment process and decision making is detached from government.

106. Table 6 summarizes the instruments discussed in this section.

<table>
<thead>
<tr>
<th>Type of Program</th>
<th>Needs It Targets</th>
<th>Potential Role for Government</th>
<th>Typical Age of Firm</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microfinance</td>
<td>Financing</td>
<td>• Establish a sound legal/regulatory framework for microfinance institutions to operate.</td>
<td>New/young firms; loan amounts may not be sufficient for those with growth aspirations.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Innovation funds</td>
<td>Financing and advisory support to investees</td>
<td>• Role of government is to ‘crowd in’ private sector finance where possible through matching funds through sound investment structures and ensure such funds have commercial investment and management focus.</td>
<td>New/young firms or SMEs looking to grow quickly</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business angels</td>
<td>Financing</td>
<td>• Establish legal/regulatory framework under which angels can invest. Help build angel investment community and ‘crowd in’ angel investors through co-investment structures, as angels may not naturally form groups and interact when there is no history of this type of investing.</td>
<td>New/young firms</td>
</tr>
<tr>
<td></td>
<td>Mentoring</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Crowdfunding</td>
<td>Financing</td>
<td>• Ensure appropriate legal/regulatory framework.</td>
<td>New/young firms</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Ensure availability of infrastructure for Internet connectivity, business registration, and payment systems.</td>
<td></td>
</tr>
<tr>
<td>Commercial bank lending</td>
<td>Financing</td>
<td>• Establish a sound legal/regulatory framework for commercial banks to operate.</td>
<td>Established SMEs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Establish mediation services for SMEs in case of loan rejection.</td>
<td></td>
</tr>
<tr>
<td>Type of Program</td>
<td>Needs It Targets</td>
<td>Potential Role for Government</td>
<td>Typical Age of Firm</td>
</tr>
<tr>
<td>--------------------------</td>
<td>------------------</td>
<td>-----------------------------------------------------------------------------------------------</td>
<td>---------------------</td>
</tr>
<tr>
<td>Investment funds</td>
<td>Financing</td>
<td>• Establish legal/regulatory framework and provide capital for co-investment funds.</td>
<td>Established SMEs</td>
</tr>
<tr>
<td>Financial infrastructure</td>
<td>Financing</td>
<td>• Establish legal/regulatory framework for credit bureau, secured transactions, and others.</td>
<td>Established SMEs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Establish legal/regulatory framework for new instruments such as leasing, factoring, and supply chain finance.</td>
<td></td>
</tr>
<tr>
<td>CGS</td>
<td>Access to finance</td>
<td>• Establish legal/regulatory framework.</td>
<td>Established SMEs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• CGSs could be public or private as well as national, regional, or local in scope.</td>
<td></td>
</tr>
<tr>
<td>EXIM bank support</td>
<td>• Market</td>
<td>• Establish legal/regulatory framework.</td>
<td>Established SMEs</td>
</tr>
<tr>
<td></td>
<td>development</td>
<td>• Minimize risk environment for exports</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Financing</td>
<td>• The bank is fully state owned.</td>
<td></td>
</tr>
</tbody>
</table>

D. Instruments to Improve Environment - Hard and Soft Infrastructure

107. The baseline infrastructure that can be used to support new SMEs is a physical or online SME support center that can provide simple services, advice, and connections that are needed by entrepreneurs and SMEs to start and run their business. These centers may offer or at least provide referrals to the training discussed in the sections above, can offer access to key administrative and regulatory information, facilitate obtaining permits and licenses, offer simple market information, and provide information on relevant other programs (for example, financing, training, etc.) that may be useful for the enterprise. For new firms, they can ideally offer a ‘one-stop shop’ that reduces the need for an enterprise to visit various different government offices—if this can be offered online, it would be even more effective. These centers can be run by government run or through industry associations or chambers of commerce and can be effective when combined with other relevant government offices, for example, technical training providers.

108. Establishing business incubators is a common approach to support the development of SMEs, especially to increase firms’ capacity. Well-designed business incubators provide a physical space for businesses to operate, along with mentorship, a network of contacts through the other businesses in the incubator, advice on financing options, assistance with business plans, and other types of support. Incubators may be used to foster technology transfer and strengthen links between research institutions, universities, and the private sector. According to one source, there are 7,000 incubators in the world today compared to 200 in the early 1990s.

109. Incubators can be classified into different types based on their focus. Traditional incubators may have some level of sectoral focus or may support any new business. Technology-based incubators help companies with products, processes, and/or services that are the result of scientific R&D or innovation and represent a high combined value. These incubators support

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biotechnology, informatics, and electronics companies. Mixed incubators provide support to both traditional and technology-based companies. Sectoral incubators support activities in a single area/sector.\textsuperscript{39}

110. Incubators may have ‘for profit’ or ‘not for profit’ status, generally depending on their ownership structure. The government, public universities, and research centers usually create nonprofit incubators. However, when the leading institution is a private company, it tends to establish a profit-seeking incubator in which it receives equity in incubated companies as either full or partial payment for the incubation. Most business incubators set time limits for incubation programs. Firms spent an average of 33 months in incubation programs. However, the range is from 1 to 72 months. Firms that are in sectors which require long R&D cycles usually stay longer in an incubation program.\textsuperscript{40}

111. Business incubators support the development and growth of SMEs by providing a wide range of services. The incubation process has three stages: pre-incubation, incubation, and post-incubation.\textsuperscript{41} Pre-incubation corresponds to the ‘seed’ stage of a firm, while incubation is associated with ‘start-up’, ‘early growth’, and ‘growth’ and post-incubation is targeted toward ‘established’ firms. Pre-incubation includes activities needed to support the potential entrepreneur in developing his/her business idea and business plan to increase the chances of a successful start-up creation. University-based incubators usually engage in pre-incubation activities.

112. As firms develop, they require more complex ‘hard’ and ‘soft’ infrastructure. Manufacturing SMEs need facilities with good-quality infrastructure, and service-based SMEs can also benefit from spatial solutions. SMEs will also need the hard and soft infrastructure that enables them to test and certify their products, as well as a range of other business environment support to facilitate their business. A selection of these needs and interventions is discussed in the following section.

\textit{Spatial solutions - Industrial parks and their variations}

113. Providing high-quality physical infrastructure and reliable utility services is particularly important for manufacturing SMEs to conduct their business, especially in countries where access to industrial land is difficult. Industrial parks are a widely used intervention. If these parks are well designed, constructed, and managed, they offer the potential to provide reliable infrastructure (for example, transport, energy) and shared services (for example, training services) in a concentrated manner to companies with similar needs, allow better spatial planning, and can lead to knowledge spillovers as like-minded companies share information and potentially work together.

114. An industrial park can vary greatly in design; some are ‘vanilla’ (generic) and are aimed at any business looking for land, and others are specialized. Examples include airport-based zones to support air-based activities (fruits and vegetables or cut flower exports for instance), agro-processing, or even simply financial services zones aiming at promoting off-shore activities. The needs

\textsuperscript{39} infoDev. 2014. \textit{Business Incubation Toolkit}.

\textsuperscript{40} The National Business Incubation Association (NBIA).

\textsuperscript{41} European Union Regional Policy. 2010. \textit{The Smart Guide to Innovation-Based Incubators (IBI)}. 
of SMEs should be incorporated into the design and management of parks as these are different from larger companies, so parks can either focus entirely on SMEs (for example, with smaller plot sizes and different services) or incorporate SME needs alongside those of larger companies. Other types of industrial parks include free trade zones and export processing zones, which provide special customs and tax treatment for export and re-export.  

115. **A science park is a variation on an industrial park** and is defined as an organization managed by specialized professionals to promote innovation and competitiveness of its associated businesses and knowledge-based institutions. Science parks facilitate the growth of innovation-based firms through incubation and spin-off processes and provide other value-added services in addition to high-quality space and facilities. They also facilitate the flow of knowledge and technology among universities, R&D institutions, firms, and markets.

116. **Technoparks' focus on technology-intensive development and universities or research institutions are usually an important part of their establishment and operation.** Technoparks have a significant role in supporting firm-level innovation and technology and enhancing the use, adaption, development, and commercialization of new technologies. They benefit from the infrastructure, human capital, and research work in a nearby university or research institution.

117. **After several decades of experience with the implementation of industrial zones around the world, the approach to zones is changing, to an approach that recognizes zones as one part of an overarching strategy for enterprise development and competitiveness.** The approach incorporates utilities and infrastructure as core offerings of industrial parks and also considers logistics, trade, land use and urban planning, skills for the companies operating in the zones, and environmental and social excellence. It is critical for zones to be responsive to market (private sector) needs. Lessons learned from experience with zones include the following:

a. Zones are not a panacea to be used to solve all problems—many have failed.

b. They consider multiple elements of the enterprise ecosystem: legal and regulatory framework, investment promotion, trade and investment policies, links with markets (buyers), skills and education, logistics, and others.

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42 There is much literature on challenges and good practices in spatial solutions for enterprises, including industrial parks, free zones, special economic zones, and others. Useful resources include but are not limited to the following:
- International Association of Science Parks (IASP).

43 International Association of Science Parks (IASP).


45 Defined broadly, including special economic zones, free zones, industrial parks, industrial estates (for SMEs), science parks, technoparks, and others.
c. They need top-level and cross-sectional leadership within government. Host governments need to ensure delivery of external infrastructure (hard and soft) that is critical to zone success.

d. Zones are evolving toward integrated services-driven economic communities that facilitate business—beyond incentives—and are much more successful when developed and/or managed by the private sector.

e. Integration of the zone master plans into regional urban development plans is critical to enhance economic and social benefits.

f. Zones can act as ‘pilots’ for reforms and innovative approaches to be tested, with the potential to roll them out across the economy if proven successful.

g. Clear vision and objectives are essential for success.

Quality infrastructure

118. For firms to be competitive in international markets, they often need to meet quality requirements or obtain internationally recognized certifications. The government has a strong role to play in ensuring availability of appropriate national quality infrastructure, including on the regulatory side (which is not a focus of this paper), as well as through availability of accredited quality control laboratories. Such laboratories tend to be private, but the system of providing accreditation to these labs that is internationally recognized is a role for the government. Support can be provided to SMEs to use these systems, for instance, to obtain obtaining common standards (for example, ISO 9000, ISO 22000) and industry-specific certifications. This support is usually delivered through mechanisms described in the ‘firm capability’ section (section IV A).

Cluster initiatives

119. A cluster is a geographic concentration of interconnected companies, organization, and institutions in a particular industry. A common intervention for governments is to work with clusters and seek to improve their performance. Suppliers, financial providers, educational institutions, business associations, and various levels of government are usually included in a cluster. Clusters affect economic development through enhanced productivity, innovation, and new business formation, through the information sharing and knowledge diffusion that comes from multiple actors in the industry being in proximity to one another. It also enables infrastructure to be used more efficiently and for deeper specializations to be developed. IT clusters in Silicon Valley, California, and Bangalore, India; electronic products clusters in Malaysia and China; and the motion picture cluster in Hollywood are examples.

120. Clusters usually evolve spontaneously over time. However, well-designed cluster initiatives may expedite the process, particularly by boosting the linkages and providing public goods through which clusters can grow. Designing a cluster initiative requires assessment of markets, products, links,

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and market opportunities and development of strategies that involve multiple stakeholders. Initiatives could focus on skills development, supply chain improvements, quality standards, marketing, forward integration, and process improvements.\(^{47}\) Cluster initiatives are typically in the end a type of value chain competitiveness initiative and should incorporate the good practices discussed under section IV.B (Instruments to Increase Access to Markets). However, other clusters such as those based on innovation and R&D have less in common with value chain competitiveness initiatives. Cluster initiatives should be organized and delivered through some type of entity that employs skilled networkers/facilitators who can make collaboration happen; however, in some cases, cluster management organizations focus on self-perpetuation and ‘grant-chasing’ rather than their core role; this is a pitfall to be avoided.

**121. Successful cluster initiatives focus on facilitating the spillover of ideas by getting businesses and other organizations to work together in ways they otherwise would not.\(^ {48}\)** This may be through joint productivity improvement, joint training and skills development, joint innovation and R&D development, joint market access activities, or combinations of all of these. Many cluster initiatives that focus only on the organizational structure of a cluster—and not on how to exploit knowledge spillovers and information sharing among firms—have failed.\(^ {49}\) As with value chain competitiveness initiatives, government should ‘follow winners’—reinforcing and building on existing and emerging clusters rather than attempting to create entirely new ones, but established clusters can then be used to deliver a variety of government assistance in a focused manner. To justify cluster development efforts, there needs to be some established businesses on the ground. Cluster initiatives should focus on allowing enterprises to better specialize and compete in international markets.\(^ {50}\)

**122. Table 7 summarizes the needs and types of programs presented in this section.**

<table>
<thead>
<tr>
<th>Type of Program</th>
<th>Needs It Targets</th>
<th>Potential Role for Government</th>
<th>Typical Age of Firm</th>
</tr>
</thead>
<tbody>
<tr>
<td>SME support centers</td>
<td>• Information and linkages to other programs listed here; market information</td>
<td>• Either physical offices or online (or both) addressing basic information gaps and needs of SMEs and coordinate breadth of government activity</td>
<td>New/young firms</td>
</tr>
<tr>
<td>Business incubators</td>
<td>• Capacity • Mentoring • Networking</td>
<td>• Coordination and spillover effects of incubators may justify government/donor funding which can be focal points for early-stage assistance.</td>
<td>New/young firms</td>
</tr>
<tr>
<td>Industrial parks, technoparks, and so on</td>
<td>• Transfer of know-how • Innovation</td>
<td>• Establish legal/regulatory framework. • Establish rules of business from those that prevail in the national territory, facilitate paperwork through one-stop shop, and so on.</td>
<td>Established SMEs</td>
</tr>
</tbody>
</table>

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## V. Institutional Structures for SME Development

123. **Equally important as identifying the needs of the private sector and devising appropriate policies and programs for addressing the needs is the implementation of these policies.** Various countries have established dedicated SME agencies (which may also exist at the subnational level) that deliver at least some of the initiatives discussed in this note and who can also provide policy and analytical input to government. This section provides examples from the United States, Ireland, and Malaysia on centrally managed SME support agencies. In addition, two examples from Turkey’s regional development agencies are provided to give a perspective on regional/local execution of private sector development policies.

124. **An SME agency’s role and tools are established through a country’s legal framework.** Some countries have developed SME promotion laws. The purpose of such laws are to address an existing issue (‘fix something that is broken’), establish an SME agency, and establish special incentives or legal regimes for SMEs. Pioneer SME Laws include the following: Japan, 1949 Law on Cooperative Association of SME, and United States, 1952, Small Business Administration Act. Over 100 countries have adopted SME laws since then. An SME promotion law may not always be necessary or useful; this would depend on the specific country context, including the existing legal and institutional setup for SME support.

125. **SME agencies can take different forms and have a range of different responsibilities.** Some are subsidiaries of mainline ministries; others have a separate legal and administrative structure and relative autonomy. Some have an explicit policy role—to develop data and contribute to policy development and develop their own initiatives; others are focused purely on program delivery. Some have extensive in-house activities and services; others act mainly as brokers utilizing the private provider market. Some also cover export promotion and support and investment attraction; elements

<table>
<thead>
<tr>
<th>Type of Program</th>
<th>Needs It Targets</th>
<th>Potential Role for Government</th>
<th>Typical Age of Firm</th>
</tr>
</thead>
<tbody>
<tr>
<td>National quality infrastructure</td>
<td>• Access to reliable infrastructure and services</td>
<td>• Some government initiative may be justified if access to land/facilities is a binding constraint or if these interventions are biased toward larger companies.</td>
<td>Established SMEs</td>
</tr>
<tr>
<td>Cluster initiatives</td>
<td>• Demonstrate that products meet standards required by the market.</td>
<td>• Ensure national standards are consistent with international standards and voluntary. • Provide internationally recognized accreditation for quality laboratories.</td>
<td>Established SMEs</td>
</tr>
<tr>
<td></td>
<td>• Transfer of knowledge on international demand and trends; promote links among actors in the industry to foster innovation and upgrading.</td>
<td>• Establish legal/regulatory framework. • Some government initiatives may be justified to overcome coordination failures.</td>
<td>Established SMEs</td>
</tr>
</tbody>
</table>
of innovation policy do not include this function. Table 8 presents different roles that SME agencies can play.

**Table 8: Roles of SME Agencies**

<table>
<thead>
<tr>
<th>Potential roles for SME agencies</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Advocacy to government</strong></td>
</tr>
<tr>
<td>• Develop SME-specific knowledge, data, and statistics (for example, through an SME census).</td>
</tr>
<tr>
<td>• Contribution to policy development - advice on regulation, infrastructure, public-private partnership activity, SME upgrading, finance.</td>
</tr>
<tr>
<td><strong>Industry services</strong></td>
</tr>
<tr>
<td>• Provide basic information about government regulation - where to go, how to go about it, provide business registration.</td>
</tr>
<tr>
<td>• Provide infrastructure - business parks, accelerators and incubators, technology diffusion centers.</td>
</tr>
<tr>
<td><strong>Business advisory and improvement</strong></td>
</tr>
<tr>
<td>• Simple - for example, online training, one-hour face to face</td>
</tr>
<tr>
<td>• Complex - facilitating longer-term engagement, for example, supply chain development initiatives</td>
</tr>
<tr>
<td><strong>Access to markets</strong></td>
</tr>
<tr>
<td>• Information on main export markets for priority products or growing domestic markets, market overview and trends, requirements for market entry, competition landscape, and so on</td>
</tr>
<tr>
<td><strong>Financing</strong></td>
</tr>
<tr>
<td>• Debt - loan guarantees, micro-credit</td>
</tr>
<tr>
<td>• Grants for various purposes, often with a matching component from the enterprise</td>
</tr>
<tr>
<td><strong>Connections - to other relevant assistance</strong></td>
</tr>
<tr>
<td>• Government providers - export, skills development, finance, and so on</td>
</tr>
<tr>
<td>• Private - business advice, registry of preferred suppliers</td>
</tr>
<tr>
<td><strong>Industry development</strong></td>
</tr>
<tr>
<td>• Analyzing industry growth and developing industry-wide growth strategies</td>
</tr>
<tr>
<td>• Programs for innovation, capability and productivity improvement, high growth companies and so on</td>
</tr>
<tr>
<td>• Network, cluster, and competitive industries’/GVCs’ initiatives</td>
</tr>
</tbody>
</table>

126. The sections below present brief overviews of SME development agencies in various regions of the world, with examples from the United States, Ireland, Turkey, and Malaysia. This is meant to be introductory and illustrative. There are many approaches to the design, administration, relationship to government, and range of services in SME agencies around the world. When deciding on the best structure and design of a new agency or program, these aspects and their relevance to the particular country context should be considered in more detail.

**A. U.S. Small Business Administration**

127. The U.S. Small Business Administration (SBA) was created in 1953 as an independent agency of the federal government to aid, counsel, assist, and protect the interests of small business concerns; to preserve free competitive enterprise; and to maintain and strengthen the overall economy of the United States. The SBA helps Americans start, build, and grow businesses. The SBA delivers its services through an extensive network of field offices and partnerships with public and private organizations.
128. The Investment Company Act of 1958 established the Small Business Investment Company (SBIC) Program, under which the SBA licensed, regulated, and helped provide funds for privately owned and operated venture capital investment firms. The SBA specialized in providing long-term debt and equity investments to high-risk small businesses. The SBA partners with private investors to capitalize professionally managed investment funds (SBICs) that finance small businesses.

129. Through the Equal Opportunity Loan (EOL) Program, the credit and collateral requirements for applicants living below the poverty level are relaxed. The aim is to encourage new businesses that had been unable to attract financial backing but were nevertheless sound commercial initiatives.

130. The SBA provides assistance primarily through its four programmatic functions:

   a. **Access to Capital (Business Financing):** The SBA provides small businesses an array of financing for small businesses, from the smallest needs in micro-lending to substantial debt and equity investment capital (venture capital).

   b. **Entrepreneurial Development (Education, Information, and Technical Assistance and Training):** The SBA provides free, individual, face-to-face and Internet counseling for small businesses and low-cost training to nascent entrepreneurs and established small businesses in over 1,800 locations throughout the United States and U.S. territories.

   c. **Government Contracting (Federal Procurement):** The SBA’s Office of Government Contracting sets goals with other federal departments and agencies to reach the statutory goal of 23 percent in prime contract dollars to small businesses. This office also provides small businesses with subcontracting procurement opportunities, outreach programs, and training.

   d. **Advocacy (Voice for Small Business):** Created in 1978, this office reviews Congressional legislation and testifies on behalf of small business. It also assesses the impact of the regulatory burden on behalf of small businesses. Additionally, it conducts a vast array of research on American small businesses and the small business environment.

131. The SBA does not provide grants for starting and expanding a business. Grants from the federal government are authorized and appropriated through bills passed by Congress and signed by the President. The grant authority varies widely among agencies. The SBA has the authority to make grants to nonprofit and educational organizations in many of its counseling and training programs, but it does not have the authority to make grants to small businesses.

**B. Malaysia - Small and Medium Enterprise Corporation Malaysia (SME Corp.)**

132. Founded on May 2, 1996, the specialized agency to prompt the development of SMEs in Malaysia, known at the time as the Small and Medium Industries Development Corporation (SMIDEC), was transformed officially on October 2, 2009, into a single agency named Small and Medium Enterprise Corporation Malaysia (SME Corp.) that formulates overall policies and strategies.
and centrally provides information and advisory services for all SMEs in Malaysia. As a federal agency under the Ministry of International Trade and Industry of Malaysia, SME Corp. has the following functions that can be grouped by its four main roles:

a. **Central Coordinating Agency:** By coordinating, monitoring, and evaluating the progress and effectiveness of SME development programs implemented by around 15 ministries and 60 agencies and collating data, SME Corp. publishes an annual report named SME Integrated Plan of Action (SMEIPA). The related ministries and agencies can gather, through this report, relevant information on possible synergies and the lessons learned that would ensure the smooth facilitation of SME development programs.

b. **National SME Development Council:** Placed under the Programme Coordination, Monitoring, and Evaluation Unit of SME Corp., the council is chaired by the Prime Minister. It has 13 other ministers as its members, as well as the Chief Secretary to the Government, the Director-General of the Economic Planning Unit (EPU), and the Governor of Bank Negara Malaysia (BNM). Having set a common definition for SME in 2004 and again in 2014, the council, as the highest policy-making body for the development of SMEs in Malaysia, is responsible for formulating broad policies and strategies to facilitate the overall development of SMEs across all sectors and reviewing the roles and responsibilities of the related ministries and agencies assigned with SME development. The council was also engaged in the SME Development Framework and the SME Masterplan and SME Act Framework.

c. **SME Masterplan 2012–2020:** The publication provides a comprehensive framework that categorizes SME development program into focus areas that influence the performance of SMEs: access to financing, market access, human capital development, innovation and technology adoption, infrastructure, and legal and regulatory environment.

d. **One Referral Center:** Located in Kuala Lumpur (head office) and in 11 states, ‘the one-stop center’ of SME Corp. disseminates information and knowledge on topics such as business start-up, market access, human capital development, financial resources, and industry know-how to foster SME development. The center also shares relevant information on government funds and incentives for SMEs and acts as a channel for feedback on SME issues. In 2014, the center recorded a total of 6,944 walk-in visitors (4,346 at the head office in Kuala Lumpur and 2,598 at the other 11 state offices).

**C. Turkey - Regional Development Agencies**

133. Turkey has 26 regional development agencies that operate within the 26 NUTS\(^{51}\) 2 level regions covering its 81 provinces. These agencies are seen as expert institutions on regional development with the necessary financial endowments that enable them to take decisions at the regional level and execute these decisions through capable staff. Since their establishment, these

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\(^{51}\) Nomenclature of Territorial Units for Statistics of the European Union.
agencies have provided important financial and technical support to public agencies, the private sector, and NGOs. On the other hand, they are responsible for attracting national and international investments to their respective region through promotion and support activities.

134. The agencies undertake studies to identify the priorities and potential of a region as well as its bottlenecks. Consequently, they devise support programs to help firms in the region grow and also address market failures. The agencies were designed to bring about a new understanding to the governance of private sector development agenda. In addition to providing grants, the agencies act as interlocutors between the private and public sector to identify the development needs at the regional level. They have a broad range of support programs that include support on industry-university collaboration, R&D and innovation, and management consultancy. The agencies follow a spatially balanced approach to regional development whereby they support and incentivize rural development as well as urban development. Particularly in poorer regions where rural development is a priority, the agencies provide support for agro-industry.

135. The agencies operate under the coordination of the Ministry of Development while managing a relatively autonomous financial and technical mechanism. This autonomy allows them to be responsive to the needs of a region and provide the public sector actors, the private sector, and the NGOs with a counterpart other than local administrative units. They act as no executor of policies but as supporters in achieving the targets set by national and regional development strategies. More specifically their responsibilities are the following:

a. Support local administrations in their planning exercises
b. Support the implementation of regional plans and programs as well as their monitoring and evaluation
c. Undertake activities in supporting regional and rural development
d. Enable cooperation between the public and the private sectors as well as the NGOs
e. Use resources in accordance with regional plans and programs
f. Undertake studies to identify developmental challenges and opportunities of a region
g. Undertake promotion activities both at the national and international levels
h. Ensure the successful conclusion and monitoring of investments
i. Support SMEs and entrepreneurs
j. Provide information on bilateral or multilateral international programs and facilitate project development within these programs
D. Ireland - Enterprise Ireland

136. Enterprise Ireland (EI) is an integrated economic development agency of the Republic of Ireland, a country with a population of 4.6 million which has undergone a significant economic transformation since the 1980s. The agency targets both start-ups and established firms and provides a wide range of assistance, with particular focus on building export-focused firms, given Ireland’s small domestic market.

137. EI is headquartered in Dublin and has a network of 9 regional offices and over 30 international offices with a staff of around 380 people. It provides a mix of funding and advisory support.

138. EI broadly divides its market into four segments:

- **Start-ups** and **high-potential start-ups.** New entrepreneurs or young businesses with the potential to develop an innovative product or service for sale on international markets and the potential to create 10 jobs and €1 million in export sales within 3 to 4 years of starting up.

- An **established SME** client is a company that is not a high-potential start-up and has an established trading record. The company (or its group of companies) employs between 10 and 250 employees and has either an annual turnover of less than €50 million or an annual balance sheet of less than €43 million.

- A **large company** is a company that employs more than 250 employees and has either an annual turnover of greater than €50 million or an annual balance sheet of greater than €43 million.

- **Researchers** in universities or research institutions undertaking research that lead to the practical application of research in business, yielding benefits to both groups.

139. EI provides funding and support for companies—from entrepreneurs with business propositions for a high potential start-up to large companies expanding their activities, improving efficiency, and growing international sales. EI also provides funding and support for college-based researchers to assist in the development, protection, and transfer of technologies into industry through licensing or spin-off companies.

140. EI utilizes a wide range of instruments and provides direct support to companies through its own services and employees and also links clients with external knowledge providers, consultants, and research and education providers. The range of instruments and offerings include the following:

- **Grants:** including to develop a business plan, explore a new market, obtain mentoring for internationalization, place graduates in SMEs, undertake R&D, hire key management, undertake lean manufacturing and business process improvement for workforce expansion and collaborative R&D
• **Vouchers;** including for SMEs to work with research agencies and for software development

• **Integrated entrepreneurship support;** a package including mentoring, incubation space, and funding scholarship

• **Training;** including for exporting and obtaining finance

• **Management improvement;** 10-month intensive programs for entering new export markets, managing high-growth businesses, or undertaking innovation projects

• **Equity finance;** including seed funding and co-investment in high-potential start-ups

• **Information;** including intelligence on export markets, export facilitation, commercialization and intellectual property management, and firm-level benchmarking

For more information: https://www.enterprise-ireland.com/en/.
Annex 1: Policies for SMEs by Type of Enterprise

<table>
<thead>
<tr>
<th>Type of MSME</th>
<th>Potential Policy Interventions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>New subsistence micro-businesses</strong>&lt;br&gt; - Youth, the marginalized, and</td>
<td><strong>Improving Firm Capability</strong>&lt;br&gt; - Simple how-to business management guides (for example, online)</td>
</tr>
<tr>
<td>unemployed and underemployed who start micro-businesses generally for</td>
<td>- Basic business advisory services and training</td>
</tr>
<tr>
<td>self-employment. Usually low skill, may be engaged in simple retail</td>
<td>- Microfinance</td>
</tr>
<tr>
<td>activities, and likely to stay informal.</td>
<td><strong>SME Access to Finance</strong>&lt;br&gt; - Making it easy to formalize and operate, one-stop shop for business registration</td>
</tr>
<tr>
<td><strong>New skill-based MSMEs</strong>&lt;br&gt; - the establishment of small businesses by</td>
<td><strong>Improving Firm Capability</strong>&lt;br&gt; - Simple how-to business management guides (for example, online)</td>
</tr>
<tr>
<td>entrepreneurs who have a skillset—a technical trade, profession, or work</td>
<td>- Business plan competitions</td>
</tr>
<tr>
<td>experience—around which the business is formed. Generally does not involve</td>
<td>- Basic business advisory services and training</td>
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<tr>
<td>a new business model or innovation.</td>
<td><strong>SME Access to Markets</strong> - Supply chain/supplier development initiatives</td>
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<tr>
<td><strong>Startups</strong>&lt;br&gt; - New innovation-based businesses that aim to scale</td>
<td><strong>SME Access to Finance</strong>&lt;br&gt; - Small ‘start-up or pre-seed’ grants/loans</td>
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<tr>
<td>quickly and utilize new technologies and business models to do so</td>
<td><strong>SME Support Environment</strong>&lt;br&gt; - Business climate reforms (making it easy to formalize and operate), one-stop shop for business registration</td>
</tr>
<tr>
<td><strong>Micro-businesses - established subsistence</strong>&lt;br&gt; - Informal micro-</td>
<td><strong>SME Support Environment</strong>&lt;br&gt; - Networking (for example, diaspora groups)</td>
</tr>
<tr>
<td>businesses that have been operating for some time. Also increasingly</td>
<td><strong>SME Support Environment</strong>&lt;br&gt; - Networking (for example, diaspora groups)</td>
</tr>
<tr>
<td>includes skilled individuals often working from home, either producing</td>
<td><strong>SME Support Environment</strong>&lt;br&gt; - Networking (for example, diaspora groups)</td>
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<tr>
<td>and trading products through online platforms (for example, creative</td>
<td><strong>SME Support Environment</strong>&lt;br&gt; - Networking (for example, diaspora groups)</td>
</tr>
<tr>
<td>businesses) or providing business services (for example, coding, design)</td>
<td><strong>SME Support Environment</strong>&lt;br&gt; - Networking (for example, diaspora groups)</td>
</tr>
<tr>
<td>sourced through ‘gig’ economy.</td>
<td><strong>SME Support Environment</strong>&lt;br&gt; - Networking (for example, diaspora groups)</td>
</tr>
</tbody>
</table>

- Formalization - through business registration
- Networking
- If it is feasible to bring the activity to scale, the types of interventions listed in the row below can be applicable.
<table>
<thead>
<tr>
<th>Type of MSME</th>
<th>Potential Policy Interventions</th>
</tr>
</thead>
</table>
| **Established SMEs** - Existing SMEs older than 3–5 years with some scale, generally mature ‘skill-based MSME’, found across the economy in all sectors, often family businesses | **Improving Firm Capability**  
- Business advisory services (management improvement)  
- Productivity enhancement (for example, lean manufacturing) through technology extension services  
- Grants to upgrade plant and equipment, subsidize management improvement advice (or combination)  
- Skills upgrading (for workforce)  
**SME Access to Markets**  
- Supply chain/supplier development initiatives  
- Value chain competitiveness initiatives  
- Export promotion and development initiatives  
**SME Access to Finance**  
- Growth financing, venture capital  
**SME Support Environment**  
- Clusters and networks  
- Industrial or Science and Technology Parks |
| **Established, growth-focused SMEs** - Existing SMEs older than 3–5 years with some scale, with growth aspirations and business model based (at least partially) on new product, business model development, or new market entry | **Improving Firm Capability**  
- Technology advice, market opportunity awareness through extension services  
- R&D/innovation support (through grants, tax concessions)  
- Productivity enhancement (for example, lean manufacturing) through technology extension services  
- Grants to upgrade plant and equipment, subsidize management improvement advice (or combination)  
**SME Access to Markets**  
- Supply chain/supplier development initiatives  
- Value chain competitiveness initiatives  
- Export promotion and development initiatives  
**SME Access to Finance**  
- Growth financing, venture capital  
**SME Support Environment**  
- Clusters and networks  
- Industrial or Science and Technology Parks |