

Strengthening the SME Sector

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Port of Spain, November 25, 2009



Why SME Development programs?

High cost of doing business: Firm size is not only determined by consumption patterns, resource endowments and technology, but also the degree of market competition, the legal and regulatory environment, the availability of credit, all of which are influenced by public policy.

Limited business upgrading: SMEs face a number of market and institutional disadvantages due to their size including disproportionately high fixed costs of accessing markets and information, credit constraints, insufficient firm capacity, research & development and training that could lead to innovations and potentially rapid growth.



Justification for Productive Development Policies to support SMEs



“Productive development policies can be broadly defined as policies that aim to strengthen the productive structure of a particular national economy.”

This broad definition includes any measure, policy or program aimed at **improving the growth** and competitiveness of **large sectors** of the economy (manufacturing, agriculture); **specific sectors** (textiles, automobile industry, software production, etc.); or the **growth of certain key activities** (research and development, exports, fixed capital formation, human capital formation).”

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Productive Development Policies come in all sizes and flavors

| | Horizontal | Vertical |
|---------------------|-------------------------------------|--|
| Public Goods | Business Climate Reforms | Clustering initiatives and targeted inputs |
| Market Intervention | Business Development Services (BDS) | Direct Sector Incentives |

Horizontal Productive Development Policies

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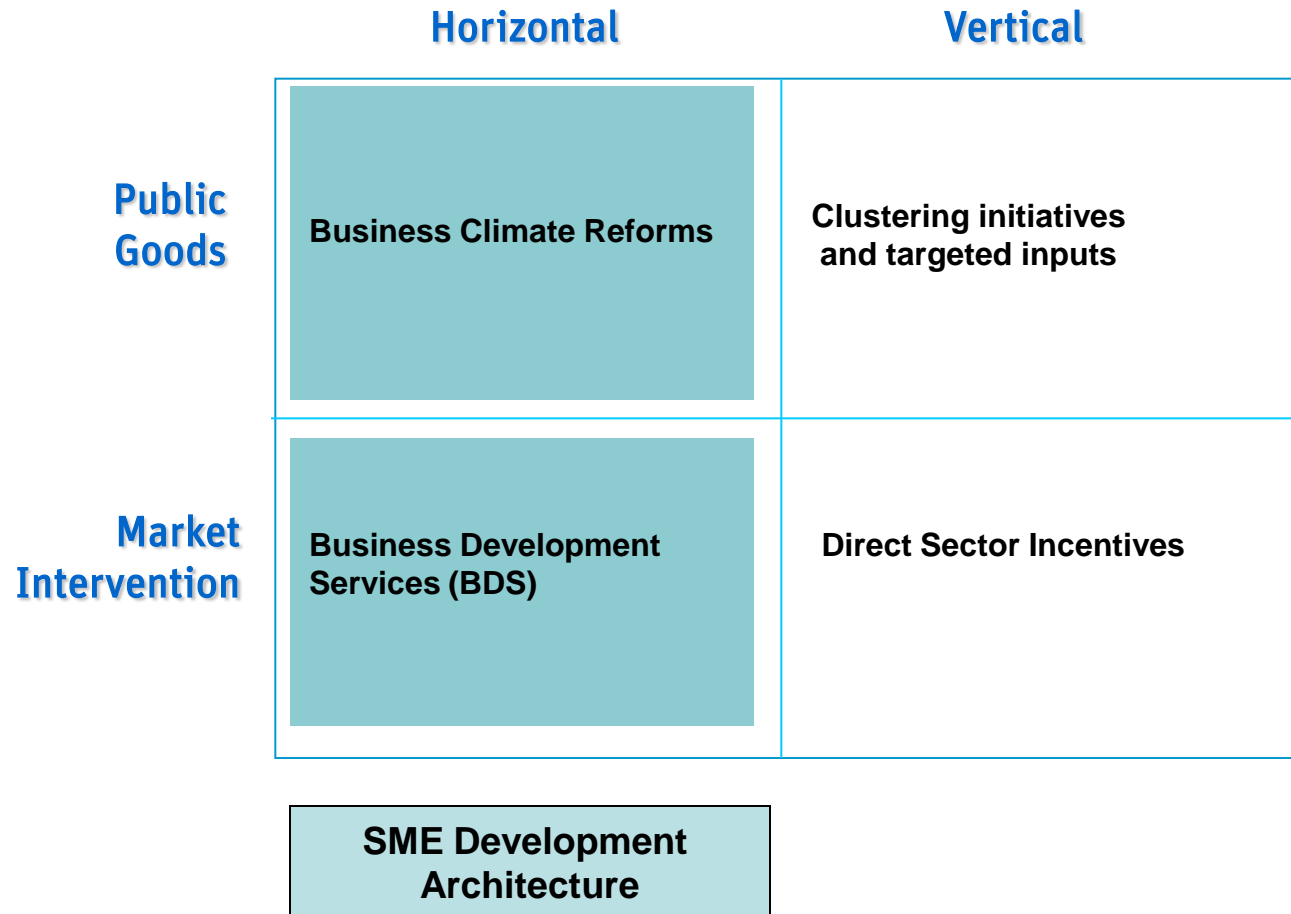
Vertical Productive Development Policies

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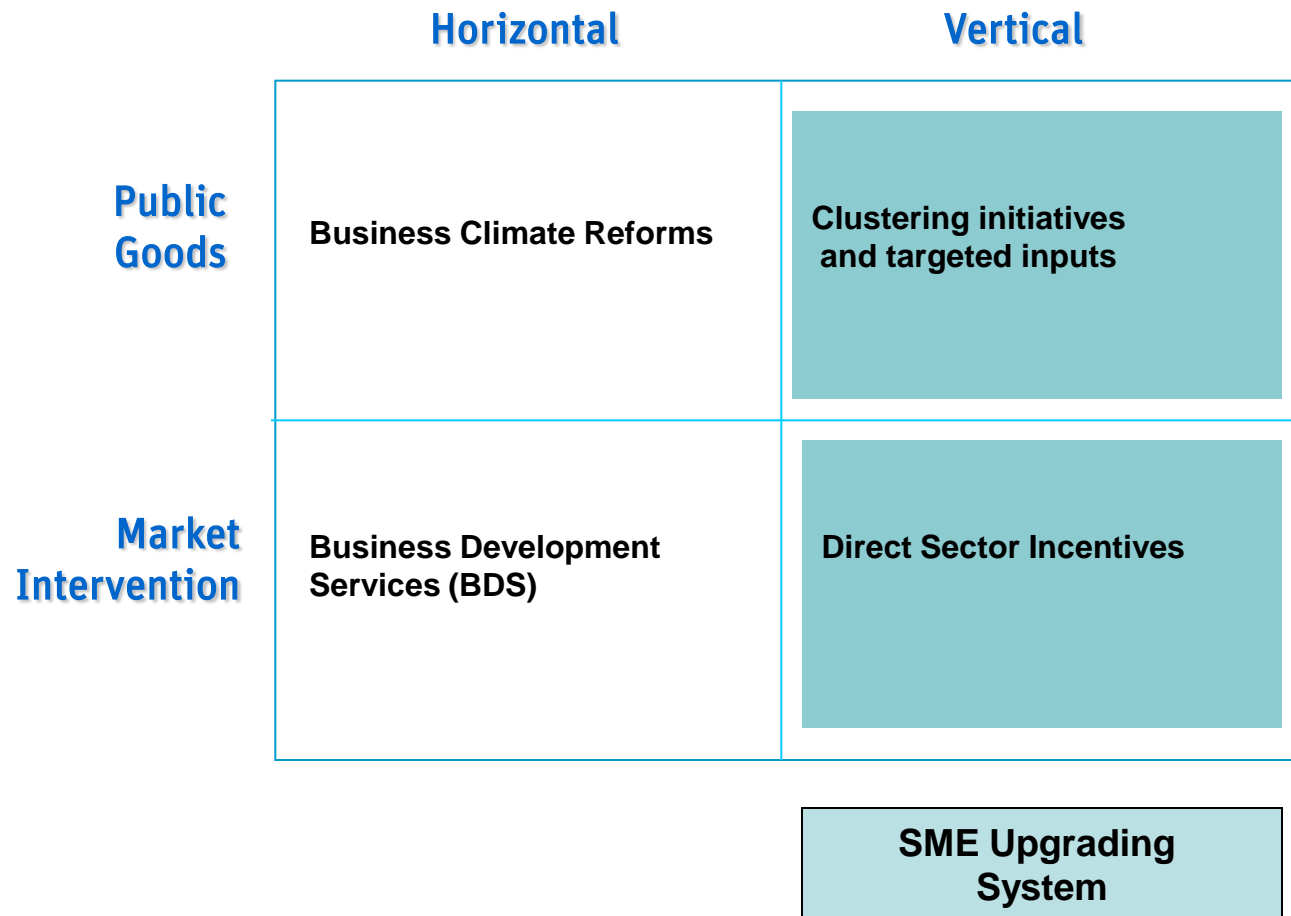
Vertical Productive Development Policies

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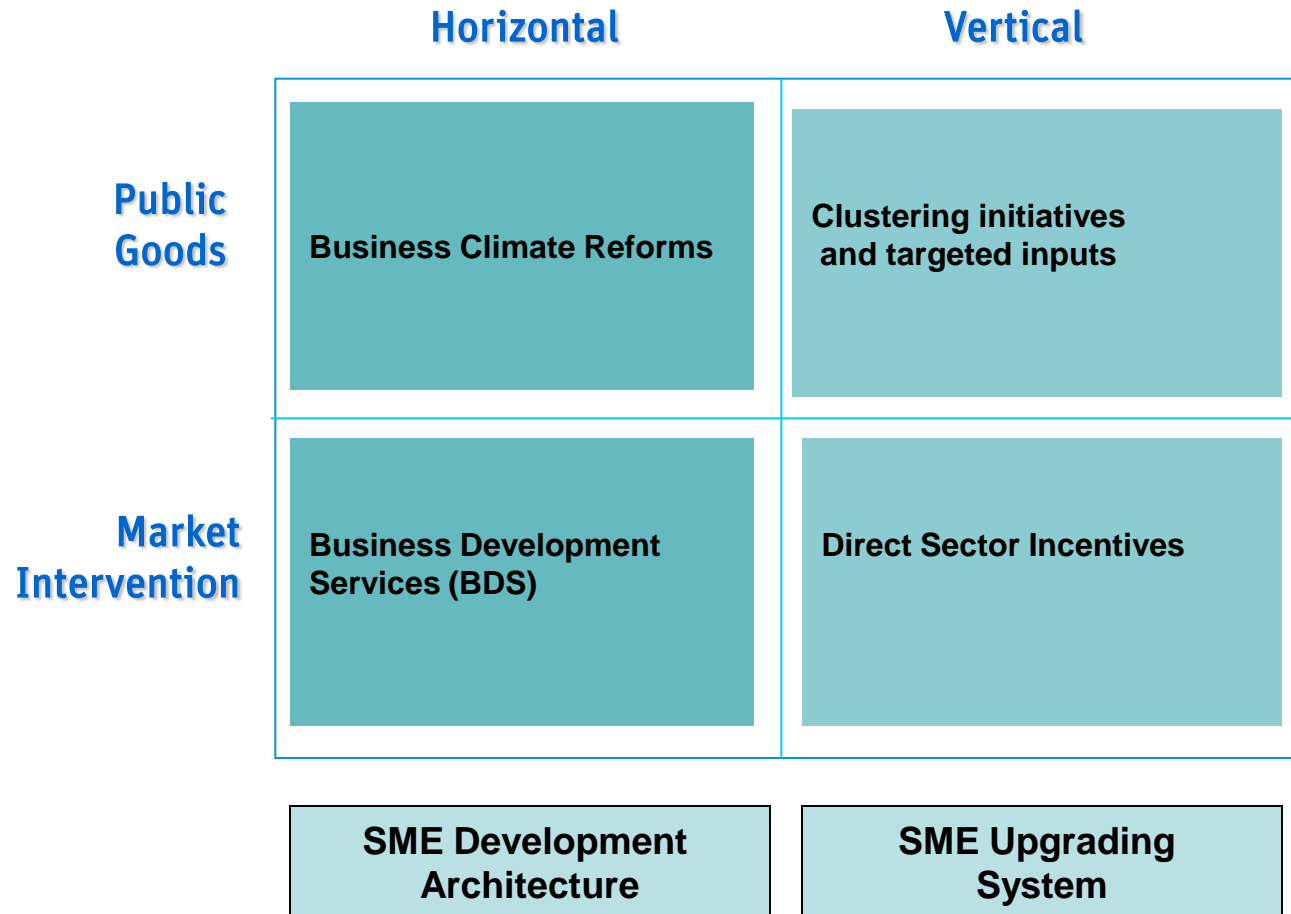
Horizontal PDPs for SME Development Ecosystem



Vertical PDPs for SME Development

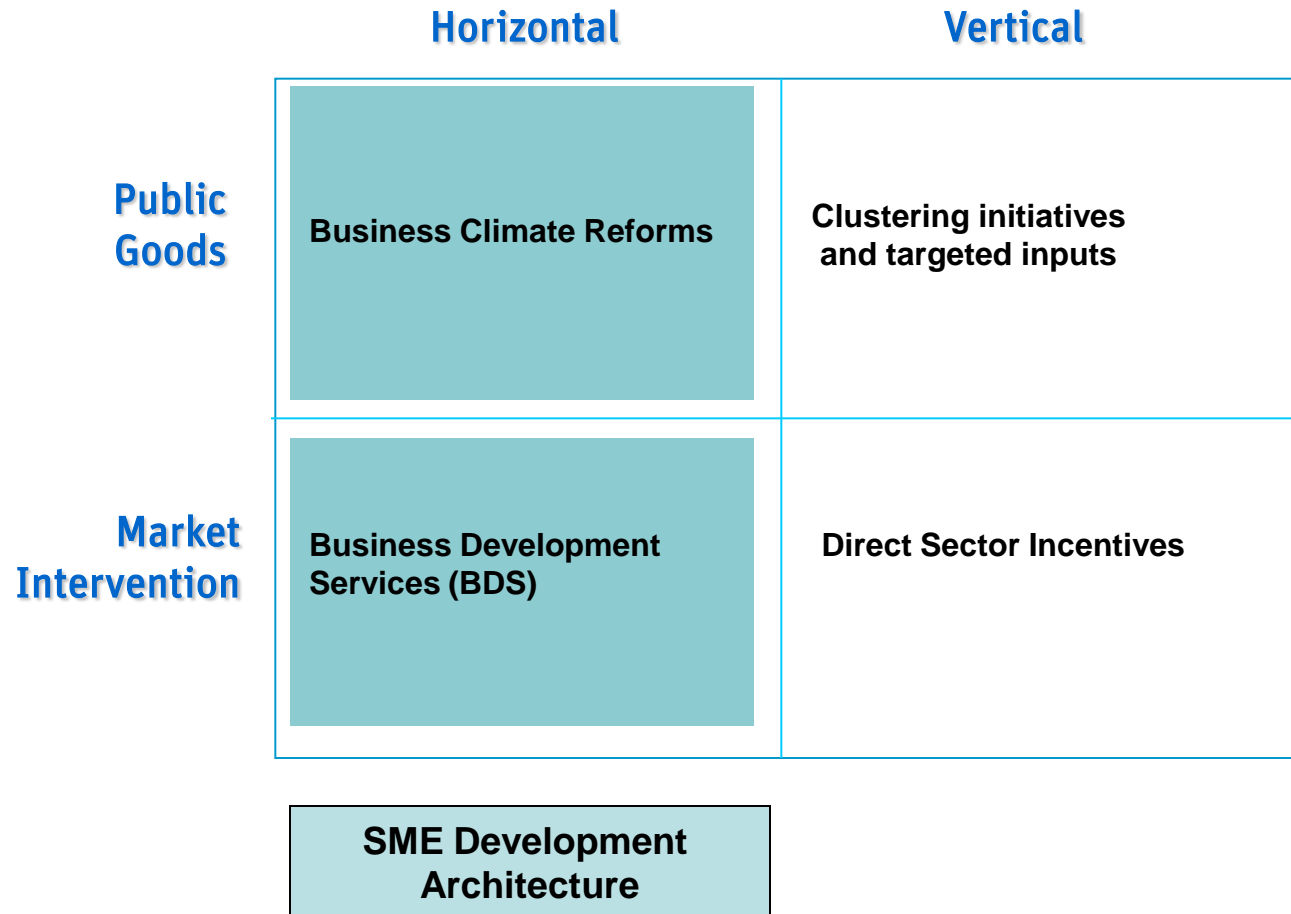


Is there a need for a comprehensive framework for SME Development?



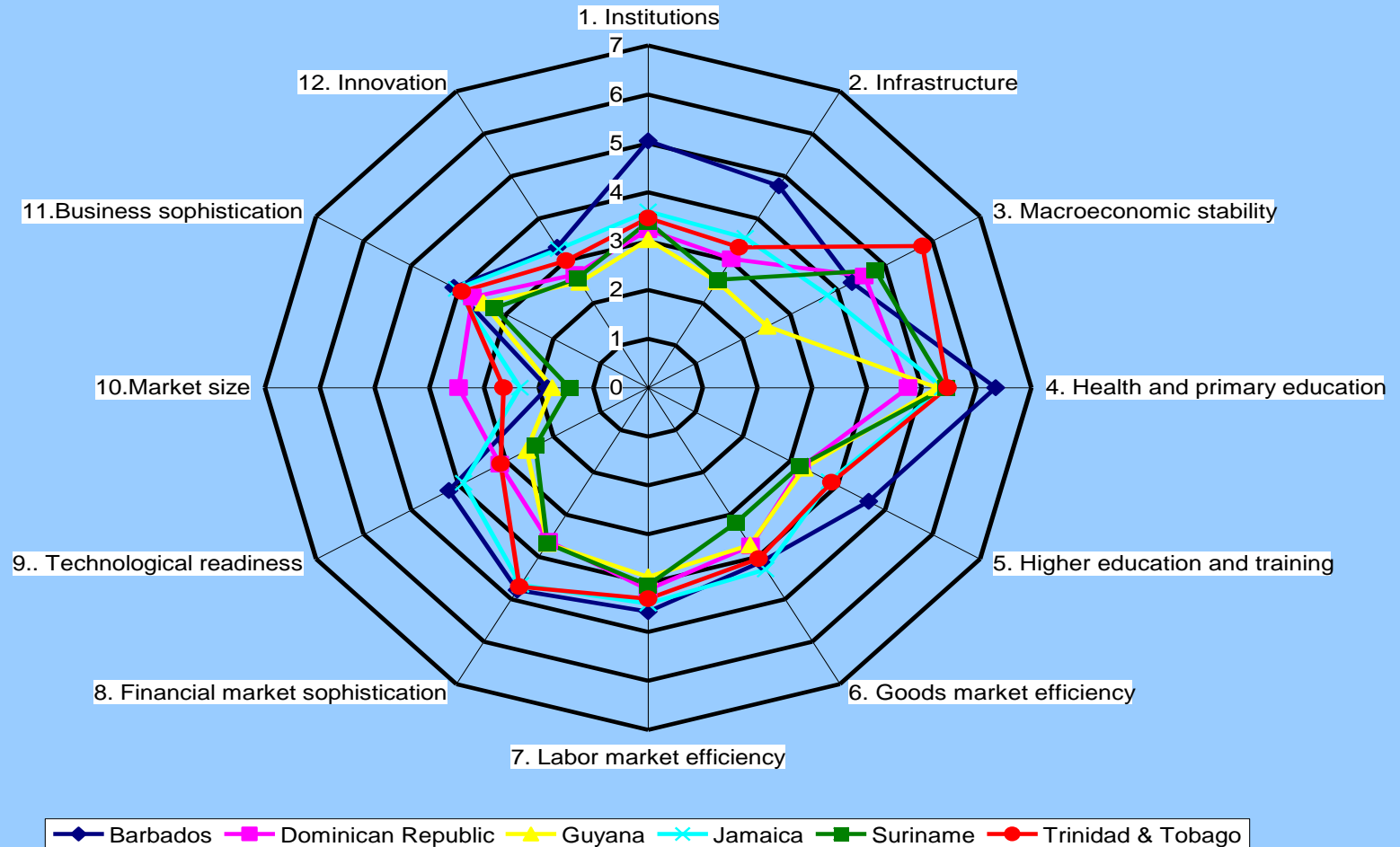
If you want to change the structure of your economy there is.

Horizontal PDPs for SME Development Ecosystem

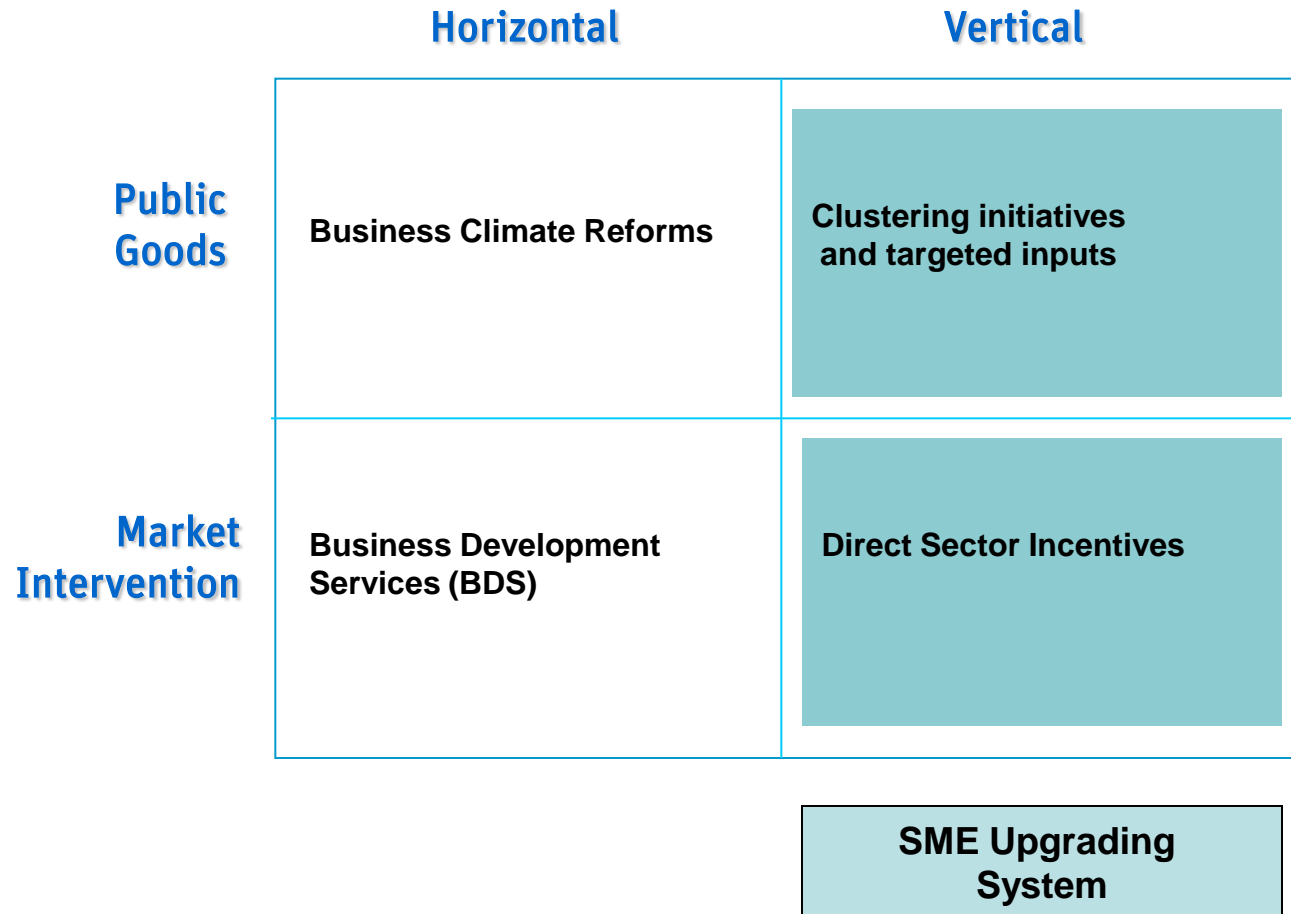


Global Competitiveness Report Ranking 2007-2008

Global Competitiveness Report Scores Caribbean 2007-2008



Vertical PDPs for SME Development

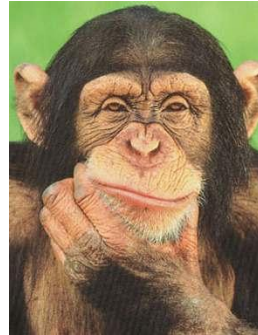


What is the view of development

- Development is about the accumulation of an increasing number of different capabilities
 - Firms and individuals specialize, countries diversify
- What are capabilities?
 - We are agnostic about their nature
 - Personal, organizational (products), social
- They are non-tradable
 - They pin down where production takes place
- Serious coordination problem
 - You cannot make things for which you do not have all the capabilities
 - You do not want to accumulate any specific capability unless all other complementary capabilities are present



Monkeys and Trees



Our metaphor:

- Products are like trees
- Firms are like monkeys
- Structural transformation: process whereby monkeys move from the poor part to the rich part of the forest
- Easier for monkeys to jump short distance

(i.e. to change to products that use similar capabilities)

Jumping to “new” trees is difficult



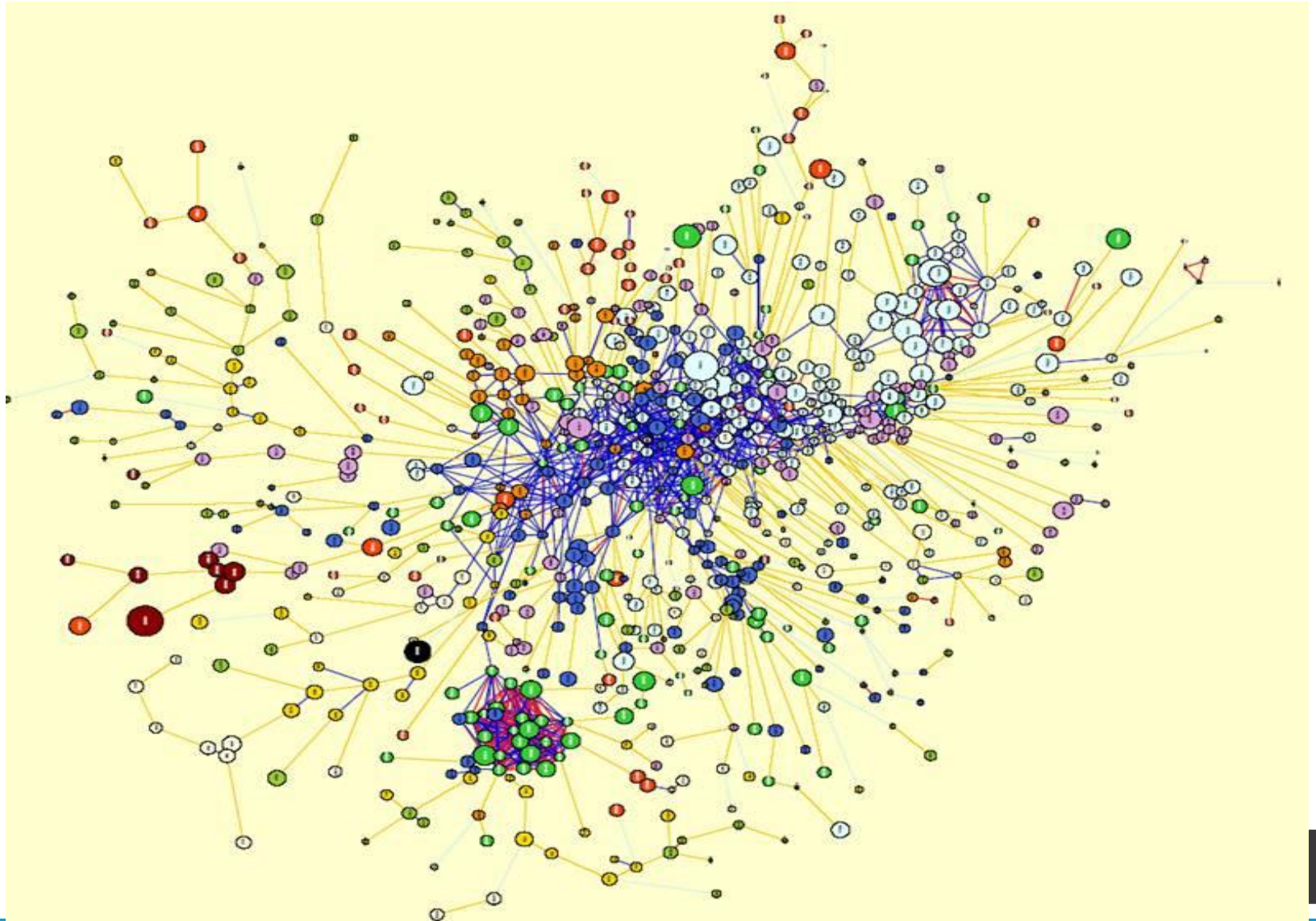
New products face a chicken and egg problem:

- Why create inputs for an industry that does not exist?
- How can the industry exist, if the inputs are not there?

In practice, new products use inputs that have been accumulated to serve other “nearby” products

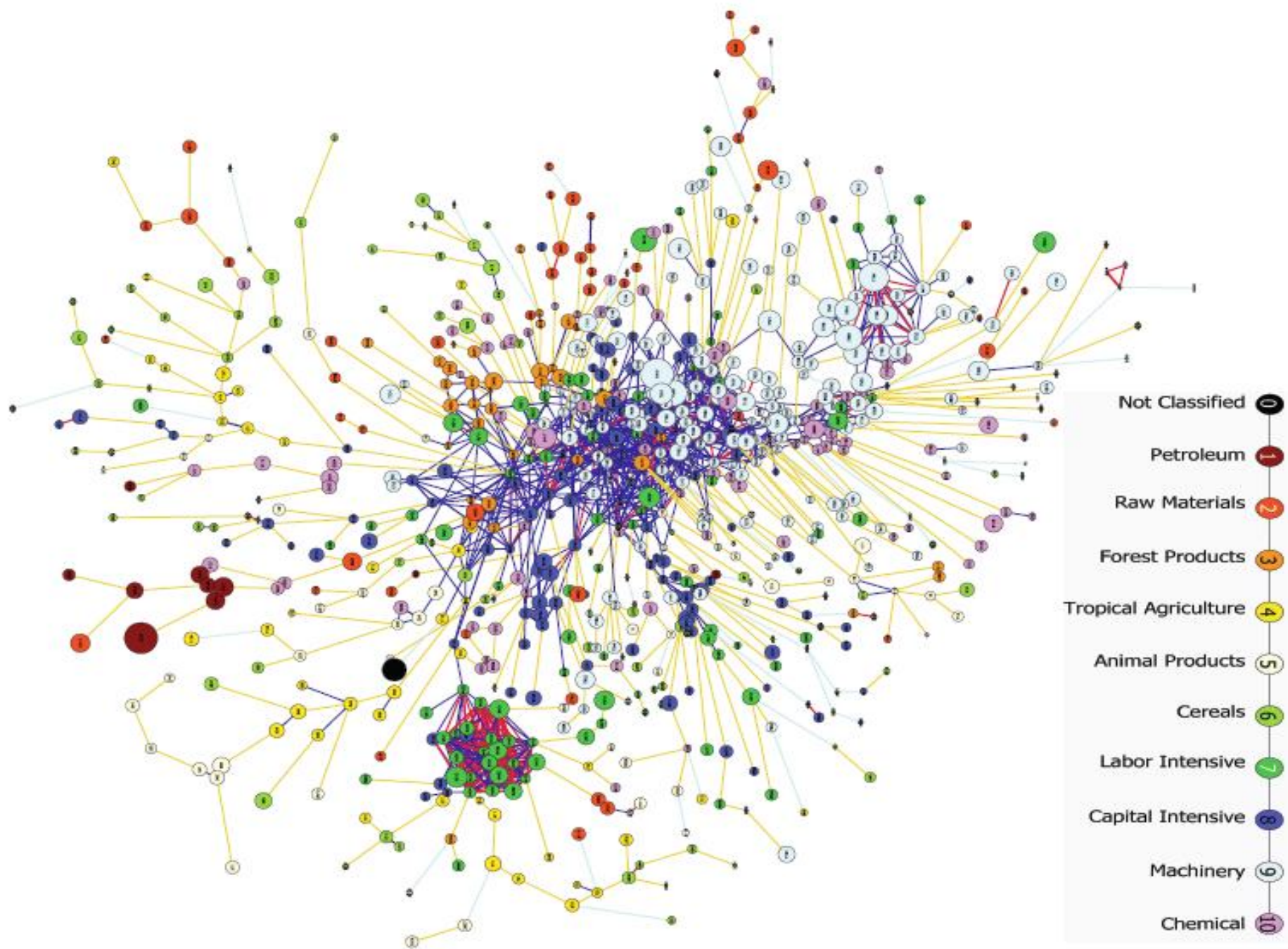
- This creates very strong path dependence

The Product Space

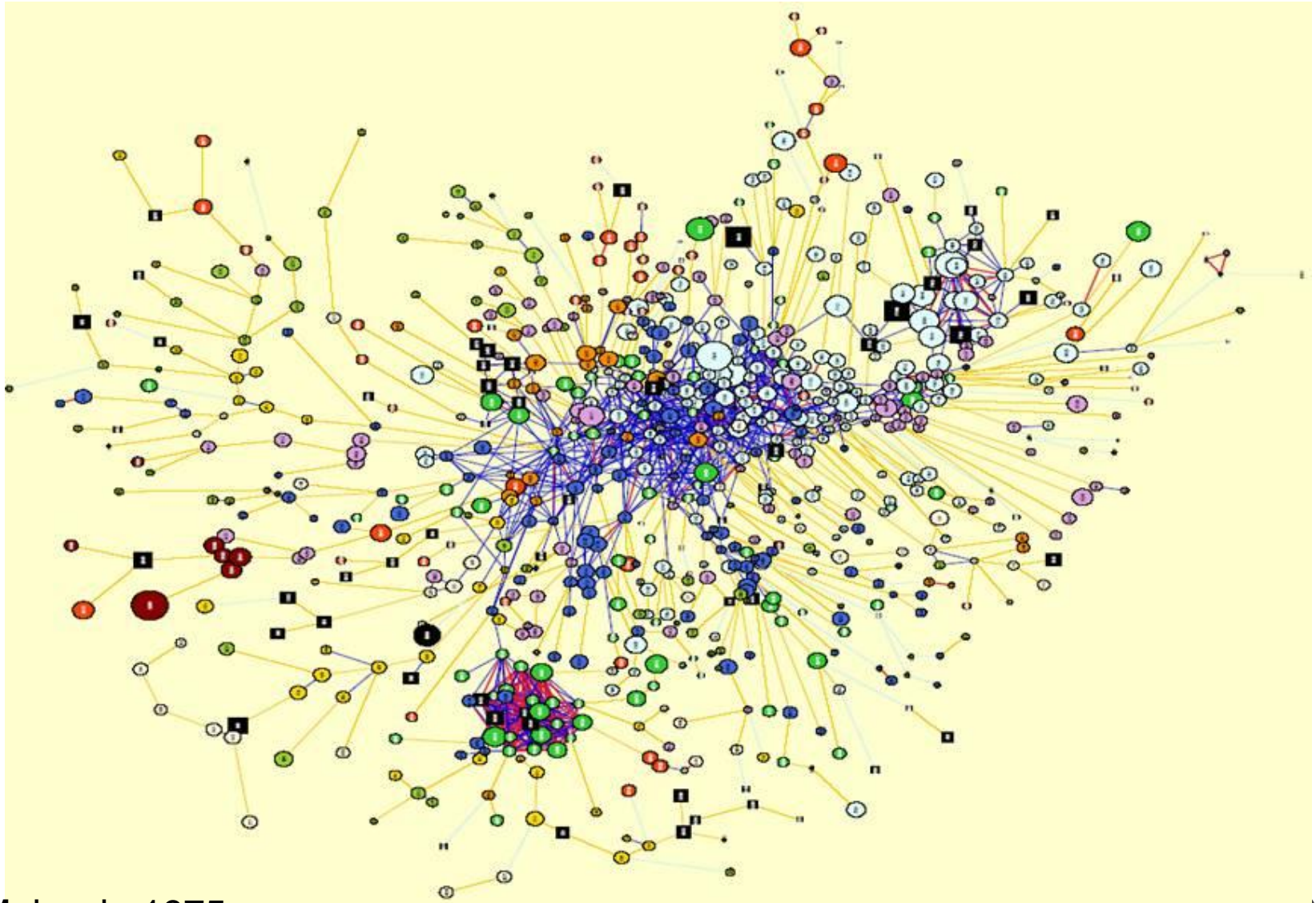


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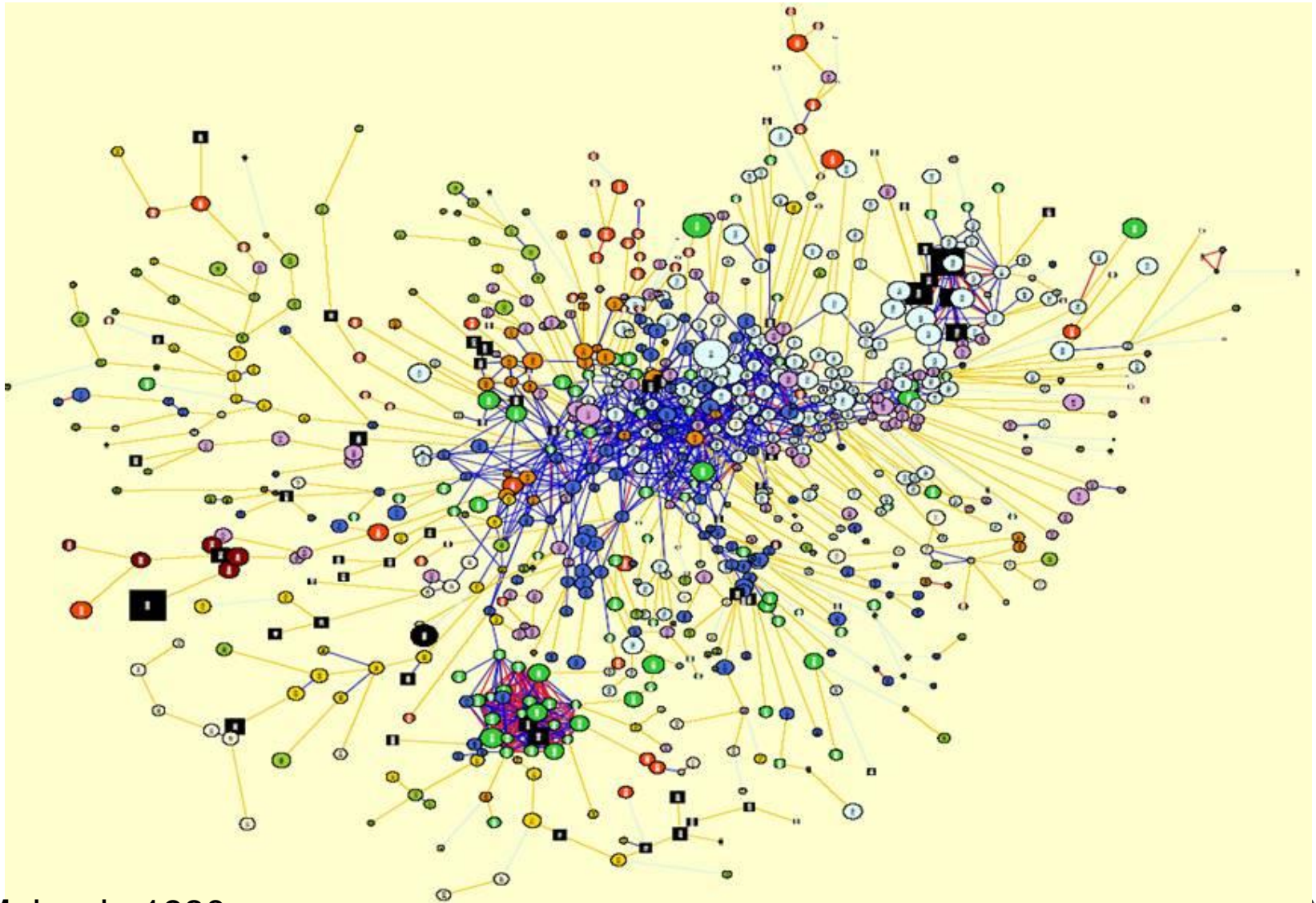
Nodes sized according to World Exports, darker links are stronger (red is strongest)₂₀



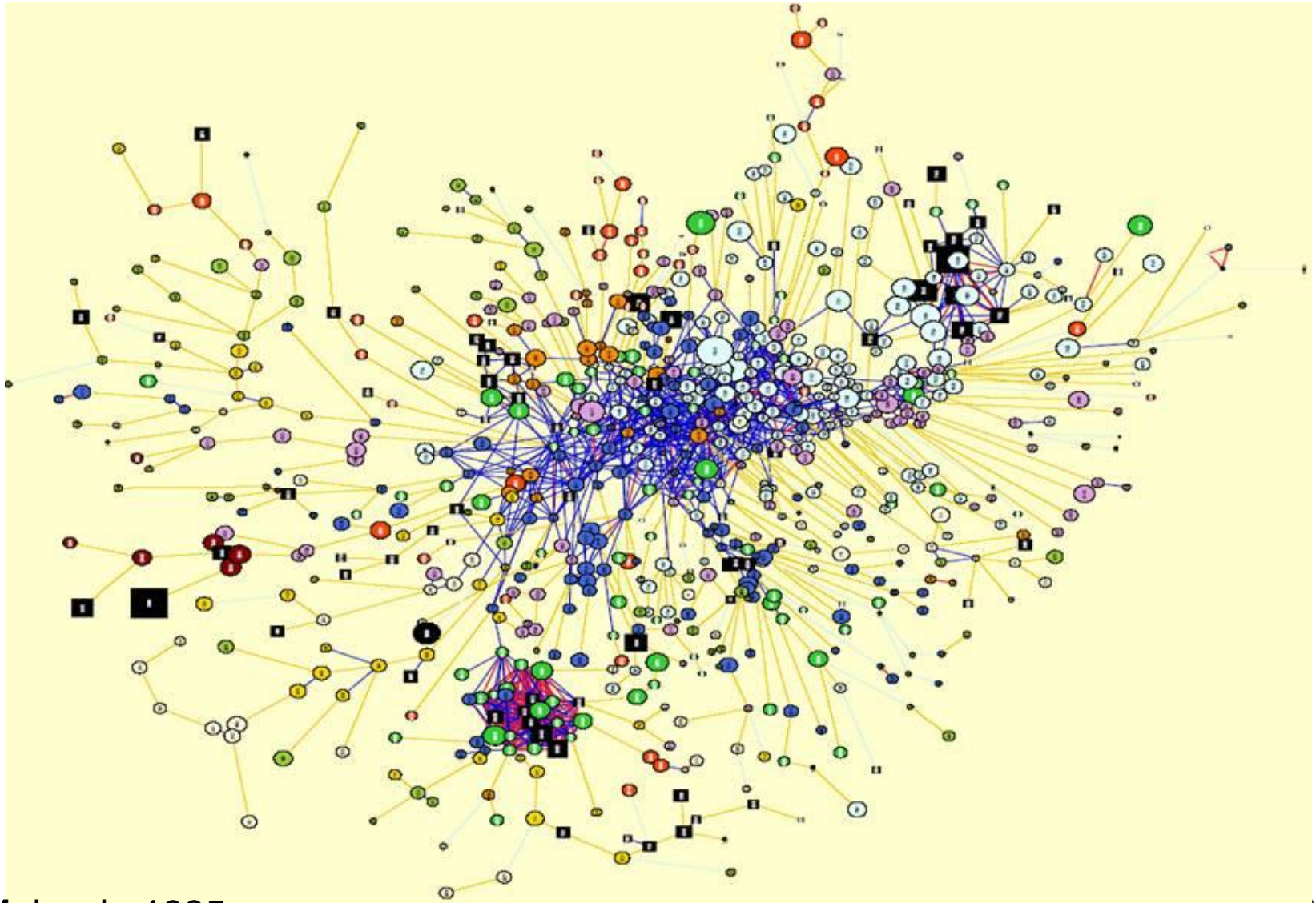
Malaysia: 1975-2000



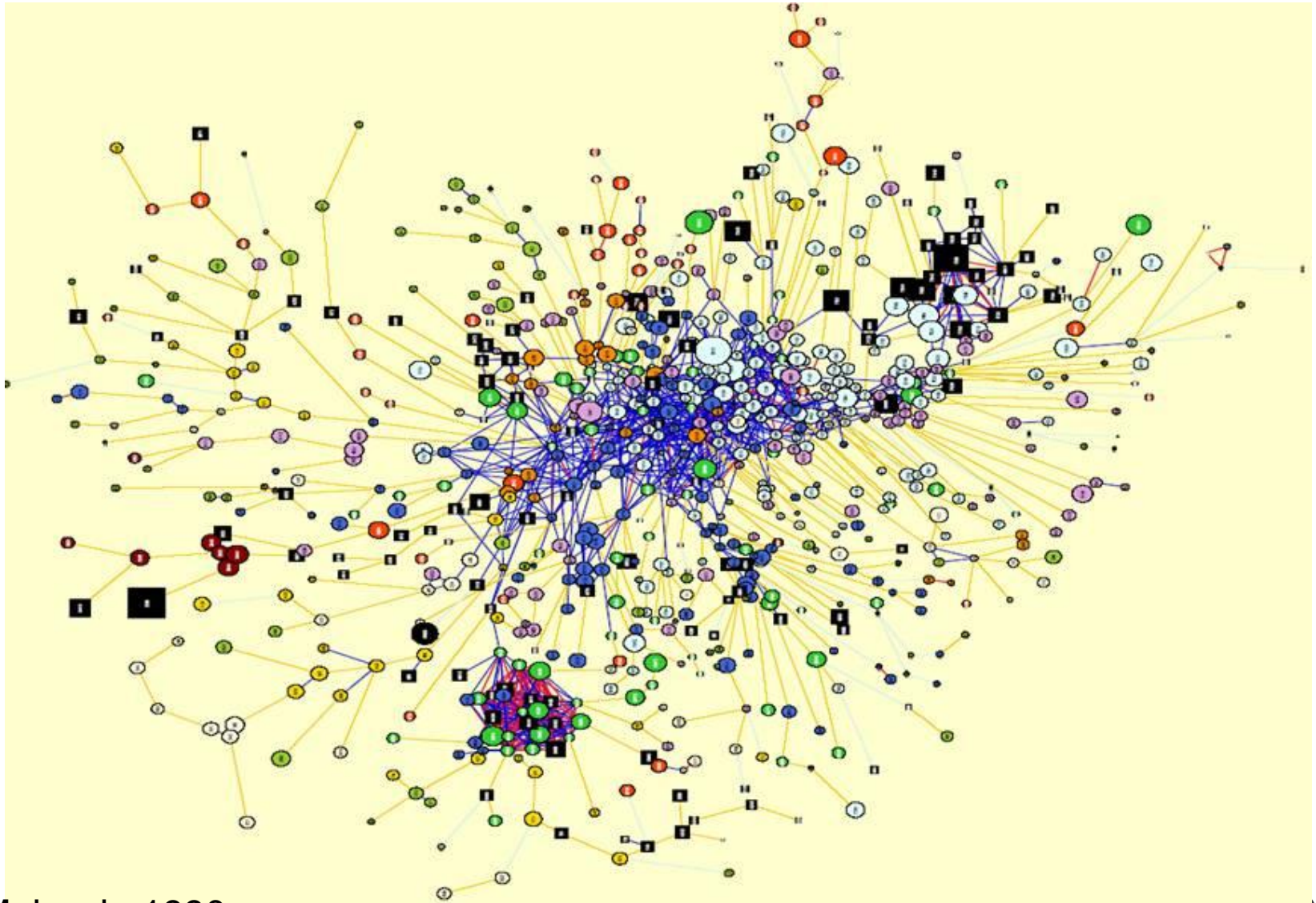
Malaysia 1975



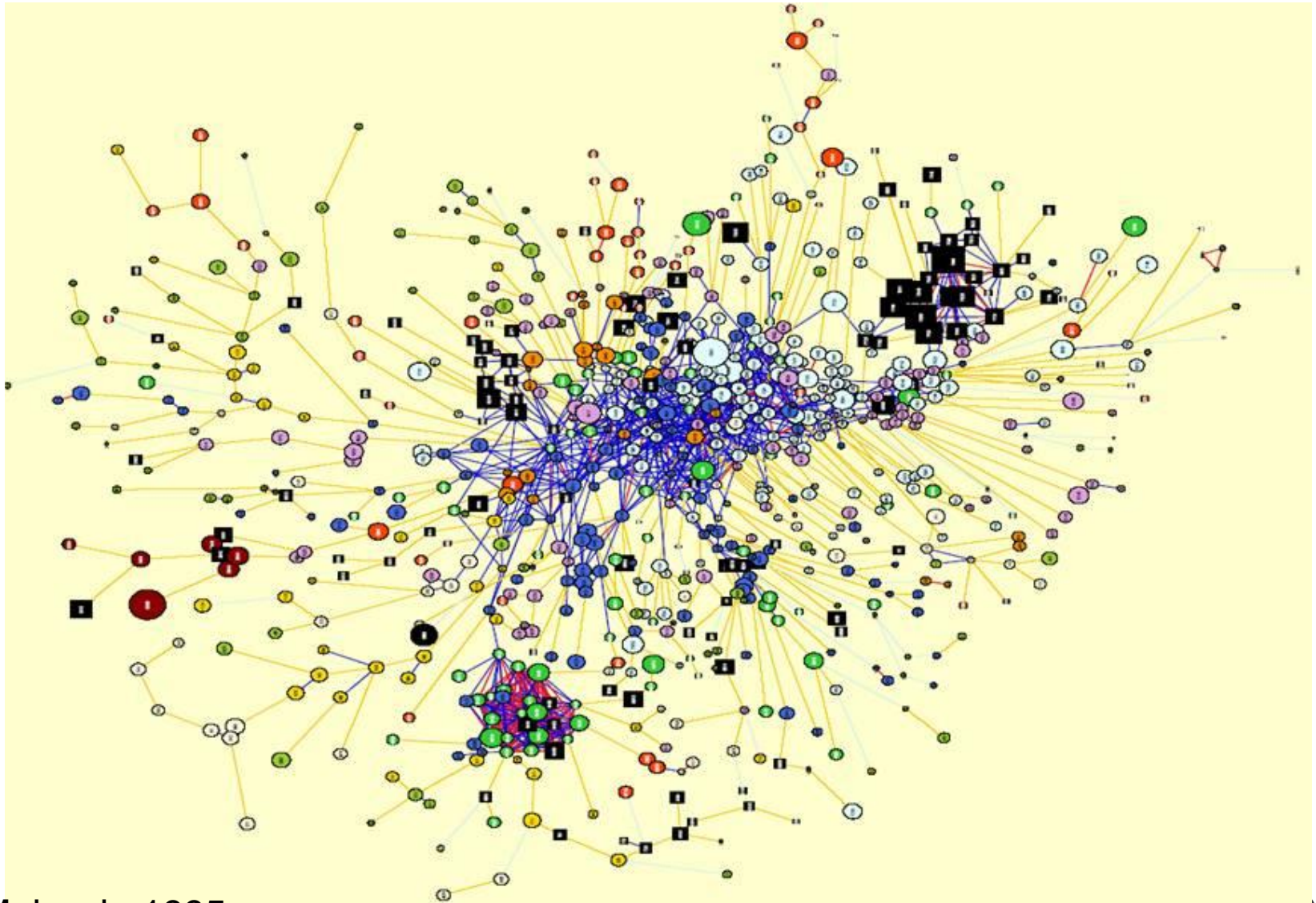
Malaysia 1980



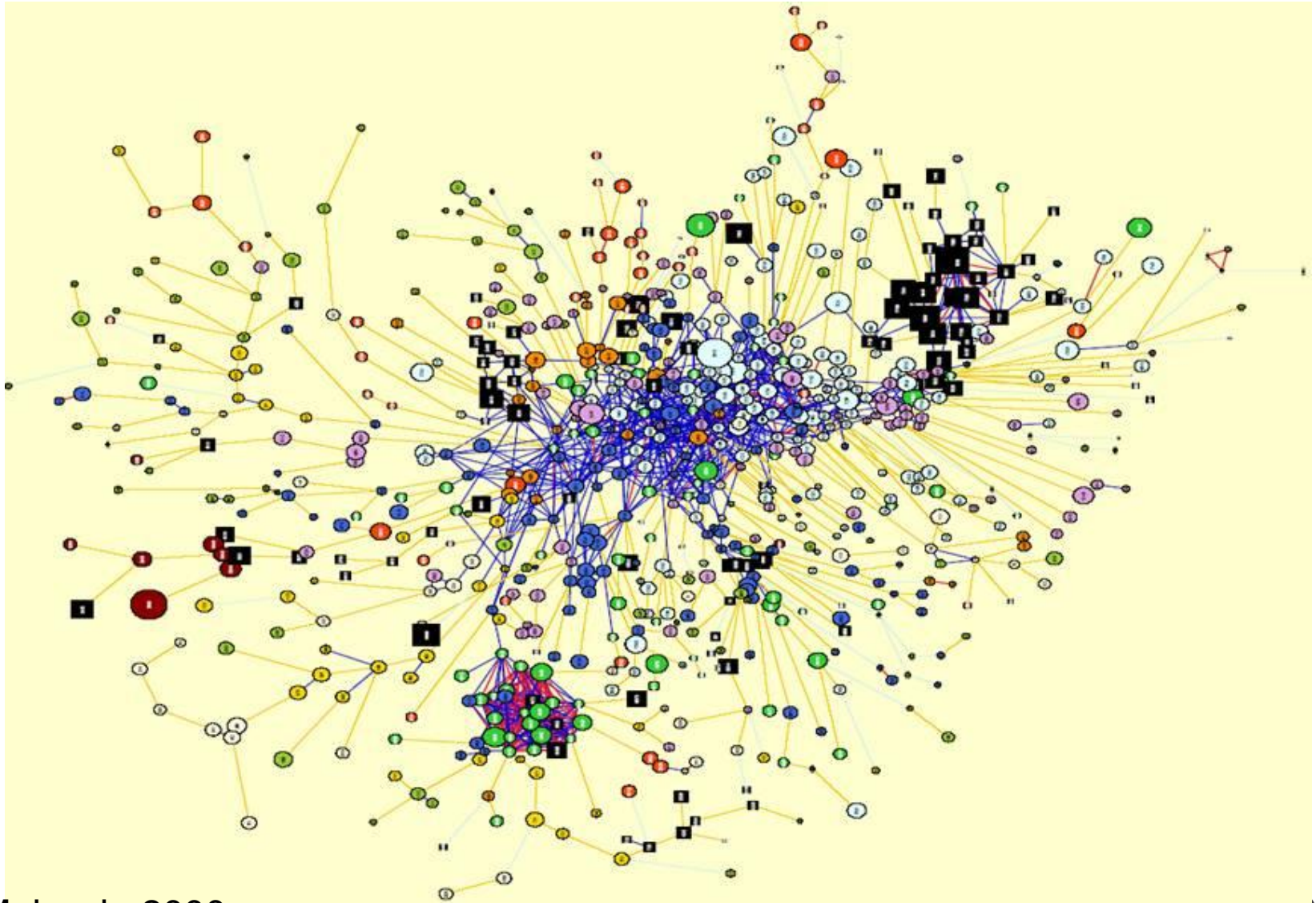
Malaysia 1985



Malaysia 1990

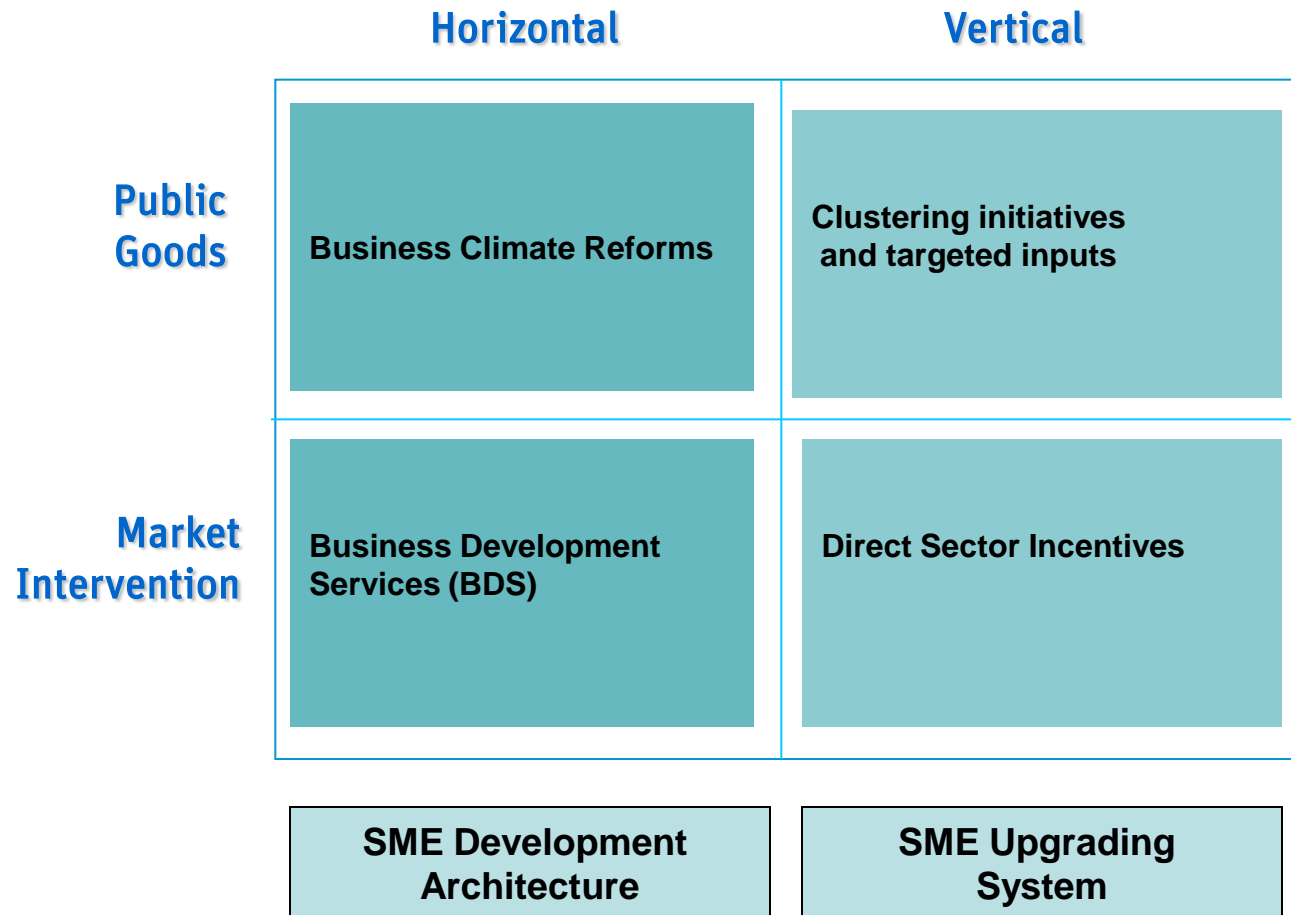


Malaysia 1995



Malaysia 2000

Is there a need for a comprehensive framework for SME Development?



The strategic setting



Do we currently have the “right” PDPs to support SMEs

Multiplicity of policies, agencies and instruments that produce overlapping efforts, confusion, inflexibility and inefficiencies.

Despite the broad range of tools available, some needs are not met and there is a certain inability to respond to challenges not originally envisaged.

Poor access and high transaction costs for users, due to the excessive range of separate channels for requesting support, and lack of institutional capacity, make the mechanisms available less transparent and less user-friendly.

When equity is considered, these transaction costs are obviously much more onerous for smaller companies, making it difficult to extend the reach of development tools to SMEs.

What is the role for the government and the private sector?

Without a strategy to foster private sector development, increase competitiveness and attract foreign investment, sustained economic growth will not be achieved.

Governments need to play an active role in this process by supporting innovative mechanisms to attract investments to improve infrastructure; fostering a business climate that encourages and rewards entrepreneurship; offering transparent laws and regulations that facilitate business development, access to finance and a stable macroeconomic environment.

The private sector needs to strengthen inter-firm collaboration, reduce costs while maintaining employment, and lay the ground for strategies of diversification, innovation, and value added exports in the medium run.



What can governments do?

The public sector can help SMEs integrate more fully and competitively into global production processes through:

- 1) Providing investment and trade information,
- 2) Establishment and enforcement of product, process, and quality standards that are consistent with global practices and training SMEs on such standards,
- 3) Facilitating and encouraging the development of market-based business development services (BDS) that help SMEs access global production networks, and
- 4) Facilitating the training and capacity building of SMEs.



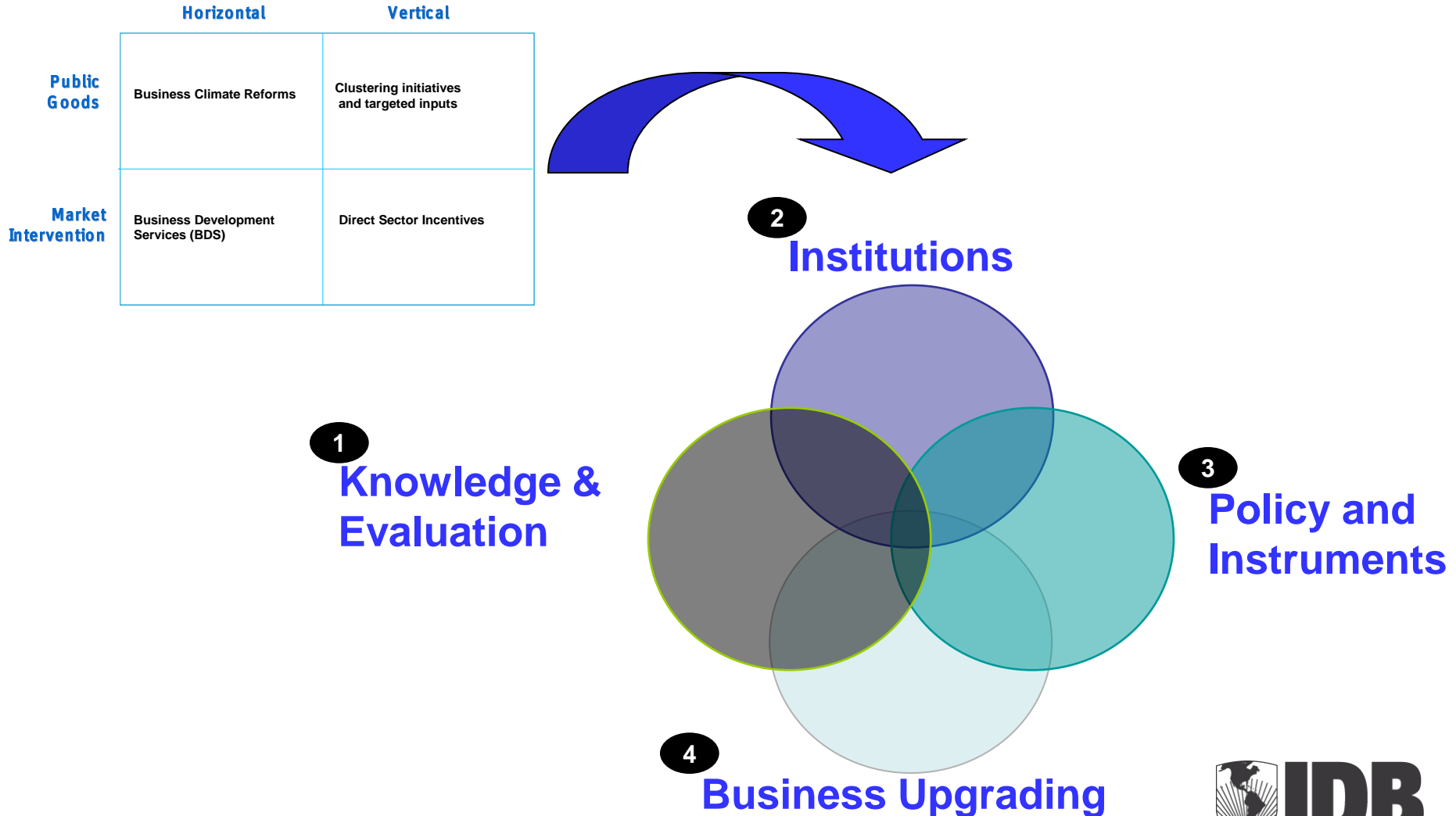
Need for Public-Private Collaboration

- The government needs to find out what new things could be feasible and identify / encourage people to come up with such initiatives.
- The government needs to be able to find out what are the missing public inputs that are required to support private sector development.
- The private sector needs information to identify new opportunities.

Need for Public-Private Collaboration

- The level of detailed information required is very high.
 - How can the government get access to this information and encourage the private sector to engage in pre-investment activities?
 - E.g. call centers, medical services, clinical trials
- To identify the problem and the solution there is a need for strong Public-Private Dialogue
 - Public-Public collaboration
 - Private-Private collaboration
 - Public-Private collaboration

Towards a comprehensive framework



Critical parts of a comprehensive framework

1

Knowledge & Evaluation

- PSD Strategies
- Evaluations, Baselines and Indicators
- Knowledge Generation and Sharing

2

Institutions

- Public-Private-Dialogue Mechanisms

3

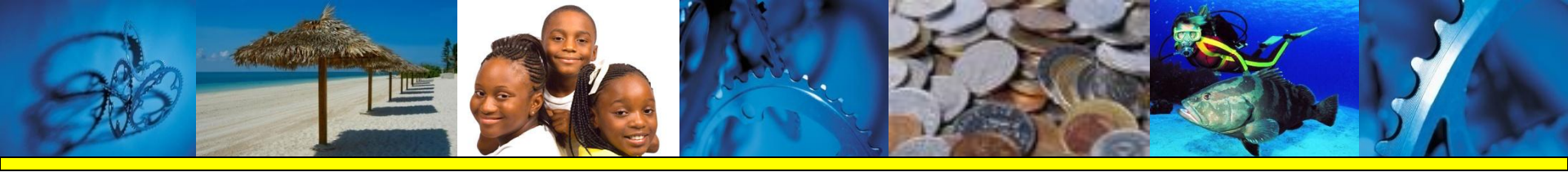
Policy and Instruments

- Business Climate Reforms
- Business Development Services
- Strategic Inputs

4

Business upgrading

- Clustering Initiatives
- Value Chain Integration
- “Self Discovery” support

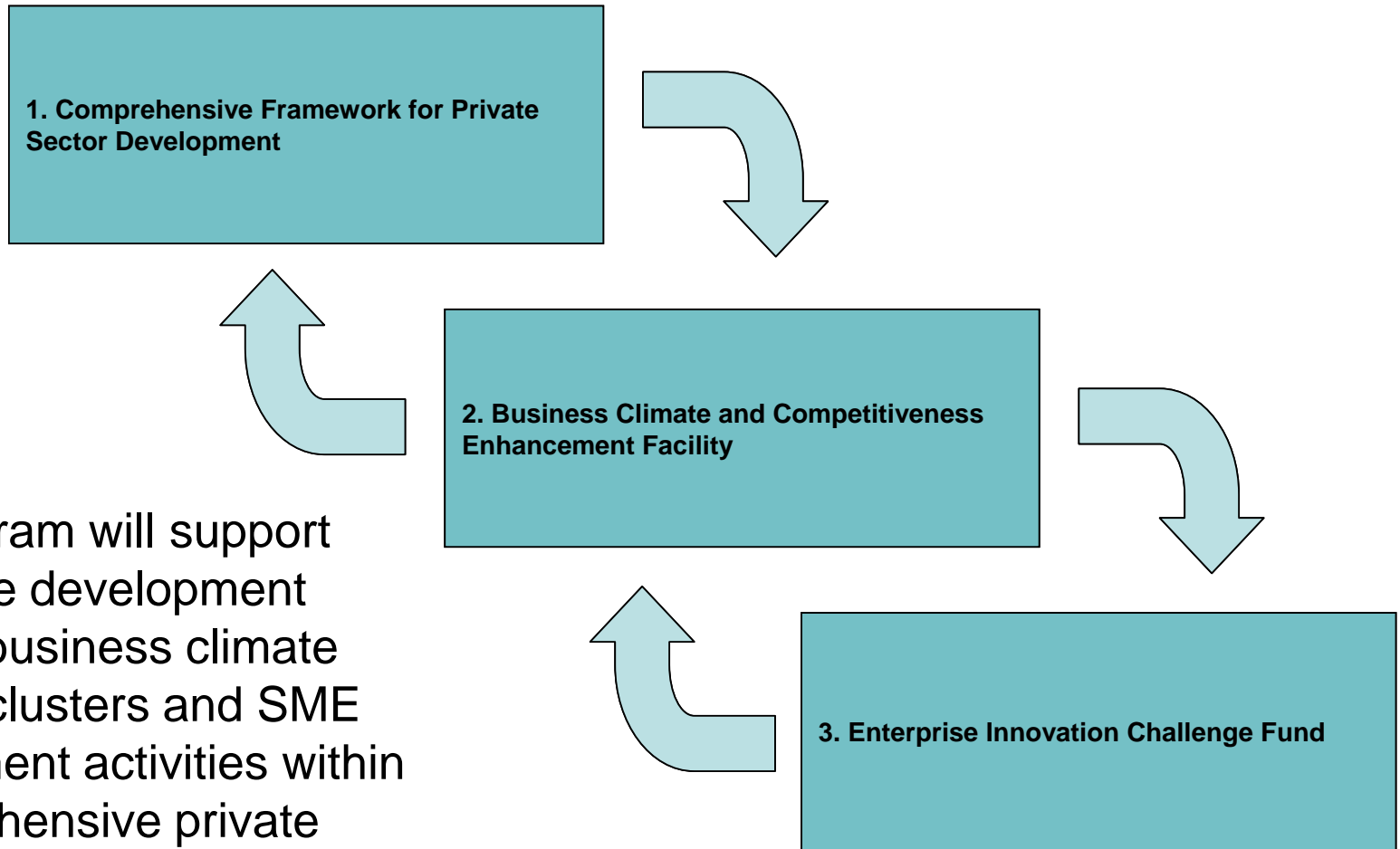


COMPETE CARIBBEAN

Private Sector Development and Competitiveness in the Caribbean



Program Structure



The Program will support productive development policies, business climate reforms, clusters and SME development activities within a comprehensive private sector development framework.

In conclusion....

To enhance private sector development and increase the impact of PSD projects, there is a need for a comprehensive program that will link business climate reforms to cluster development initiatives and to improvements at the firm-level. To develop such an action plan, governments and the private sector need to agree on a medium-run agenda to improve competitiveness (Private Sector Development Strategy), prioritizing strategic investments, policy reforms, institutions, instruments and initiatives to boost the private sector.



Inter-American Development Bank / www.iadb.org

