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Policy options for strengthening SME competitiveness*

Note by the UNCTAD secretariat

Executive summary

The issues note "Improving the competitiveness of SMEs through enhancing productive capacity" (TD/B/COM.3/51) discussed by the Commission on Enterprise, Business Facilitation and Development at its seventh session highlighted the importance of competitiveness for maintaining high levels of income and employment and focused on building consensus on what competitiveness is at the level of a nation and at the level of an enterprise; identifying the drivers of competitiveness; and examining the policies and measures that Governments could adopt to enhance enterprise competitiveness.

This issues note seeks to take the discussion further by identifying concrete policy options that developing countries could adopt to strengthen enterprise competitiveness. It focuses on micro and meso policies for enterprise development to identify the most effective entry points and mechanisms for a private sector development strategy and action plan. It also reviews in a concise manner the key areas of enterprise policy that have been examined by the Commission since UNCTAD X.

*The document was submitted slightly late because the division was heavily involved in servicing another intergovernmental meeting at the time.

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1. Introduction

1. The issues note "Improving the competitiveness of SMEs through enhancing productive capacity" (UNCTAD, 2002a) discussed by the Commission at its seventh session highlighted the importance of competitiveness for maintaining high levels of income and employment. It adopted the following definition of competitiveness: *"a nation's ability to produce goods and services that meet the test of international markets while simultaneously maintaining and expanding real incomes of its people over the long term"*. It noted that there is a gap in literature with regard to examining in detail the policies and support programmes that are necessary for strengthening productive capacity at the enterprise level, particularly of small and medium-sized enterprises (SMEs). It set out to close this gap by:

- Building consensus on what competitiveness is at the level of a nation and at the level of an enterprise;
- Identifying the drivers of competitiveness;
- Examining the policies and measures that Governments could adopt to enhance enterprise competitiveness.

2. This issues note seeks to take the discussion further by identifying concrete policy options that developing countries could adopt to strengthen enterprise competitiveness. It will not present the usual macroeconomic, legal and regulatory prescriptions or the usual recommendations for investing in physical infrastructure and human development (health and education) necessary for private sector development. Those prerequisites are addressed in virtually every development report. Instead, it identifies the most effective entry points and mechanisms at the meso and micro levels for a private sector development strategy and action plan[1]. In particular, the note contains policy options in the following areas:

- Regulatory environment;
- Public–private sector dialogue;
- Business development services;
- Access to finance;
- Financial and fiscal incentives;
- Inter–firm cooperation;
- Business linkages between large and small enterprises;
- Entrepreneurship and competitiveness;
- Policy coherence at the international level.

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1 See also UNCTAD(2001a) for an action plan for African-Asian cooperation.

2. Competitiveness as a long-term strategy

3. One of the main messages of this note is that countries need a comprehensive strategy for competitiveness to improve their structural position in the global economy. Greater competitiveness allows developing countries to diversify away from dependence on a few primary commodity exports and move up the skills and technology ladder in order to sustain rising wages and permit greater economies of scale and scope in production (UNCTAD, 2000b, p.117). New patterns of competition require active micro policies and measures aimed at shaping new industrial locations; and existing enterprises have to restructure their activities and facilities. Such a strategy should be based on a national vision stemming from a consensus among the national stakeholders and an awareness of both the national goals and the steps that have to be taken to achieve them. Such an exercise should begin with stocktaking in terms of strengths and weaknesses of existing policies, programmes and structures at all levels (macro, meso and micro). Then, on the basis of the stocktaking, the stakeholders should design competitiveness policies and programmes that contribute continuous increases in the value added of national production. To achieve such increases, enterprises must transform their ways of competing; they must shift from comparative advantages (i.e. low-cost labour) to competitive advantages, namely the ability of their enterprises to compete on cost and quality, delivery and flexibility.

4. A special case for government intervention to help SMEs to become competitive can be made based on the importance of this sector – SMEs usually comprise about 99 per cent of all enterprises, account for 50 per cent of manufacturing output and from 44 to 70 per cent of employment, and play an especially important in new job creation (UNCTAD, 2002a). However, numerous market failures prevent domestic enterprises from building competitive advantages because they cannot access finance, information, technology and markets. Specific policies, programmes and appropriate institutional frameworks are needed to help SMEs overcome these failures. According to Chudnovsky (2001), to transit the high road to competitiveness, firms, both large and small, in developing countries have to build and continuously enhance endogenous capabilities. These capabilities can be applied to add value to existing activities and to make new products and start new services that can compete in the global economy.

3. Regulatory environment

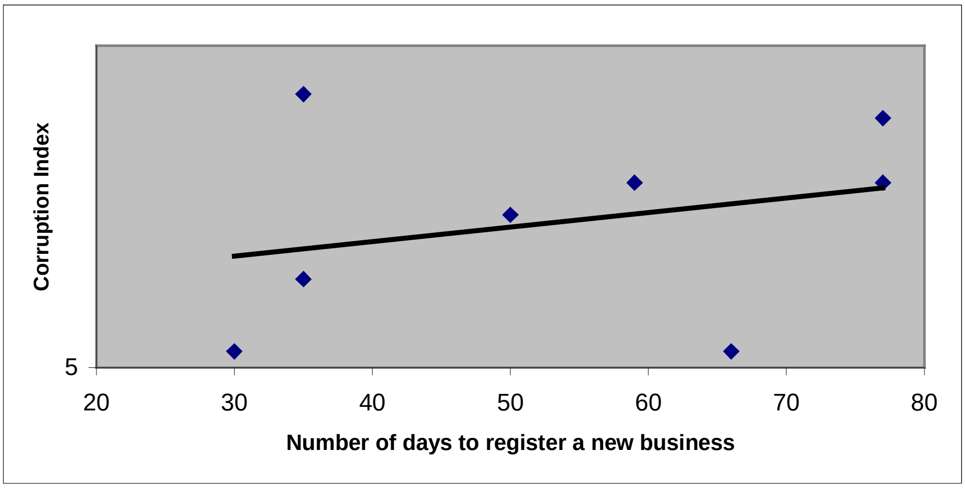
5. Regulation is necessary for the private sector to operate efficiently. A simple, transparent, stable and enforceable regulatory environment forms the base upon which a dynamic enterprise sector can develop. Bannock et al. (2002) highlight some of the difficulties that enterprises typically face regarding the regulatory environment:

- " a dynamic MSE [micro and small enterprise] growth contribution has been curtailed…in the Third World by the regulatory iron curtain between the formal and the informal sectors, lack of property rights and, in most cases also inappropriate macroeconomic frameworks and governance".

- " Civil servant, South Africa: There are 65 laws to comply with in order to register a business in South Africa. People don't know what to do or where to start. Let alone who to ask for help".

6. These quotations indicate that enterprises in developing countries face a heavy and costly regulatory burden that discourages especially the smaller enterprises from entering the formal sector of the economy. On the other hand, the regulatory system yields very few benefits to enterprises as it does not provide a clear framework in which business transactions can be enforced or in which property rights are clearly defined. A further concern is that complex and heavy regulatory frameworks are often associated with high levels of corruption, as the figure below indicates in the case of Africa.

Figure 1. The Corruption Index* and the time required to register a business in Africa



Sources: Transparency International, www.gwdg.de/~uwvw/2002Data.html (18/3/03); Djankov et al. (2000); Bannock et al. (2002).

*The Corruption Index is inverted from the index published by Transparency International. Thus the larger the value of the inverted corruption index, the more corruption is present in the country.

Policy recommendations

7. *Firstly, there is a need to simplify the existing business regulations in order to reduce the administrative burden that enterprises face. This can be achieved in a relatively short space of time if the Government is sufficiently committed to the reforms. Governments can establish a user-friendly one-stop shop for business registration and licensing for domestic enterprises, much as they have done for foreign investors in the form of investment promotion agencies.*

8. *Secondly, there is a need to strengthen judicial institutions so that contracts can be enforced, property rights are respected and companies that default on their debts will go*

through an orderly bankruptcy procedure. While it is relatively easy to reduce the administrative burdens, changes in the legal system cannot be achieved over night, but they require a long-term commitment to gradually build up the capabilities of the respective institutions.

4. Public–private sector dialogue

9. The most effective and also the most feasible long-term solution for improving the regulatory environment from the point of view of enterprises starts with public–private sector dialogue. Effective interaction and dialogue between the Government and the private sector, including non-governmental organizations, play a key role in creating a coherent policy framework and effective support measures and structures for the development of enterprises.

10. Some form of public–private sector interaction exists in virtually all countries at various levels of government, including regional and local administrations, and sometimes for particular sectors. However, in many developing countries, contacts between the Government and the private sector are often informal, spontaneous, partial or unstructured. Furthermore, they often lack transparency or clarity in terms of defining the objectives to be achieved and the issues to be addressed, including the particular needs of SMEs. Moreover, government–private sector contacts are often highly personalized or opaque, which can lead to undesirable results. SMEs usually have little trust in Governments and see them as a source of problems because of burdensome regulations and inspections and unfair taxation rather than as a source of assistance.

11. Shortcomings in such interactions deprive the Government of appropriate inputs for policy-making and enterprises of inputs from the Government for their strategic planning. Consequently, because of such shortcomings, it is not always evident that the process of policy and institutional development in support of SMEs in individual countries responds effectively to the needs and concerns of SMEs or takes sufficiently into account the difficulties or constraints faced by them.

12. Seldom are all members of the private sector represented in this dialogue. SMEs, women entrepreneurs and young entrepreneurs particularly feel neglected or unable to participate owing to various constraints, including lack of information, shortage of resources,

work pressure and various other obstacles. Moreover, the activities of the institutions or agencies that participate in this dialogue are sometimes heavily politicized.

Policy recommendations

13. *Firstly, Governments should establish mechanisms for structured public–private sector dialogue. These could take the form of consultative business councils, advisory panels, chambers of commerce and business associations. Such mechanisms should meet the following criteria:*

- *All relevant stakeholders are represented and the criteria by which they are chosen are transparent;*
- *The objectives and the agenda are clearly stated and relevant to the stakeholders;*
- *Sessions are held regularly, or are called on the basis of criteria that are transparent and accepted by all stakeholders;*
- *There is transparency regarding how and by whom the agenda is set, how representatives are selected, and how often meetings are held;*
- *There is accountability/ monitoring of progress or impact of dialogue;*
- *A two-way street exists – as a forum for the Government to sound out the private sector on issues and a route for the private sector to raise issues;*
- *Dialogues are held at all levels: national, regional and local.*

14. *Secondly, Governments should promote training and capacity building to make public sector dialogue work; without it certain segments of the business community will not be able to adequately put forward their concerns and needs. Also, representative organizations must be strengthened through capacity-building efforts. Box 1 contains a checklist for private sector business associations.*

Box 1. Checklist for private sector business associations

- How representative are the associations?
- How are they elected?
- How are they managed?
- How do local producers, large and small, get heard within these bodies?
- Who decides what tasks the association takes on?
- Is there a specialized secretariat and, if so, do local producers manage it?

Source: Nadvi (1999).

15. *Finally, and perhaps most importantly, Governments should have an open and positive attitude towards dialogue with the private sector and genuinely be willing to take into account private sector views in policy-making. For many Governments this will require a change in culture from a more "administrative approach" to a more "managerial approach" towards the private sector.*

5. Business development services

16. Over the past decade, Governments and international donors have increasingly turned their attention from merely offering financial assistance to providing business development services (BDS) for SMEs in the recognition of the fact that financial support alone is not enough for achieving sustained competitiveness.

17. BDS are all types of SME support services, including training, consulting, technical and managerial assistance, marketing, physical infrastructure and policy advocacy. BDS interventions are specifically aimed at helping small enterprises to overcome market

imperfections and inadequate access to technology, as well as to operate more competitively and with greater efficiency in domestic and global markets.

18. In 1997 the Committee of Donor Agencies for SME Development developed new guidelines for the design and delivery of BDS, aimed at increasing the effectiveness, outreach and sustainability of BDS interventions. A series of principles of good practice have been endorsed by the international community, including:

- Focusing on stimulating the demand for BDS by sensitizing SMEs to their benefits;
- Replacing the provision of direct services by government with the development of private intermediary institutions (BDS suppliers);
- Making targeted and time-bound use of subsidies.

19. Effective business intermediary organizations for the provision of financial and non-financial services are essential for enabling enterprises to take what has been defined as the "high road to competitiveness" and to be "partnership-ready". Action in this area will address the "capacity gap" in human capital in terms of technical and management skills.

Policy recommendations

20. *In principle, BDS support to SMEs should be provided by the private sector and, where BDS are already demanded by the market, Governments should not be direct service providers. Instead they should make indirect use of local (meso) support structures in the private sector such as capacity-building programmes, business associations and private consultants. Should there be an unfavourable cost-benefit ratio or in cases of "free riders" (where public goods are concerned), government subsidies could be considered. In any event, mechanisms and structures should be conceived in a business-like manner.*

21. *Bearing in mind the time pressures on SMEs, BDS must be brought as physically close and made as convenient as possible for the small-scale entrepreneur. This requires the maximum feasible vertical and territorial decentralization in organizing BDS. Approaches in recent years have concentrated on the creation of business support centres in various regions and localities of the country where they could be justified by the number of potential beneficiaries. Generally speaking, they are one-stop centres where entrepreneurs have access to a whole set of services and inputs (i.e. entrepreneurship training, information,*

finance, quality control, networking and business counselling) needed to grow their businesses and to confront increasingly competitive external pressures.

6. Access to finance

22. Finance has been identified in many business surveys as the most important factor determining the survival and growth of SMEs in both developing and developed countries. Despite the importance of SMEs to the economies of both developing and developed countries, they have traditionally had difficulty in obtaining formal credit or equity.

Commercial banks and investors have been reluctant to service SMEs for a number of reasons, including the following (UNCTAD 2002d):

- SMEs are regarded by creditors and investors as high-risk borrowers because of insufficient assets and low capitalization, vulnerability to market fluctuations and high mortality rates;
- Information asymmetry arising from SMEs' lack of accounting records, and inadequate financial statements or business plans, makes it difficult for creditors and investors to assess the creditworthiness of potential SME proposals;
- High administrative/transaction costs of lending or investing small amounts do not make SME financing a profitable business.

23. Some commercial banks have started to service the SME market by using financial innovations to cut both the costs and risks of lending to this sector. Leasing is also an attractive option for meeting the needs of SMEs for plant and equipment. Venture capital, on the other hand, is not an option in most developing countries because of the stringent market conditions required for the industry to be viable.

Policy recommendation

24. *To encourage commercial banks to lend to SMEs, central banks and designated financial service regulators must play a proactive role. Government and the central bank must set out a policy framework for channelling adequate funds to the SME sector. In clearly indicating the right direction to the suppliers of capital, regulators could explore set-aside mechanisms for SMEs (i.e. quotas and targets). Certainly, increased transparency would influence the lending practices of commercial banks. The central bank could require, for example, disclosure of the composition of bank loan portfolios by different categories of borrowers. The Government/central bank might also consider a set of special measures for SMEs (guarantee programmes, more user-friendly and transparent disclosure systems, IT-driven appraisal systems) to reduce the risks perceived by banks.*

7. Combining BDS and finance

25. Providers of business services are often better placed than financial institutions to identify potential clients, ascertain their creditworthiness, pre-screen project proposals, disseminate user-friendly financial and accounting systems, monitor repayment, exert peer pressure and maintain one-to-one contacts during the entire payback period.

Policy recommendation

26. *Governments should promote partnerships between financial and non-financial institutions in order to facilitate access to finance by cutting both the costs and the risks of servicing the SME sector.*

8. Financial and fiscal incentives

27. Often financial and fiscal incentives are needed to enable SMEs to keep up their cash flow or to assist disadvantaged enterprises in rural areas or in distressed sectors.

28. Among the incentives that may be considered are:

- Financial incentives: grants, subsidized credits and insurance at preferential rates;
- Fiscal incentives: tax holidays, reduction or exemption from taxes on profits, capital, labour, sales, value added, imports and exports; and
- Other incentives: for example, subsidized infrastructure and subsidized utilities.

29. Great care should be taken when designing incentive schemes, so that moral hazard problems and adverse selection are avoided. Incentives must be tailored to each country's economic and fiscal situation. Incentives must be provided in a transparent manner, and must be monitored, and there must be strict accounting.

9. Inter-firm cooperation

9.1 Industrial clusters

30. Clustering has the potential to enable developing countries to overcome some of the main barriers to industrial development. With suitable help in the form of technological assistance, financial support and a stimulating environment, clusters can produce goods with a high technological content and become competitive on a global scale.

Policy recommendations

31. *Policy intervention should be confined to strengthening only selected clusters with high growth potential, and not supporting agglomerations of tiny firms in an indiscriminate manner. Experience shows that focused measures such as the creation and/or strengthening of technical schools, research centres, export promotion boards, quality certification*

institutes, and business associations, and trigger mechanisms such as promoting brand names and new product/location images, and establishing strategic alliances among public and private actors, can play a role in stimulating and supporting change, tacit knowledge flows and interactive learning.

32. *In particular, the following good practices should be kept in mind when implementing cluster development programmes:*

(a) Initiatives should be defined and implemented with bottom-up involvement of the main local interest groups, both public and private. This requires consensus-building processes, involving workers and employers either directly or through their associations.

(b) Recipients themselves should be in charge of the needs assessment process, and not just involved in the programme as end-users. A participative approach is essential if common strategic visions and alliances are to be created on a long-term basis.

(c) "Social" innovation is required in order to help local actors face global changes. In general, obstacles to generating changes in attitudes, functions and distribution of power are much more difficult to overcome than strictly technical or technological problems.

(d) The target of support measures should not be a single enterprise, but a network of enterprises. Providing common services has two main advantages: (i) it lowers transaction costs; and (ii) it helps generate interaction between enterprises, improving their efficiency and maximizing the potential of the group through the development of mutual learning.

9.2 Export processing zones, industrial parks and incubators

33. Government efforts should not concentrate on backward regions with limited infrastructure and scarce availability of skilled human resources. Rather, export processing zones (EPZs) and technopoles should be located close to commercial, industrial or scientific hubs, where the expansion of industrial production is already taking place in a competitive manner.

Policy recommendations

(a) Targeted industrial development measures should be considered as a development catalyst for the rest of the economy. Innovative public–private sector partnerships should be promoted. The Government can provide infrastructure, but facilities and basic services in the EPZs should be administered by the private sector.

(b) The successful promotion of industrial zones necessarily involves a wide range of complementary factors such as business development services, human resource or skills development, finance and technical assistance including that necessary to upgrade technology.

(c) The interaction between the local industry and the local community as a whole is very important in order to generate positive externalities. Industrial zones must include local

firms from a number of sectors so as to boost interaction with the main tenants and achieve external economies.

9.3 Business linkages between large and small enterprises

34. Business linkages can be a remarkable source of technology diffusion and mastery. There are many types of linkages—backward, forward, research and development (R&D) and spillover effects. The most fruitful are the backward linkages between large and small enterprises. Vertical linkages can be fostered with larger enterprises that are prepared to offer assistance and advice to small businesses. TNC–SME linkages whereby transnational corporations (TNCs) build up competitive supply chains can help SMEs access new and diversified markets, and information on market trends, acquire and master new technologies and skills, and solve cash flow/finance problems. Through linkages TNCs share their road maps with the SMEs so that they can preposition themselves and be ready for changes in market and technology trends.

35. A number of countries, including Ireland, Malaysia, Mexico, the Philippines, South Africa and Singapore, have benefited from the positive developmental impact of TNC–SME linkages that have been instrumental in modernizing and dynamizing their local industries. According to UNIDO (2002), these countries upgraded their local productive capacities and enhanced their industrial performance by integrating into the TNC supply chain. Research by UNCTAD (2001) shows, however, that this does not happen automatically. It requires a partnership among all stakeholders: government, TNCs, SMEs and their support agencies. Probably one of the most successful programmes is the Malaysian global supplier programme, which develops SME capabilities and competencies and provides business opportunities through partnerships between the Government, TNCs and SME support agencies.

Policy recommendation

36. *The Government must have the vision and commitment to integrate business linkages into its overall development strategy; it must attract the right TNCs; it must ensure that the country's people have the right skills; it must give economic incentives to both TNCs and SMEs alike; and it must engage in public–private sector dialogue in order to constantly adapt its strategies to changing conditions. The SME support agencies must give selective support to SMEs to make them partnership ready by enhancing their core competencies in terms of management and technical skills. TNCs must adopt a systematic approach to mentoring and coaching SMEs and be willing to delegate to local managers who best know how to work with local enterprises.*

10. Technology development and financing

- *"Lack of financing and appropriate technology is clearly a major handicap to developing country producers and exporters and it inhibits developing countries from deriving full benefits from their trade rights. Many solutions being proposed in the* *post-Doha programme will be viable only if financing is available"(Rubens Ricupero Geneva, 18 February 2002).*

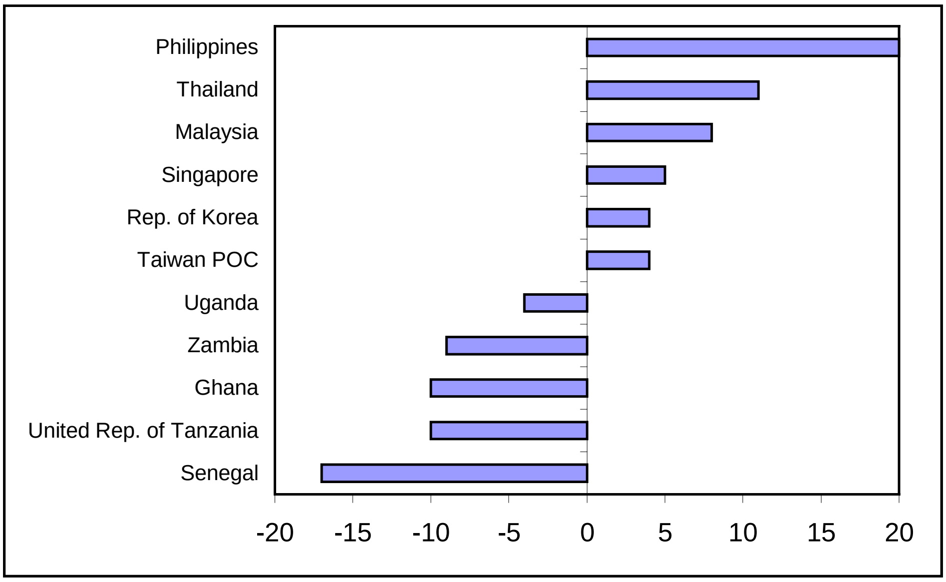
37. Technology development is a critical determinant of the ability of developing country enterprises to compete in global markets. However, several studies show that only a handful of developing countries have managed to narrow the "technology gap" compared with developed economies, with many other countries falling further behind.

38. As UNIDO's Competitive Industrial Performance Index shows, most of those economies that are getting ahead are located in Asia. Some critical factors responsible for the success of the Asian economies can be observed,[2] such as:

- Vision and commitment of government;
- Skills training;
- Attracting export-oriented FDI;
- Support for local industry; and
- Local technological efforts in terms of R&D.

39. There was also an element of luck involved in the Asian success, namely the rise of the semi-conductor industry – that, combined with sound industrial policies and the right framework conditions, contributed to the Asian success. Therefore, replicating Asian policies will not have the same effect in African or Latin American countries since both the international framework and the opportunities have changed. Nevertheless, the principles behind the success of Asian, such as those listed above, are still a starting point.

Figure 2. Change in the CIP ranking for selected countries between 1985 and 1998



Source: UNIDO (2002).

[2] Source: Expert Meeting on Policies and Programmes for Technology Development and Mastery, including the Role of FDI, Geneva, 16–18 July 2003. See also UNCTAD (2003b).

40. Furthermore, with regard to financing technology, the difficulties that enterprises face in obtaining finance are more pronounced when it comes to obtaining financing for technology investment. The outcome of technology investments, especially in cases of R&D projects, establishing technology start-ups, launching new products or adapting new products, is highly uncertain, with the possible returns to the investment materializing only after lengthy periods (UNCTAD 2002c).

Policy recommendations

41. *Integrated technology and industrial policies for competitiveness play an important role in enabling countries to move up the technology ladder. Such polices require sustained support and use public–private partnerships to implement them, with the Government as the facilitator and the private sector as the driver.*

42. *Governments could consider targeting a new kind of foreign investor who is willing to bring knowledge-intensive investment and transfer technology while not forgetting the need to provide assistance to local enterprises. Furthermore, incentive policies should be geared to enabling enterprises (local and foreign) to build technical capabilities, as these policies are the foundation for competitiveness.*

43. *Drivers for technology development (such as skills development, R&D capabilities, ability to attract foreign direct investment, strengthening local enterprises, and infrastructure) are interrelated. Therefore, Governments cannot afford to neglect any of the*

key drivers for technology if they wish to create a virtuous circle for technological development.

44. *It is clear that private sector financing on its own is not a sufficient source of funds for technology-based SMEs, especially in countries that have a bank-dominated financial system and weak traditions of equity financing. Therefore, government financial support in some form is needed, for example grants, loan guarantees and equity to remedy some of the market failures that exist in regard to financing technology-based SMEs and start-ups. Government involvement is especially needed where uncertainty and longlead times discourage the usual supply of finance. The risks to government financing, such as creating market distortions, moral hazard and adverse selection, should be closely examined when there is government intervention.*

11. Entrepreneurship and competitiveness

45. The Global Entrepreneurship Monitor (GEM) consortium conducted a survey of 37 countries on levels of entrepreneurship in developed and developing economies. Figure 3

depicts some of their results for levels of entrepreneurship in different regions of the world. It shows that levels of entrepreneurial activity vary considerably between regions and countries.

The figures range from fewer than 5 entrepreneurs per 100 adults in some European and developed Asian economies to over 20 in some developing Asian countries. Generally, levels of entrepreneurship are higher in developing countries than in developed countries.

46. Although the survey finds that high levels of entrepreneurship activity are associated with high levels of economic growth, some puzzling observations can be made from the data. For example, Singapore, which has been rated by some surveys as the most competitive economy in the world, has low levels of entrepreneurial activity. The GEM survey makes an interesting distinction between "necessity entrepreneurs" and "opportunity entrepreneurs" that partly explains this paradox. There are, of course, several other factors that contribute to the fact that high levels of entrepreneurship are not necessarily associated with high levels of competitiveness.

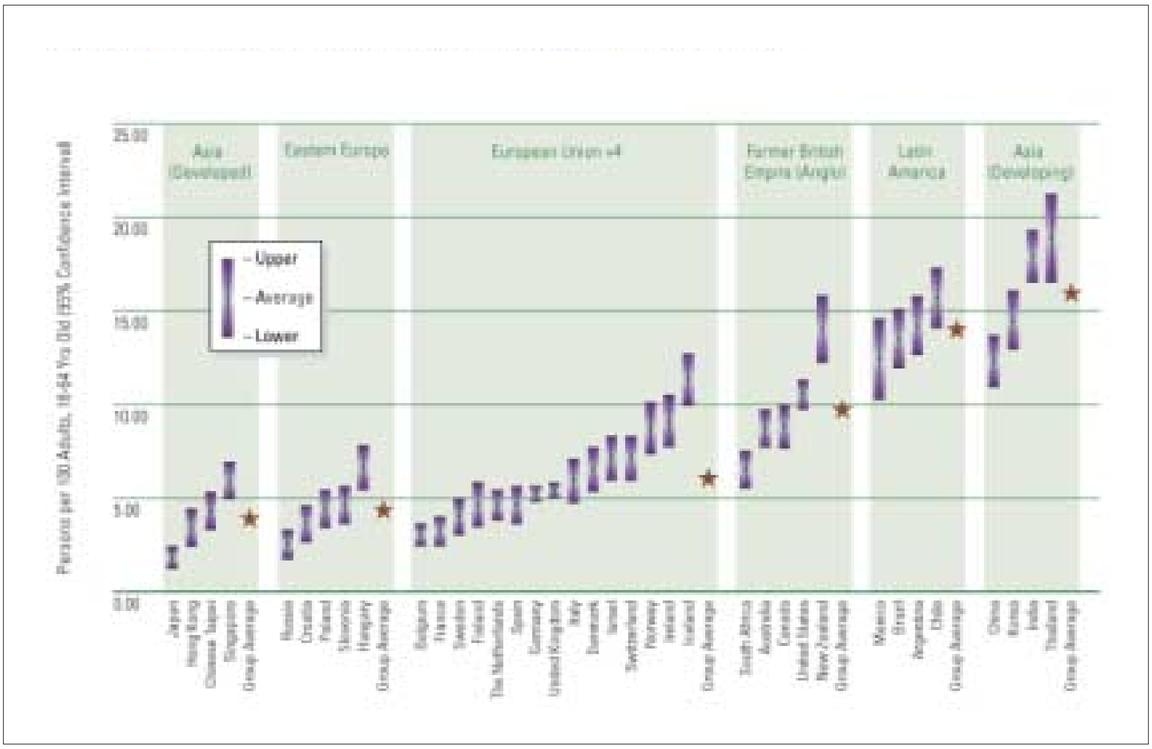
47. Necessity entrepreneurs are defined as people who have become entrepreneurs because they cannot find other suitable work. Opportunity entrepreneurs, on the other hand, are entrepreneurs because they choose to pursue a business opportunity and are therefore more likely to pursue growth-oriented businesses and contribute more to the competitiveness of the country. The survey finds that the numbers of necessity entrepreneurs are generally significantly higher in developing countries than in developed countries.

48. A further distinction is made in the survey, namely "high-potential entrepreneurs". These are entrepreneurs that aim for very high growth rates. The survey defines them as entrepreneurs that expect to create 20 or more jobs within five years and have the intention to export goods and services. It found that such enterprises are extremely rare, but play a very important role in the creation of new jobs and in promoting economic growth and the competitiveness of the country.

Policy recommendation

49. *Necessity and opportunity entrepreneurs, especially high-potential entrepreneurs, have different roles in an economy and require different policies. Necessity entrepreneurs play an important role in poverty eradication, while opportunity entrepreneurs, especially high-potential entrepreneurs, contribute more to enhancing the competitiveness of the economy. Therefore, Governments should consider devising separate policy approaches for the different types of entrepreneurs.*

Figure 3. Entrepreneurial activity by global regions



Source: Reproduced from the GEM Survey.

12. Policy coherence at the international level

50. The policy directions indicated so far for achieving competitiveness at the micro level need to be evaluated in terms of their consistency with international and regional agreements. For example, Governments might be constrained in their ability to promote micro improvements by macro policies such as structural adjustment policies, the Basle II Capital Accord, the EU rules for establishing a single financial market and the WTO agreement on subsidies.

51. The new economic model of trade liberalization, privatization, deregulation and foreign direct investment as advocated by the Bretton Woods institutions largely ignored the microeconomic conditions for development and SMEs. The prescriptions of the Washington Consensus failed to deliver the expected results in terms of growth, productivity, equity and environmental impact in most developing countries. Development requires not only macroeconomic and political stability but also well-functioning markets and institutions. The Washington Consensus failed to include policies both for institution-building and for microeconomic improvements in the areas of competition, technology and enterprise.

52. The impact of excessively restrictive fiscal and monetary policies can defeat industrial policies and micro improvements. For example, while the International Monetary Fund helped Thailand avert the collapse of its banking system, the policies to save the financial system affected the domestic economy, particularly SMEs, far more than anyone anticipated without achieving the main aim, which was to shore up the baht. Ironically, Japanese TNCs were more concerned with the state of the Thai micro economy and the ability of Thai SMEs to survive the credit crunch. This was largely because the Japanese TNCs understood that their viability and competitiveness rested on the well-being of Thai SME suppliers (Régnier, 2000). Therefore, Japanese TNCs undertook a series of support measures that enabled their Thai suppliers to survive the crisis.

53. A analysis of the impacts of the World Bank's Economic and Structural Adjustment Programme (ESAP) undertaken by Zimbabwe from 1991 to 1998 showed that the changes effected through the ESAP moved Zimbabwe down the production value chain, that is in the opposite direction from that needed to improve competitiveness. (McPherson, 2000).

54. The proposed new Basle II Capital Accord, which replaces the 1988 Accord in 2007, aims to align risks with capital requirements. While it could improve the functioning of financial markets, it may have a negative impact on SME finance in the short to medium term, as well as causing increased concentration in the banking sector. Objections have been raised in both Europe and North America and there are calls for more study of its impacts before proceeding with implementation. Under the new accord, the risk weighting on loans to SMEs could be increased because these loans are perceived as very risky and in general are made against inadequate collateral. If the risk weights are increased, this will cause the bank to increase the risk premium charged to the SME. The use of ratings to determine the risk weights could also affect SMEs since the cost of providing them with a rating is extremely high. Rating firms will find it difficult to use their current scales and practices to rate SMEs, because they generally lack knowledge of the SME risk profile. If the SME does not have a risk rating, this will increase the risk weights. The higher the bank's risk the greater the reserves required, and since such reserves often earn minimal interest, banks will be tempted to avoid SME lending altogether.

55. The WTO Agreement on Subsidies and Countervailing Measures (ASCM) might narrow the national policy space to strengthen competitiveness at the enterprise level. The agreement uses four criteria to determine the existence of a subsidy:

- It should be a financial contribution;
- It should be a contribution from a Government (or public) body;
- It should confer a benefit;
- It should be specific (certain enterprises, industries, regions).

56. Articles 8 and 9 introduced a traffic light mechanism whereby prohibited subsidies (for export or import substitution or contingent on local content) were red light, while yellow light subsidies were actionable and green light subsidies were non-actionable. The ASCM section on non-actionable subsidies has lapsed. This was the result of a decision taken by the developing countries because they thought that developed countries would use them as "safe harbours". This has created an environment that lacks legal security, as Governments could be subject to procedural harassment, which could have a detrimental effect on public assistance for technology. Some developing country experts are recommending that the transition period be extended for developing countries on export subsidies and that technology subsidies be reclassified as "non-actionable" exclusively for developing countries. It was also suggested that it is important to negotiate special clauses for SMEs to be included in the WTO Agreements, as this sector is largely neglected in trade agreements and could be seen as a non-distortionary horizontal policy measure.

Policy recommendation

57. *UNCTAD recommended in the* World Investment Report *2002 that certain incentives offered to foreign or domestic firms that have a impact should be non-actionable. Such impacts would involve the creation of more and deeper linkages, the provision of technology, and the training of local suppliers and their personnel. The distortive effects of such measures could be reduced by open and transparent processes with regular reporting and accounting of the costs of incentives used, accompanied by an assessment of their effectiveness (Hughes and Brewster, 2002).*

13. Conclusions

58. This issues note has reviewed a wide range of policy areas in enterprise development and presents policy options after each segment for ways to enhance the competitiveness of enterprises in developing countries. It also presents in a concise way all the key areas of enterprise policy that the have been examined by the Commission since UNCTAD X. The note could serve as a policy guideline for enterprise competitiveness that could be presented and debated at UNCTAD XI.

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