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BEST PRACTICE POLICIES FOR SMALL AND MEDIUM-SIZED ENTERPRISES

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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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Pursuant to Article 1 of the Convention signed in Paris on 14th December 1960, and which came into force on 30th September 1961, the Organisation for Economic Co-operation and Development (OECD) shall promote policies designed:

- to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;
- to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and
- to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

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Publié en français sous le titre :

LES MEILLEURES POLITIQUES
POUR LES PETITES ET MOYENNES ENTREPRISES

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FOREWORD

When it was created in 1993, the Industry Committee's Working Party on Small and Medium-Sized Enterprises (SMEs) decided to include the analysis of best practice in SME policies as part of its programme of work.

With a view to carrying out this important task, the Working Party agreed that Member countries themselves would choose and analyse policies applied in their countries which they consider to constitute "best practice". This edition of this annual report provides a selection of presentations made by Member countries at the Working Party's meetings during 1995, together with a summary of the issues discussed. The summary chapter was prepared by Professor David Storey (Director of the Centre for SMEs, University of Warwick, United Kingdom) in co-operation with the OECD Secretariat.

The Working Party on SMEs and the Industry Committee recommended that this report be made available to the general public. It is published on the responsibility of the Secretary-General of the OECD.

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EXECUTIVE SUMMARY

The Industry Committee Working Party on SMEs conducted in 1995 an analysis of Best Practice in SME Policies. Its purpose was to identify which policies appear effective, which seem to be less effective, and the reasons for this.

This summary reports on the presentations and discussions in four main policy areas: financing; business environment; management capacity; and access to markets.

FINANCING

In its deliberations on financing, the Working Party considered the questions of Venture capital: Alternate sources of financing; and SMEs and joint ventures.

Venture capital: Alternative sources of financing

Although venture capital is not a source of finance for most SMEs it can be very important for funding "high risk and high return" businesses. In particular, technology-based firms are often the focus for such types of initiatives. The attitude of governments to supporting the provision of venture capital varies widely between the more interventionist approaches of Korea and Finland, and the "hands off" approach of Switzerland and the United States. Both approaches, however, can point to considerable success – the investments by the Ministry of Trade, Industry and Energy in Korea are reflected in the 85 000 jobs in supported companies. On the other hand the US small business investment companies (SBICs), where management and investment decisions lie with the companies, have also been very effective in delivering equity capital to technology-based firms in the United States for more than 35 years.

SMEs and joint ventures

Joint ventures include strategic alliances, licensing agreements, franchises, etc., involving linkages between an SME and other enterprises.

The role of government can be to facilitate this role by sponsoring international trading opportunities such as Europartenariat. The key lesson is to achieve maximum value from bringing together large numbers of SMEs, by ensuring that such meetings are structured, planned and well organised so as to ensure the maximum level of interaction between firms with common interests.

BUSINESS ENVIRONMENT

In the area of business environment, the following topic was discussed:

Reduction of administrative and regulatory burdens on SMEs

This was a topic of considerable interest to SMEs. The Dutch and Portuguese experience was that, to be effective, the attack on administrative and regulatory burdens had to be seen to have political commitment at the highest level. In Holland the deregulation commission was chaired by the Prime Minister; in Portugal the task force by a State Secretary.

Even in these circumstances however, progress was slow and, rather than diffuse efforts across a wide range of topics, it was better to have highly pragmatic and focused initiatives.

The increasing use of electronic data interchange (EDI) constitutes a real opportunity for reducing administrative burdens, most notably those associated with taxation.

MANAGEMENT CAPABILITIES

The following topics were examined in this area: Quality: Tools to improve SME competitiveness; and Mentoring: Improving the internal capability of SMEs.

Quality: Tools to improve SME competitiveness

A number of countries were seeking to enhance the competitiveness of SMEs by programmes designed to improve the quality of management in such firms. French and Dutch experience was that it was vital to minimise confusion on the part of the SME owner about the wide range of assistance which was often available. This has lead to the establishment in Holland of the "enterprise house" which provides one-stop shop assistance.

The French experience was that the take-up of assistance schemes was more likely where there was formal accreditation of the award/qualification. This served to enhance the credibility of any award.

A major question is the extent to which it was appropriate for government to stimulate and subsidise the purchase by SMEs of external consultancy and advisory services.

Mentoring: Improving the internal capability of SMEs

Discussion here focused upon the Law 44 Initiative in Southern Italy under which young people establishing a business for the first time have experienced "mentors" made available to them.

The experience of the scheme is extremely positive, as reflected in the finding that 80 per cent of the businesses survive over a four year period. This is exceptionally high for any group of new businesses, but is particularly so for young entrepreneurs, whose businesses are more likely to fail than those established by entrepreneurs in mid- or later life.

The Italian scheme is very expensive in terms of mentoring costs, but clearly the results are highly impressive.

ACCESS TO MARKETS

In this area the following topics were discussed: Business networks: Government facilitation of market development through electronic commerce and information technology; Access to new markets for SMEs of Central and Eastern European and OECD countries; and The implementation of a programme fostering the participation of SMEs in international fairs and exhibitions.

Business networks: Government facilitation of market development through electronic commerce and information technology

Several interesting points emerged from the experience of the United States and Canada in providing enhanced access to electronic commerce through information technology.

The first was a recognition that if access to electronic commerce was to be by SMEs themselves then the database has to be "user friendly" (defined as ensuring the SME does not have to go beyond four levels to complete the information search). However if the information service is to be focused, not upon SMEs themselves but on their advisers, then more sophisticated procedures could be used.

A question also emerged about the extent to which national databases and commercial information should be accessible to non-nationals who have not paid for the construction of such databases.

The question of an appropriate pricing policy for the use of such databases was also discussed. Should the state subsidise the provision of such information? The benefits were that this could enhance the competitiveness of a large number of "national" firms, but possibly at the expense of undermining the commercial information sector.

Access to new markets for SMEs of Central and Eastern European and OECD countries

SMEs in economies in transition, in particular, have major problems in accessing markets in developed countries. Their inability to understand customer needs, limited experience of packaging and linguistic problems, all serve to inhibit market penetration.

One way to overcome this is to develop a mentoring capability in ethnic groups located in developed countries the most notable being Polish immigrants in the United States. This could be a very efficient way of transferring expertise and information from developed economies to economies in transition.

The implementation of a programme fostering the participation of SMEs in international fairs and exhibitions

Greece reported on a programme to encourage mainly micro enterprises to sell more heavily abroad. The programme funded the production of brochures and travel abroad to trade fairs by Greek SMEs.

The scheme appears to have been extremely successful. Exports are now taking place to a huge variety of countries. One year after the scheme ended, 30 per cent of the firms continued to participate in trade fairs at their own expense. Indeed, 60 per cent of the firms who previously did not export currently do so.

SUMMARY AND CONCLUSIONS

INTRODUCTION

This is the second annual publication of the OECD Industry Committee's Working Party on SMEs. The Working Party on SMEs meets twice a year and seeks to disseminate best practice in SME policy through its country representatives.

The Working Party identified four broad areas which cover the main issues related to SMEs, and where it believes governments can have a significant effect in contributing to "best practice". These are:

- *Financing:* facilitating efficient and unbiased financial markets for SMES.
- *Business environment:* facilitating a suitable business environment for SMEs.
- *Management capability:* facilitating eduction, training and capability of SMEs to compete.
- *Access to markets:* facilitating access to information, networking and the global markeplace for SMES.

The Working Party procedure is for topics of general interest related to these four broad areas to be identified in advance by country representatives. Papers from interested countries on "best practice" within their country are then sought from the interested parties and a short verbal presentation is made. Following those presentations a general discussion takes place, seeking general lessons, and in which participants also provide their own experience of policy in the area. This chapter seeks to reflect those discussions, as well as providing a very brief synthesis of the country best practice papers. The majority of the papers are presented in full later in the report.

It must be emphasized that the purpose is not to produce a "manual" of best practice, but rather a forum for discussion which can lead to best practice.

FINANCING

Venture capital: Alternative sources of financing

Four presentations were made in this session – by Finland, Korea, Switzerland and the United States.

The Finnish presentation described the regional network of venture capital funds emphasizing Finland's commitment to the support of high-technology businesses. Funds focused upon the seven Finnish science parks, as a networking development.

Korea emphasized the commitment of the Ministry of Trade, Industry and Energy (MOTIE) to encouraging start-ups, particularly in high-technology sectors. Currently firms in which investments have been made provide more than 85 000 jobs.

Switzerland's federal government, on the other hand, has exhibited a strong reluctance to intervene in the market-place. A bill to provide guarantees against innovation risks for small and medium-sized enterprises was rejected at a referendum on the grounds of discriminating in favour of particular groups of businesses. Intervention at the federal level is much more limited than in some of the individual Cantons within Switzerland.

The United States reviewed the Small Business Investment Companies (SBICs) and their record since 1958. Currently 280 such SBICs exist to provide risk capital not readily available from banks. The philosophy of the US government is that it should facilitate the establishment of SBICs, but their management and investment decision taking should lie with the companies alone.

The four presentations and the subsequent discussion all raised the question of whether or not the state should intervene in the provision of financial capital in the form of equity to small enterprises. Some types of enterprise – such as start-ups or technology-based enterprises – can present particular problems.

The central issue was whether or not there was a failure in the market place to provide adequate finance and, if so, why. Three reasons emerged in the discussion:

– Whilst investment in quoted companies provided investors with an easily identifiable exit route, the same was not the case for unquoted or private businesses. The absence of such an exit route therefore served to reduce the willingness of "outsiders" to invest in smaller companies.

– Small companies were perceived as more risky than large firms, with new enterprises or start-ups being particularly risky. Furthermore, some types of small company – most notably those in the high-technology sectors – whilst not necessarily more risky, may be more uncertain investments to venture capitalists.

– To overcome these uncertainties venture capitalists need to incur costs in assessing risks associated with potential investment. Since these assessment costs are often high, when combined with the monitoring costs of post investment decision, this can make small-scale financial investment uneconomic.

The four presentations illustrate that different approaches to these problems may be adopted. The Korean and Finnish experience implies a clear commitment to overriding the market in these areas, whereas the Swiss, and to a lesser extent the United States', experience suggests greater unwillingness to take such a course of action.

The actions which can be taken by the state are either to reduce the risk or to increase the benefits to venture capitalists. A number of policies to reduce risk are discussed in the papers. For example Finland has sought to ensure that its regional venture capital funds are allied to a Science Park which often specialises in developing firms in particular sectors. In this way risk can be more accurately assessed. On the other hand the US policy for SBICs views the management of the companies as the prime decision taker and it is that expertise upon which the US government relies. It is also possible to use the taxation/fiscal system to lower the loss with failed investments.

An alternative policy is to seek to improve the benefits which flow from venture capital. For example the managerial resources of the companies could be supplemented through the provision of subsidised advice, training networks could be improved, etc.

It is clearly vital to assess the effectiveness of such initiatives, and to achieve this it is necessary to specify the criteria upon which such judgements should be made. A number of criteria were suggested such as the promotion of additional start-ups, faster growth in existing businesses and faster diffusion of new technologies. These could all constitute elements within the benefits side of a cost benefit analysis.

Governments, however, also have to examine the costs of failure of these investments. No consensus emerged as to what was an appropriate failure rate for investee companies, but it was recognised that zero investment failures suggest the schemes were providing little additionality. Equally, high failure rates would undermine the political credibility of such schemes.

There was agreement of a clear need for evaluation. In the meanwhile three areas for policy consideration emerged:

– The European Union policies to subsidise the assessment and monitoring costs for venture capitalists undertaking risky investments were thought to be worthy of further consideration.

– A number of countries favoured the use of fiscal incentives to encourage wealthy individuals and financial institutions to invest in smaller companies.

– In some instances market failures could be overcome, at least in part, by improved information provision. Wealthy individuals with personal funds which they would be willing to invest in small companies could be put in contact with businesses seeking such funds.