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REPORT OF THE EXPERT MEETING ON SUSTAINABLE FINANCIAL AND NON-FINANCIAL SERVICES FOR SME DEVELOPMENT

Held at the Palais des Nations, Geneva,
from 2 to 4 June 1999

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I. AGREED CONCLUSIONS AND RECOMMENDATIONS

A. Financial services

The Expert Meeting,

1. Recognizing that financial institutions find it difficult to serve small and medium-sized enterprises (SMEs) because of high risk and high transaction costs, lack of experienced personnel and a preference for larger, more profitable clients;

2. Acknowledging that the provision of financial services must be closely linked to the delivery of business development services that can improve both the viability of SMEs and their ability to repay loans, as well as reduce the transaction costs of providing such loans;

3. Realizing that, without access to finance, SMEs will not be able to start up, grow or engage in the continuous innovations that are necessary to compete in the national and global economy;

4. Noting that SMEs' financial needs must be matched with appropriate financial instruments and programmes;

5. Further noting the absence of standardized tools to permit the identification and assessment of SMEs' performance by both banks and equity markets,

Calls upon

Governments and the international community:

1. To strengthen the ability of their financial institutions to serve all creditworthy clients, including SMEs. They should consider using flexibility in adjusting the regulatory requirements where necessary to allow banks to better service SMEs. They should also encourage the use of innovative practices where feasible, such as group lending and such mechanisms as peer pressure, linking savings with credit, and the possibility of continued credit.

2. To consider other innovative mechanisms, such as credit guarantee schemes, credit rating systems, and credit scoring systems, which could reduce the transaction costs involved, and leasing, which could lessen the demands for capital outlays for SMEs. Where capital markets

permit, the possibility of securitization of SME loan portfolios should be explored, which would have the benefit of increasing the volume of funds available for further SME lending;

3. To avoid non-sustainable subsidized interventions which could distort financial markets;

4. To encourage lending institutions to establish a prudent balance between the equity contributed by the SME and the loan capital provided to cover the cost of the business project in order both to increase the personal stake and commitment of the entrepreneur in the business and to reduce the debt-servicing burden;

5. To encourage and facilitate the modernization and diversification of the local financial sector with a view to promoting the creation, mobilization and efficient use of national savings in favour of SMEs;

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6. To identify and promote innovative approaches, including those used by microcredit institutions, which could be used by mainstream financial institutions to reduce the risks and transaction costs of lending to SMEs, and to report back to the Commission as soon as possible;

7. To continue its work on recommendations for an accounting system that will allow SMEs to produce transparent, reliable and standardized financial and business information that can be used for credit evaluation, credit ratings and credit scoring, as well as for internal management purposes, and to report back to the Commission as soon as possible;

8. To identify and test ways of linking credit, leasing, equity and venture capital funds with creditworthy SMEs which have been through a pre-screening and capacity- building system such as the EMPRETEC programme or which have been identified by microfinance institutions, extrabudgetary resources permitting;

9. To identify and test innovative services that can be adapted and applied to SMEs, working jointly with microfinance and other institutions and in close cooperation with local business development services, extrabudgetary resources permitting. UNCTAD should document and report its findings to the Commission.

B. NON-FINANCIAL SERVICES

The Expert Meeting,

1. Recognizing that SMEs have an essential role to play in the generation and distribution of income, job creation, poverty alleviation, community development; and the efficient integration of developing countries, in particular least developed countries (LDCs), into the global economy;

2. Realizing that many SMEs are unable to make their full potential contribution because they lack access to markets, finance, technology and business skills;

3. Noting that effective and efficient business development services can help SMEs solve these access problems, and that the development of such services can be promoted through public-private sector dialogue and cooperation agreements, based on transparent and businesslike approaches;

Calls upon

Governments and the international community:

1. To adopt, disseminate and adapt to the local context the following principles of good practice when promoting the delivery of business development services for entrepreneurship, productivity improvement, mobilization and efficient use of local savings.

2. Business development services should be:

(a) Demand-driven and provided in a decentralized manner when possible by those who can relate closely to the client's needs; they should also be designed specifically for the target groups and the local context;

(b) Focused, strategic and delivered where feasible on a collective basis and on an individual basis when business environment, size and local conditions permit;

(c) Market-oriented and businesslike;

(d) Aimed at gradual cost recovery;

(e) Delivered within the context of a clear strategy for attaining sustainability within a reasonable period.

3. Governments in the process of shifting from a supply-driven approach to a demand-driven approach are invited to consider:

(a) Focusing on core functions of the State (e.g. health, education, law and order, basic training, infrastructure and information networks) in order to create a favourable business environment for SMEs;

(b) Facilitating business services, rather than providing them directly, and widening the market for local capacities;

(c) Avoiding the distortion of the market for local business services;

(d) Ensuring that quality and ethical standards are set for the business service providers;

(e) Creating an environment where incentives are given for capacity-building among entrepreneurs for the use, adaptation and development of technology and supporting research and development and technical services.

4. Governments and the international community should encourage business service providers to consider such strategies as cross-subsidization, diversification of products and clients, and the undertaking of various revenue-generating activities in order to minimize the possibility of priority being given to the better-paying clients, to the neglect of SMEs run by entrepreneurs often regarded as "disadvantaged" (e.g. women entrepreneurs, young entrepreneurs and rural entrepreneurs).

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5. To contribute to the effectiveness and efficiency of business service providers by developing indicators that would measure the performance of their activities in terms of scope, outreach, impact, cost recovery and sustainability, and to report back to the Commission at the earliest opportunity.

6. To identify, on the basis of case studies, ways in which technology services could become an effective tool for SME development, and to identify business development services that could be provided for the industrial upgrading of clusters.

II. CHAIRPERSON'S SUMMARY

1. In opening the Expert Meeting, the **Deputy Secretary-General of UNCTAD** reiterated the great importance of small and medium-sized enterprises (SMEs) in terms of income and employment generation and poverty alleviation. Many SMEs had not been able to achieve their full potential, however, because of a variety of constraints and barriers, including inadequate access to markets, finance, technology and other business support and capacity-building activities and services. The "traditional access" problems had been compounded by globalization and liberalization: production had become more and more knowledge-based, and competition arose on the basis of both continuous innovation and price. Consequently, entrepreneurs hoping to be competitive in the global economic environment must master design, have extensive knowledge of market conditions and technology, and remain innovative on an ongoing basis.

2. On the other hand, however, many developing countries had been grappling with the ways and means to provide effective assistance to their SME sectors in managing such "access" problems. In this context, there was a consensus that appropriate business development services (BDS) could certainly increase the competitiveness of SMEs. The Expert Meeting should therefore concentrate its efforts on identifying best practices in delivering business development services to SMEs. The Meeting was a follow-on to the March 1999 conference in Rio de Janeiro on *Building a Modern and Effective Business Development Services Industry*, which had been sponsored by the Inter-American Development Bank, World Bank and International Labour Organization (ILO) as well as the Committee of Donor Agencies for SME Development. The ideas from and conclusions reached in Rio had been instrumental in producing an UNCTAD issues paper entitled *Providing sustainable financial and non-financial services for SME development.*

3. The Expert Meeting was the result of close cooperation between two different divisions of UNCTAD: the Division on Investment, Technology and Enterprise Development, and the Division for Services Infrastructure for Development and Trade Efficiency.

4. The **Director of the Division on Investment, Technology and Enterprise Development** emphasized the vital role of business development services to SMEs, particularly because the best practices of yesterday would no longer be adequate for the challenges of the new, globalized competitive environment of today. SMEs are currently facing intense pressures to be and remain innovative, thus requiring a far greater volume of in-house and external resources, linkages, partnering, and leverages than is now available or accessible to them.

5. The issues in business development services to be discussed by the Expert Meeting included the means of identification of the most efficient service providers, and how to assess

their performance; the appropriate subsidization of such services; and the ways and means to ensure that “marginal” clients, such as young, rural or women entrepreneurs, received adequate support for their businesses. The difficulties faced by SMEs in accessing financial services included the perceived high risks for lenders; high transaction costs due to the absence of effective methodologies of risk assessment; the lack of adequate information, such as accounting records and other financial documentation, from the SMEs themselves; and lenders' bias in favour of large corporate borrowers.

6. It was important for the Meeting to produce concrete recommendations, especially on principles of good practice for business service providers and the performance indicators to be tested and used; the measures to be implemented to avoid exclusion of marginal clients; good practice in financing SMEs; and what UNCTAD might do in this area in future.

7. The first session of the informal meeting opened with presentations by two resource persons on the role of BDS in helping SMEs to increase their competitiveness in local and global markets. Among the issues considered were (i) the real needs of SMEs and effective ways of meeting them; (ii) whether government institutions should be direct service providers or provide indirect assistance via local support structures; and (iii) how the principles of subsidiarity and sustainability could best be implemented.

Business development services

8. The core principles of good practices in delivering BDS to SMEs, which had been developed by the Committee of Donor Agencies for SME Development, were outlined by a resource person. Now embodied in a framework shared by those donor agencies and government institutions currently involved in the BDS field, these principles were identified as follows:

(a) BDS should be businesslike and demand-led. This implies, first, a transactional (and not charitable) relationship between providers and clients; secondly, the importance of identifying appropriate providers (e.g., those who could relate directly to their clients’ needs in terms of structure, culture and so forth), of involving the right kind of clients, and of following approaches which would ensure competitive product pricing and development; and thirdly, the necessity of having or adopting the right systems of control

(b) The BDS provider should have an explicit approach toward sustainability of the services, such as being specific about the proposed long-term picture. Service providers, the State and the donors need to have targets in mind. The level of subsidies given, or the level of sustainability to be reached, could vary considerably among the countries concerned, depending on the State’s role in supporting SMEs and on the availability of donor assistance;

(c) BDS should be focused and delivered, where possible, on a collective basis rather than to individual clients. At certain critical stages of their development, however, SMEs might need more individualized and customized services. The level of subsidies or of sustainability should be predicated on a strategic awareness and thorough understanding of what local providers were good at, who the core client group was, and with whom appropriate networks should be developed in order not to duplicate already existing efforts, among other things;

(d) BDS should be based on participation and built on ownership and close interaction between providers and SME clients. Since (personal) ownership is a distinctive characteristic of SMEs, it should also be a characteristic of BDS providers if they are to better understand their clients' needs;

(e) BDS should enhance outreach - including reaching out to more SMEs, and facilitating and encouraging "natural" learning (i.e., learning from other enterprises rather than from a consultant);

(f) BDS should be delivered according to the principle of subsidiarity. This principle establishes who can do what best, and implies a critical perception of the envisaged role of the State (is that role consistent with what the State *ought* to do?).

9. The State's role and its capacities to promote BDS varies greatly among countries. However, a basic function of the State should include such crucial elements of the "big picture" as the maintenance of macroeconomic stability, the rule of law and regulations (including those on property rights), and the provision of essential infrastructure and services (e.g., utilities, health, education, research and development, training, procurement facilitation, information dissemination, standard-setting and so forth). Without these elements, the provision of BDS to SMEs will neither have maximum impact nor ensure their increased viability. In general, therefore, Governments should act as facilitators rather than direct BDS providers, stimulate market development rather than subsidy dependence, avoid distortionary intervention, and promote the private sector as the main engine of business development, innovation and competitiveness.

10. In a follow-on presentation, another resource person pointed out the need to create BDS based on market demand and on the real needs of SMEs. The traditional government approach had tended to focus on the creation of many supply-driven BDS institutions and providers and to rely on young academics or young government officials for service delivery. Such intervention often proved to be ineffective, and the quality of the delivered services was often not satisfactory or relevant. There had been strong demands for BDS in the area of technology transfer; however, little had been achieved in this area by most supply-driven BDS. In the past, this was due mainly to the type of personnel delivering the services.

11. BDS could be better delivered and have greater impact if they were more focused on target beneficiaries, for example, by selecting clients and SME audiences on a sectoral basis rather than simply concentrating on the size or scale of the enterprises concerned. In addition, the provision of BDS to groups or clusters, rather than on a one-to-one basis, would prove more cost-efficient and hence sustainable. A problem to be overcome in this approach was the question of commercial confidentiality, as some of the enterprises participating in any given sectoral group could be direct competitors in the market place.

12. While Governments should act as the facilitator, rather than be involved as a direct provider, of BDS, they should also be encouraged to rely on existing or potential BDS providers in the market, such as professional consultants, staff of universities and even the personnel of large companies, or to make use of available business networks or associations, such as Chambers of Commerce and Industry and other sectoral groupings.

13. It was important to consider both the original aims of the BDS and the impact of those services on the economy as a whole, for example on employment, outputs and exports. Cost recovery and sustainability could be important indicators; in reality, however, high levels of government subsidization were common, even in the industrialized countries. The resource person then indicated the possibilities of using BDS – particularly from larger to smaller clients, or from the fees for more viable services (such as advice on legal, accounting, marketing and technology issues) to cross-subsidize the delivery of those services generating less income, such as training and advisory services and other capacity-building activities.

14. During the discussions that followed the presentations, there was extensive debate on the respective and relative roles of government and the private sector in BDS. In particular, the limited role of government – if confined, as had been suggested, to facilitating the development and operation of commercial BDS providers – was questioned by many experts. Government had to take certain critical policy decisions as well as enter into official negotiations affecting various economic sectors and service providers, including BDS; as such, it could not just be a mere facilitator of the existing BDS. Another expert stressed the importance of the Government as a direct provider of BDS in places and regions where no commercial BDS existed, as was the case in many African countries and some economies in transition. The collective political importance of SMEs, and various market imperfections, were mentioned. These political, economic and structural realities called for government intervention, including through the direct provision of BDS; they also meant that the transition from supply- to demand-driven BDS could be a gradual process.

15. Other experts highlighted the facilitating role of government. In Thailand, for example, legislation for the promotion of SMEs had been enacted and efforts made to coordinate action plans for the development of SMEs. The potential and current BDS providers within the private

sector would be invited to participate as members of an SME promotion committee and to identify what kind of BDS should be provided. Moreover, the Government would establish an SME development fund to support all activities, including the provision of training services, for the benefit of those enterprises. In the context of SME promotion, the importance of the private sector as a source of BDS to meet the highly diverse needs of SMEs was noted. Private providers were not all adequately qualified, however, and there would be a role for government in regulating and supervising the quality, standards and prices of commercial BDS. Another expert related the successful experiences of the Government of Israel as a (direct) BDS provider through its incubator scheme for new immigrants, and the positive contribution of army technical training to the development of business skills, entrepreneurship and networking.

16. Sustainability and cost recovery should assume less importance when economies were undergoing periods of economic downturn or when markets were not as yet sufficiently developed; in these cases, BDS measures would have to take social objectives into account, such as employment and poverty alleviation. In addition, the ability to pay for services would likely differ among SMEs and in accordance with the type of service provided, since each type of service had a different cost structure. In addressing these concerns, sustainability and cost recovery should generally be the goals of every BDS provider. Such matters were extremely important, not only because donors and Governments could not continue to support BDS indefinitely, but also because experience had shown that business valued most what it had paid for and that service providers were thus compelled to improve their services in order to justify charging for them.

17. Even though these goals could only be achieved incrementally and in stages in the context of developing countries, nevertheless it was still important to set goals for sustainability and gradually begin working towards them. It was conceivable that some BDS services would require subsidies for a long time. For that reason, the challenge of sustainability encompassed a vision of the future. Differences in ability to pay offered opportunities for cross-subsidization between those SMEs that could pay for services and those that could not. Moreover, BDS providers might consider operating non-related profit-making services in order to subsidize less profitable but vital services that were too expensive for the majority of SMEs.

18. The resource persons recognized and reiterated the positive role Governments could play to foster SME development. First and foremost, Governments should make the utmost effort to provide basic facilities and services. Secondly, there would be a role for the State in setting up and monitoring the standards and quality of commercial BDS. In certain stages of development and in some of the least developed countries (LDCs), government subsidies to BDS would be necessary, although such assistance should be carefully targeted and gradually reduced after a certain period of time. Thirdly, direct government intervention in BDS could be useful in the area

of technology transfer and related capacity-building measures, especially if carried out in collaboration with research and training institutions.

19. Some Western experiences in BDS were useful in that context, particularly those relating to science park/technology park schemes implemented with the active participation of universities and other tertiary institutions. However, most European experiences in BDS, although illuminating as examples, would have limited relevance for the LDCs and thus were generally not suitable for wholesale or unqualified replication. Some European Union schemes on SME innovation had proved very effective, and consideration of that track record might be useful for developing countries.

Promoting access to technology

20. The two presentations made in the second session of the informal meeting dealt with various mechanisms and policies for improving access, upgrading knowledge and diffusing innovation to small firms, with particular attention paid to information technology. Among the issues discussed by experts in this session were: (i) policies and measures that Governments should adopt to facilitate access by SMEs to technologies and know-how and to stimulate innovation; (ii) the skills needed by SMEs in developing countries to acquire and operate information systems, and how such skills could be developed; and (iii) how networks and partnerships could enhance developing countries' access to information.

21. Two resource persons provided an account of specific experiences in Costa Rica, Ghana and Zimbabwe in respect of BDS for SME competitiveness and issues related to SME access to technology and know-how. Particular attention was given to the use of diagnostic tools developed by the Foundation for the Technological and Industrial Development (CODETI) in Costa Rica to draw up competitiveness improvement plans that included specific actions to be implemented by each manufacturing firm in order to upgrade technologically. An important aspect of implementation of the competitiveness plans was the follow-up stage, which included a review of impact indicators and an assessment of firm sustainability.

22. The experiences of UNCTAD's Centres for Innovation and Enterprise Development (CIEDs) in Ghana and Zimbabwe demonstrated the need for cooperation and joint action between existing local technological, managerial and financial service providers, including business associations. Such collaboration and interlinkages would be essential in fostering a culture of innovation and technological dynamism in manufacturing enterprises. The CIEDs were particularly concerned about the need to avoid duplication and set out to "network" and broker relationships among the various service providers.

23. They had also given themselves a goal of full cost recovery within five years, and the objective was being realized by providing their target group of firms at the initial stage of operation with a free diagnostic service (based on the diagnostic tools developed by CODETI, among others); thereafter, a fee based on the outcome of the diagnostic exercise and the projected savings to be made by each firm would be negotiated with the particular client enterprise. This approach had proven successful because the exercise encouraged the firms to define their problems and, with the help of the CIEDs, identify innovative solutions. During the process, the CIEDs were able to prove themselves to the firm and gain its trust, thus facilitating the negotiation of a fee. Cost recovery was expected to become easier as the CIEDs built up a portfolio of satisfied clients and a solid reputation that would allow them to start charging for all their services. The CIED experience provided a useful example of how to deal with the question of whether or not to charge, as well as when and how.

24. The CIED experience also illustrated the pros and cons of the sectoral vs. the multi-sectoral approach to the provision of BDS. In Ghana, for example, the focus was on a relatively narrow sector of wood processing, whereas in Zimbabwe, the main objective was to assist firms in a variety of sectors. It was now clear that the sectoral approach had many more advantages, particularly in respect of opportunities of cost recovery; however, this approach would not be the best if the sector chosen was not a dynamic one.

25. Performance management and indicators were a difficult and complex subject which the Meeting had barely touched upon. An important question related to performance measurement was that of what was to be measured. There were many possibilities, such as scope, outreach, impact, cost recovery and sustainability. The CODETI programme seemed to focus more on issues of impact and raised the interesting question of the kinds of indicators that should be used. The representative of the secretariat informed the experts that a virtual conference was currently in progress on the issue of performance measurement and invited them to contact the secretariat if they had interest in its outcome or in participating in a follow-up conference organized by the Donors' Committee and to be held in Hanoi in early 2000.

26. As to SME access to technology and know-how, it was suggested that there were two ways to address the problem - the transfer of technology from developed to developing countries, and the development of local capacities, with greater emphasis on the exchange of knowledge and information among countries of similar levels of development. However, experts generally agreed that this was not in fact a choice between two distinct approaches. It would be pointless to focus on importing foreign technology because local firms might not have the necessary absorptive capacity to utilize the technology effectively. Hence, technology transfer from abroad had to take place in tandem with initiatives to develop indigenous technological capacities. Foreign direct investment (FDI) had an important role to play in the transfer of technology to developing countries, and accordingly, the issue of investment incentives and the protection of

intellectual property deserved careful attention in light of the need to enhance SME access to technology and know-how. In some cases an element of "countertrade" (barter) could also be considered as complementary to traditional forms of FDI. That approach was being applied to some extent in Asia.

27. In seeking to enhance the competitiveness of SMEs, each country had to assess its own needs. Some countries, for example, found that science parks suited them best, while others opted for incubators. Whichever the case, such local assessment was necessary, as without it no outside support could achieve the desired effect within the desired time-frame.

28. The role of donors in respect of technology transfer and local technological capacity-building was also discussed. Donors could play an important role in enhancing local capacity, although at some point, locally developed technologies would require private capital for their commercialization. It might be better for countries to try to upgrade their industries through local efforts and cooperation among their own firms before seeking external technical assistance. Chile, for example, through its own efforts, had became a major world player in the salmon and wine industries.

29. The UNCTAD secretariat concluded the discussion with a presentation on electronic commerce, which represented both a challenge and a set of new opportunities for SMEs in developing countries. Important areas of concern and difficulty for SMEs related to access, know-how and trust, and in that context, effective distribution, telecommunications infrastructure, and competition policy were perceived as crucial issues for policy attention.

30. Another major constraint for SMEs in developing countries was the capacity to produce website contents. Concern was expressed over the widening gap between developed and developing countries in terms of SMEs' capacities to engage in e-commerce. The need first to develop an "e-commerce culture" in developing countries was emphasized. In particular, it would be important to overcome the lack of legislation that could serve as a framework for e-commerce both globally and domestically. Security was a central element with regard to trust. In those countries where e-commerce was the most advanced, Governments had been instrumental in promulgating legislation and promoting dialogue on the issue. In addition, organizations such as the World Intellectual Property Organization (WIPO) and International Telecommunication Union (ITU) had an obvious role to play in the international regulation of e-commerce. Entities such as banks and insurance companies also had a major stake in e-commerce transactions, through their financing and insurance liabilities; their intervention in that area would thus be conceivable in the continuing absence of workable regulations and the resulting disorder .

31. UNCTAD had planned a series of national and regional workshops bringing together different stakeholders in order to compare experiences and stimulate discussions on e-commerce

in developing countries in preparation for the upcoming Ministerial Conference of the World Trade Organization (WTO), to be held in Seattle in late 1999.

Access to financial services

32. The third session of the informal meeting opened with an introductory presentation by the secretariat on the challenges and opportunities in financing enterprise development. Access to financial capital that was both timely and adequate remained one of the main constraints for microbusinesses and SMEs. Among the contributing factors were the lack of reliable information on their financial state and business operations; various imperfections in the financial market, resulting in a bias towards larger borrowers; a high risk premium charged on SME lending; and, in some countries, difficulties in enforcing repayments. Concerted efforts had long been made to redress the problem, but the general impact and outreach of such initiatives and programmes, especially those on the supply side, had been limited. In particular, subsidized credit had proved costly and created distortions in financial markets. It had also “crowded out” the emergence of commercial actors and players in the financial market, and was not of much help to women and minorities as borrowers. In certain cases, BDS played an important role in securing financial support from banks and other financial institutions, where appropriate technical and managerial support services were provided to requesting SMEs on an efficient, selective and regular basis. Similarly, the inclusion of financial institution representatives on the governing board of non-financial BDS could facilitate easier access to financing for selected SMEs.

33. Among the major lessons to be drawn from microfinancing was the need to run credit programmes on a business, and not on a charitable, footing. Group lending and other innovative lending procedures and practices contributed considerably to lowering transaction costs on both sides. The default rate could be lowered through peer pressure, promises of continued or follow-on credit, and savings-based credit allocations. Business financing through equity or venture capital was severely constrained by the lack of adequate information from SMEs themselves and of standardized financial reporting systems; the underdevelopment of local financial markets and facilities; and the absence of related legislation and regulations.

Lessons from microfinance

34. The feasibility of applying microfinance practices to the financing of SMEs was examined with special reference to the experiences of the K-Rep project in Kenya. K-Rep, formerly a non-governmental organization (NGO) specializing in microfinance, had recently been converted into a commercial bank. The range of financial services and products on offer had to be broadened

as a result of a wider deposit base, the expansion of client micro-businesses into small-scale enterprises, and the risk-spreading diversification of loan portfolios.

35. Several important lessons could be drawn from the successful experience of K-Rep in servicing microenterprises. Various well-known techniques had reduced risks and transactions costs, including:

(a) The group-based approach and group guarantees;

(b) The promise to increase the size of new loans over time;

(c) The lowering of interest rates on subsequent loans;

(d) Simple appraisal forms;

(e) Credit decisions linked to follow-up business development services; and

(f) The use of performance criteria vs. asset criteria for collateral.

36. Access to credit was only one of the needs of SMEs. Indeed, entrepreneurs provided with non-financial BDS often did better in terms of timely loan servicing and business expansion. These non-financial services included capacity-building in management and other business skills. The group-based lending approach was effective for microenterprises in terms of simplified lending procedures, lower transaction costs, closer monitoring and timely repayments (including through peer pressure). That approach, however, was not entirely suitable for larger loans where it was necessary to secure additional collateral. In offering services to SMEs certain new problems would have to be tackled, such as identifying innovative forms of collateral and the need to customize loans.

37. Lessons from a technical assistance project for the financing of SMEs in Guinea-Conakry were presented. The “3A Enterprises” had come into existence in 1988 from what had originally been a multilateral/bilateral technical assistance project supported by the United Nations Development Programme (UNDP), the United Nations Industrial Development Organization (UNIDO) and the Office for Industrial Development of Morocco. The project had successfully provided both financial and non-financial services to a large number of SMEs. It had access to diverse sources of financial resources and had to comply with very different conditions for their use (e.g., potential entrepreneurs had to be under age 40; have disabilities; or be female heads of households). It had nevertheless provided support to approximately 900 managers/projects, created over 2,000 jobs and contributed to a change of attitude towards entrepreneurship through the training of over 300 managers.

38. After some time, however, the question of institutionalizing services such as those provided through the project had had to be addressed. This had culminated in the creation of an independent entity, the 3A Enterprises, which functioned according to private-sector norms while benefiting from some government support. 3A Enterprises differentiated between the provision of short-term credit to the private sector and functions where risk was involved (investment credits and the free provision of advisory services). Its example showed that Governments, donor institutions and development organizations could usefully identify specific modalities for rendering financial and non-financial services to SMEs, to be accompanied by specific institutional modalities that suited the particular conditions then prevailing in the countries concerned.

39. In the ensuing discussion, the need to develop supplementary services and to associate bankers with BDS was stressed. The peer group approach to the financing of microenterprises could be applied to SME financing, and the size of such groups would be critical. Some women's groups and group loan guarantees in Italy, for example, involved only 10 members to ensure more regular contact. In that connection the question arose as to whether such guarantees were legally enforceable. The resource person explained that guarantees in Kenya were legally binding and that legal instruments covering movable property were used.

National experiences and initiatives

40. One expert drew attention to the importance of SMEs in Japan's economy. They constitute 98.9 per cent of the total number of enterprises and employ 77.6 per cent of all workers. The Government had recognized the crucial need to encourage SME activities and to shift from an industrial to a knowledge-based economy. Among the financial and tax measures it had undertaken to assist SMEs were the following:

(a) Subsidies for research and development costs;

(b) Guarantees of loans when extended by the Credit Guarantee Association;

(c) Venture capital funds for SMEs;

(d) Tax reductions for capital investment;

(e) Credits for machinery leasing;

(f) Loans for modernization of equipment;

(g) Loans at low interest rates;

(h) Investments by the Small Business Investment Corporation;

(i) Tax breaks for “SME investment angels”; and

(j) Tax breaks for SMEs to carry forward losses.

The Government did not, however, provide direct assistance to SMEs.

41. Experts outlined a range of direct and indirect financial measures as well as diverse institutional arrangements to promote SMEs and encourage training in several developing countries. In Turkey, for example, a small enterprise was defined as having an asset value averaging $2.5 million and employing up to 50 persons, and a medium-sized enterprise, as employing 150 persons. But a unique (universal) definition of SMEs did not exist, and that fact had created complications in the implementation of financial and technical assistance programmes. SME promotion incentives included low interest rates and tax breaks. However, the venture capital market was not well established in Turkey, and government incentives and credit systems had been designed with large industries and enterprises in mind. Access to, rather than the cost of, credit was a major financing problem for SMEs. In some countries, such as Pakistan, matters relating to SME development were handled by a government ministry for SMEs, while in others, there were specialized financial and non-financial institutions to serve and protect their interests.

Linking financial instruments with SME needs

42. The fourth session of the informal meeting focused on practices, methodologies and instruments that would improve the sustainability of financial services for SME development. Issues under discussion included (i) what role government, the private sector and SMEs should play in the provision of financial services; and (ii) how private equity funds could be channelled to SMEs.

43. The first resource person for the session outlined the importance of standardized financial reporting and accounting with respect to SMEs’ access to finance. Transparent, standardized finance-related information provided by SMEs was an important element for obtaining loans from banks and for cooperation with other partners. In addition to quantitative indicators, many other characteristics of the business under consideration would have an impact on the willingness of banks and other credit institutions to provide financing to SMEs. These included the qualifications of entrepreneurs, including their managerial capabilities and vision of the firm's strategy. Capacity- building would be important in those connections, as most SMEs in developing countries often did not have trained personnel, particularly accountants, to ensure transparency in their relations with banks and business partners.

44. Another resource person concentrated on the issue of guarantee schemes and other financial instruments to enhance SME access to credit. Entrepreneurs should not seek 100 per cent financing from loan capital, and a certain share, up to 25 per cent of required resources, should be in equity capital. Venture capital could be an important source of financing. However, as its providers would naturally be looking for high future returns, such funds were usually directed to high-technology enterprises. Another possible constraint was that a venture capital provider might wish to play an active role in the enterprise management. Moreover, the exit phase, when the venture capital was to be liquidated, could cause great problems for the enterprise's viability. For firms unable to borrow for the acquisition of capital equipment, leasing could be an advantageous option. Its feasibility depended greatly on the existing legislation, taxation and accounting rules. There were also leasing schemes under which ownership of equipment could be gradually transferred to the lender.

45. Credit guarantee schemes (CGSs) were aimed at sharing risks, as the lender would be compensated for all or part of the loss on a loan default. Usually banks did not favour them, preferring to have direct control over the recovery of loans. Most guarantee organizations tried, mainly through fees charged for the guarantees, to cover all administrative costs of the scheme from income once the fund had been set up. Fees usually ranged from 1 per cent to 4 per cent of the loan amount but in some cases were based on the amount of the guarantee. Additionally, a proportion of the available guarantee fund could earn income for the organization managing the scheme if it was invested in some relatively liquid form. However, it would be difficult at the start of an operation for a guarantor to predict *ex-ante* the likely levels of (*ex-post*) loan default for such investments.

46. Generally, where a country lacked a culture of loan repayment, CGSs could play an important role in risk reduction. They were of particular relevance to those entrepreneurs who had sound and viable projects but who could not produce the required collateral. Guarantee schemes should be assessed on the criterion of loan additionality, meaning that the introduction of the guarantees resulted in a significant increase in lending to SMEs and that those that had not previously had access to finance were now able to obtain credit. The effectiveness of the scheme could be evaluated with reasonable confidence only in the long term, e.g., after some five years of operation.

47. A common criticism of CGSs was that of "moral hazard": their existence tended to weaken the will and commitment of borrowers to repay the loan and of lenders to collect payments vigorously. That problem could be managed by requiring those who obtained credit to offer whatever collateral they could, and the guarantee would then be offered to a bank for the non-collateralized part of the loan. In addition, the lending institution must assume a proportion of the default risk involved in a loan default, and in that regard, best practices seemed to indicate that lenders should assume 25 per cent to 40 per cent of the risk, and not less than 20 per cent.

Banks often lost interest in a scheme which guaranteed 50 per cent or even less, as they would then have to go through the whole process of obtaining collateral for their share of the risk. One thing was certain, however: CGSs could not be imposed on a weak financial system with inefficient institutions and an inadequate legal and regulatory framework, or in a culture that condoned non-payment of debts.

48. Commenting on the resource persons' interventions, various experts said that Governments should play an important role in facilitating SME access to financial resources, particularly through the promotion of credit institutions. Feasible options for increasing the available volume of credit resources included the mobilization of cooperatives' funds, local savings and other domestic sources of funds. The lack of own equity capital and difficult access to venture capital were among the major problems facing SMEs in developing countries. Another possible option was to use stock exchange listing to mobilize equity capital, as had been done in the NASDAQ system (United States). There was certainly room to assist enterprises in their dealings with banks and other credit institutions, in preparing business plans, in selecting partners, and in preparing to meet stringent listing requirements.

49. While there should be no expectations of considerable returns from SME activities, the stabilizing effect of their operations on income and employment was nonetheless noteworthy. The establishment of arbitration facilities served to ease the process of dispute settlement between borrowers and lenders. It would also be important to standardize financial information and accounting procedures. Relations between banks and SMEs should be transparent and based on mutual trust and in that regard credit rating and risk assessment systems played a positive role and should be encouraged.

50. UNCTAD's work on accounting for SMEs would provide a guideline for producing standardized financial information needed by investors and creditors and for internal management purposes.

III. ORGANIZATIONAL MATTERS

A. Convening of the Expert Meeting

1. In accordance with the agreed conclusions adopted by the Commission on Enterprise, Business Facilitation and Development at the closing meeting of its third session on 14 December 1999,[1/] the Expert Meeting on Sustainable Financial and Non-Financial Services for SME Development was held at the Palais des Nations, Geneva, from 2 to 4 June 1999. The Meeting was opened on 2 June 1999 by Mr. Carlos Fortín, Deputy Secretary-General of UNCTAD.

B. Election of officers

(Agenda item 1)

2. At its opening meeting, the Expert Meeting elected the following officers to serve on its Bureau:

Chairman:	Mr. Miguel von Hoegen	(Guatemala)
Vice-Chairman-cum-Rapporteur:	Mr. Paul Frix	(Belgium)

C. Adoption of the agenda

(Agenda item 2)

3. At the same meeting, the Expert Meeting adopted the provisional agenda circulated in TD/B/COM.3/EM.7/1. Accordingly, the agenda for the Meeting was as follows:

1. Election of officers

2. Adoption of the agenda

3. Development of sustainable local services and national and international support measures including financial and non-financial services, human resource development, access to information and an assessment of access to technologies, to improve and promote the role and capacity of small and medium-sized

[1/] See Report of the Commission on Enterprise, Business Facilitation and Development on its third session (TD/B/45/15-TD/B/COM.3/20), chap. I, para. 20.

enterprises in developing countries within the framework of a dialogue between the private and the public sector

4. Adoption of the outcome of the Meeting

D. Documentation

4. For its consideration of the substantive agenda item (item 3), the Expert Meeting had before it an issues paper by the UNCTAD secretariat entitled "Providing sustainable financial and non-financial services for SME development" (TD/B/COM.3/EM.7/2).

E. Adoption of the outcome of the Meeting

(Agenda item 4)

5. At its closing meeting, on 4 June 1999, the Expert Meeting adopted its agreed conclusions and recommendations (see section I above), agreed to incorporate the Chairperson's summary into its report (see section II above), and authorized the Vice-Chairman-cum-Rapporteur to prepare the final report of the Meeting, under the authority of the Chairman.

Annex

ATTENDANCE */

1. Experts from the following States members of UNCTAD attended the Meeting:

Argentina
Bangladesh
Barbados
Belarus
Belgium
Benin
Bolivia
Brazil
Bulgaria
Cameroon
Chile
China
Colombia
Côte d'Ivoire
Cuba
Czech Republic
Ecuador
Egypt
El Salvador
Equatorial Guinea
Ethiopia
Finland
Germany
Guatemala
India
Indonesia
Iran (Islamic Republic of)
Israel
Italy
Japan
Lesotho
Libyan Arab Jamahiriya
Lithuania
Mali
Mexico
Morocco
Mozambique
Nepal
Netherlands
Nicaragua
Niger
Nigeria
Norway
Pakistan
Peru
Philippines
Poland
Republic of Korea
Romania
Russian Federation
Rwanda
Saudi Arabia
Sierra Leone
Solomon Islands
Spain
Sri Lanka
Sudan
Switzerland
Thailand
Tunisia
Turkey
Uganda
United Kingdom of Great Britain and Northern Ireland
United Republic of Tanzania
Viet Nam
Yemen
Zimbabwe

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*/ For the list of participants, see TD/B/COM.3/EM.7/INF.1.

2. The following intergovernmental organizations were represented at the Meeting:

African, Caribbean and Pacific Group of States
Agency for Cultural and Technical Co-operation
Arab Labour Organization
Arab Maghreb Union
Commonwealth Secretariat
European Community
South Centre

3. The following specialized agencies and related organization were represented at the Meeting:

International Labour Organization
International Telecommunication Union
United Nations Industrial Development Organization
World Trade Organization

4. The United Nations Development Programme was represented at the Meeting.

5. The following non-governmental organizations were represented at the Meeting:

General Category

International Chamber of Commerce
International Christian Union of Business Executives
International Confederation of Free Trade Unions
World Association of Small and Medium Enterprises
World Federation of United Nations Associations
World Savings Bank Institute

Resource Persons

Mr. A. Bah, National Project Manager, UNIDO Project, Guinea
Mr. Abeeku Brew-Hammond, Kumasi Institute of Technology and Environment, Centre for Innovation and Enterprise Development, Ghana
Mr. Alan Gibson, Springfield Centre for Business Development, Durham, United Kingdom
Mr. Khantiko Kong, Director, Alliance 3 Development Partner, France
Mr. Jacob Levitsky, Consultant, World Bank
Mr. Jorge Monge, President CODETI (Foundation for the Technological and Industrial Development of Central America), Costa Rica
Mr. Kimanthi Mutua, Project Manager, Kenya