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Ad Hoc Working Group on the Role  
of Enterprises in Development  
Second session  
Geneva, 3 July 1995  
Item 6 of the agenda

**DRAFT REPORT OF THE AD HOC WORKING GROUP ON THE ROLE OF  
ENTERPRISES IN DEVELOPMENT ON ITS SECOND SESSION**

Rapporteur: Mrs. Heather Booth di Giovanni (United Kingdom of  
Great Britain and  
Northern Ireland)

**INTRODUCTION AND ITEMS 1, 2, 3 and 4**

<u>Speakers:</u>	Officer-in-charge of UNCTAD Secretariat	Indonesia
	Japan	Brazil
	Spain (for European Union)	Czech Republic
	China	Nigeria
	Romania	Egypt

**Note for Delegations**

This draft report is a provisional text circulated for clearance by delegations.

Requests for amendments - to be submitted in English or French - should be communicated **by Friday, 14 July 1995 at the latest** to:

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## INTRODUCTION

1. The second session of the Ad Hoc Working Group on the Role of Enterprises in Development was held from 3 to 7 July 1995 at the Palais des Nations, Geneva. In the course of the session, the Ad Hoc Working Group held ... plenary meetings and ... informal meetings.

A. Opening statement

2. The Officer-in-charge of UNCTAD, in welcoming the participants, noted with satisfaction that the work of the first session had attracted a great deal of interest on the part of Governments, United Nations agencies and the private sector. He said that he was especially impressed by the fact that the participants had not shied away from difficult questions and had been candid in their descriptions of the problems faced. The differences in country conditions and varying levels of development had necessitated a variety of country approaches to the development of small and medium-sized enterprises (SMEs). The deliberations showed a rich diversity of views and experiences, and offered important insights into the crucial role of Governments in creating an enabling environment for SME development. It was generally agreed that Governments might need to intervene in favour of SMEs, especially where there were noticeable market failures, monopolistic market control, bureaucratic or regulatory barriers to competition and market entry or where policies biased in favour of large enterprises prevented SMEs from competing effectively.

3. Turning to the two substantive items on the agenda, he expressed confidence that valuable insights and lessons learned would be drawn from the exchanges of country experiences concerning (a) interactions between the development of SMEs and of capital markets and banking systems; and (b) identification of areas where technical cooperation in support of policy development for SMEs could be strengthened. The question of finance was of vital importance for the viable development of SMEs, since their access to formal financial institutions and organized capital markets was often restricted, compelling them more so than large enterprises to rely on their own savings and retained earnings to finance their operations. Experience had shown that closer cooperation among small firms and between large and small firms, as well as appropriate government support, could play an important role in facilitating access to finance by SMEs. There seemed to be a general consensus that Governments should undertake measures aimed at reducing the inherent risks and the costs related to lending to SMEs, including the development of loan guarantee programmes, as these could have an important bearing on the attitudes and practices of commercial banks. At the same time, consideration needed to be given to minimizing the risk of moral

hazards. Furthermore, Governments could help by promoting the financial institutions that provided services adapted to the needs of SMEs. Finally, backward and forward linkages between firms should also be encouraged, as they could bring benefits of economies of scale as well as reinforce the bargaining power of small firms in their dealings with financial institutions. The secretariat had identified four broad areas where technical cooperation in support of policy development for SMEs could be strengthened: (a) the policy and commercial framework for enterprise development, with particular reference to SMEs; (b) institutional support for SME development; (c) promotion of inter-firm linkages and the modernization of SMEs; and (d) regional cooperation on SME development. The donor community had played and would no doubt continue to play an important role in this regard.

4. In closing, he observed that the identification of "best practices" and other important elements of policy at the national and international levels by the Ad Hoc Working Group could greatly help in the search for ways to strengthen the role of enterprises, particularly small and medium-sized enterprises, in the development process.

## Chapter I

### INTERACTIONS BETWEEN THE DEVELOPMENT OF SMEs AND OF CAPITAL MARKETS AND BANKING SYSTEMS:

- (a) Generation of domestic savings
- (b) Access to capital markets and other sources of financing

### IDENTIFICATION OF AREAS WHERE TECHNICAL COOPERATION IN SUPPORT OF POLICY DEVELOPMENT TO ENHANCE THE ROLE OF SMEs COULD BE STRENGTHENED

(Agenda items 3 and 4)

5. For its consideration of these items, the Ad Hoc Working Group had before it the following documentation:

"Issues concerning SMEs' access to finances", Report by the UNCTAD secretariat (TD/B/WG.7/6);

"Technical cooperation for policy development to enhance the role of small and medium-sized enterprises," Report by the UNCTAD secretariat (TD/B/WG.7/7).

6. The Chief, Privatization and Enterprise Development Branch, introduced the two substantive reports prepared by the secretariat. "Issues concerning SMEs' access to finance" (TD/B/WG.7/6) addressed the main reasons for the difficulties that SMEs faced in securing adequate access to finance for their development and expansion. This report also discussed the role of the formal sector, including commercial banks, development banks, special SME financial institutions, savings banks and credit cooperatives, rural banks and equity and venture capital. It highlighted the role of informal finance, including lending by individual money-lenders, mutual savings and loan associations and partnership firms, and related issues, including regulatory aspects. The document concluded with an examination of measures to enhance the access of SMEs to finance, including the generation of domestic savings. The second report, "Technical cooperation for policy

development to enhance the role of small and medium-sized enterprises" (TD/B/WG.7/7), discussed major areas of concern, including how technical cooperation could be strengthened, and policy development for enhancing the role of SMEs in the development process. It built on the work and results of the first session, particularly concerning the creation of favourable "framework" conditions, including a sound policy and commercial framework, as well as efficient market conditions for SME development. Market-based support measures provided to SMEs could ensure the availability and efficient utilization of essential inputs, such as finance and market information, which firms needed for their development and expansion into export markets. The importance had also been recognized of strengthening inter-firm linkages, both domestic and international, for the development and modernization of SMEs. In closing, he emphasized the important role of the donor community in providing support in various areas, for example in strengthening research and institutional capacity and inter-firm linkages as well as supporting the promotion of regional cooperation on SME development, in order to enhance the role of SMEs in the development process.

7. The representative of Japan said that, for successful economic development, it was imperative to foster the private sector and endeavour to promote entrepreneurship and increase productivity. Small and medium-sized enterprises played a significant role in this attainment. While the best policy towards SMEs might be one of "maximum openness, minimum intervention", government did have a role in creating a favourable enabling environment, helping SMEs gain access to information, human resources and capital markets. The establishment and growth of an efficient financial sector was an essential condition for the development of a viable private sector; however, in general, it was extremely difficult for small businesses to have access to bank funds at affordable rates of interest. In order to rectify this situation, as well as speed up achieving the objective of developing financial markets, specialized financial institutions had been set up in Japan, Republic of Korea, Taiwan Province of China, Thailand and Malaysia. These had contributed to the growth of this sector. While policy-based financing was one of the most important means by which Governments could foster healthy financial markets, it should be used only as a temporary measure to overcome such "market failures" as externalities, the "paucity of Schumpeterian rents" and the "principle of increasing risk," as observed in the *1994 UNCTAD Trade and Development Report*. Any such measures should be implemented only on a small scale and be aimed at reinforcing the deficient part of the private financial activities only until such time as the latter had acquired capabilities for long-term capital supply and risk management. He then outlined three important considerations when applying policy-based financing: (a) excessive credit supply into the financial market could create inflationary

pressures and inefficiency in the allocation of scarce investable resources; (b) the specific financial fields should not be in competition with those of private financial institutions; and (c) elimination of government influence in the decision-making process of lending by the parastatal financial institutions. Policy-based financing in Japan had been successful because of the macroeconomic background against which it had taken place. Relevant in this context was the containment of inflationary pressures through the implementation of good macroeconomic management policies combined with financial austerity which made the maintenance of real interest rates at low equilibrium levels possible and consequently attracted the savings of the Japanese people without weakening their propensity to save. Furthermore, through incentives such as tax exemptions, it had been possible to create a system to retain the surplus cash savings of households at lower deposit rates than those of the commercial banks. Policy-based financing had thus made it possible to ease the burden on the Government's budget. Lastly, the loan guarantee programme employed by the commercial banks had helped in supplying additional funds to the market, further strengthening the Government's policy-based lending programme.

8. The representative of Spain, on behalf of the European Union, stressed the importance of SMEs as an instrument for economic growth. The useful documentation prepared by the secretariat had mentioned several forms of financing undertaken by credit institutions, development banks and other financial institutions catering to the needs of SMEs. However, ways in which to form and build up risk capital deserved more attention. There was a need to study informal SME financing, which he considered a form of complementary financing. Viable financing mechanisms depended not only on the development of the financial system and information systems but also on transaction costs as they affected returns on investment and hence credit availability. He emphasized the heterogeneity of SMEs and their relative weakness to influence economic fluctuations and market changes. Solving such problems was necessary. Successful conclusion of the deliberations should lead to the speedy implementation of concrete actions. Such action would be the most important stage in the work at hand.

9. The representative of China expressed appreciation for the high quality of the documentation prepared by the secretariat. The question of financing was relevant worldwide because, for SMEs, the possibility of self-financing was almost invariably limited. The usual major sources of financing, banks, were by definition profit-oriented, and SMEs, usually economically weaker if not viewed as rather insignificant, were rarely in a position at the outset to guarantee a profit to lenders. All this made SMEs financially rather unattractive. Hence strengthening and perfecting national financial systems

would improve SME's access to finance in developing countries. For this undertaking the State bore major responsibility. The experiences of other countries would, it was hoped, provide practical guidance for decisions on policy design and likewise the exchange of views of the experts would also contribute significantly to advancing knowledge of this important subject.

10. The representative of Romania drew attention to the fact that financing was a major factor inhibiting the development of SMEs in her country. While efforts had been made to modernize the country's banking system, the current unavailability of medium and long-term finance on reasonable terms to SMEs was detrimental to their operations. Rising interest rates had made debt financing unattractive. Consequently, entrepreneurs had to rely primarily on their own resources which often proved to be insufficient. As part of the Government's support policy to SMEs, two soft loan schemes for SMEs were in operation. Finally, she expressed confidence that the session would allow countries to benefit from other countries' experiences concerning effective financial mechanisms and policies facilitating SMEs' access to formal financial institutions, criteria for assessing government interventions and related procedures in favour of SMEs, and mechanisms to strengthen international cooperation to promote growth through the development of the SME sector.

11. The representative of Indonesia drew attention to a conclusion reached in the recently concluded discussion on the role of enterprises in development in the ECDC context, which held that it was of great importance to expand contacts and linkages among business enterprises of developing countries through, inter alia, the organization of meetings of business enterprises, dissemination of information on developing countries, support for business associations such as Chambers of Commerce, trading companies and others, promotion of joint ventures, as well as buyer/seller meetings based on precise identification of trade potentials. These were all matters closely related to the concerns of the present Ad Hoc Working Group. The enterprise sector was an integral part of private sector activities and could be categorized as an agent of development. Consequently, it could not be excluded from policy decisions. Substantive support of UNCTAD's work in this area was useful in enabling the enterprise sector to better confront global markets now that the Uruguay Round had been concluded. Many measures taken in developed country markets were obstacles to market entry of enterprises from developing countries. In Indonesia, the export programme was seen as the engine of economic growth and wellbeing. To this end, a Ministry on Cooperatives and Small Enterprises had been established. In conclusion, he said that UNCTAD had an important role to play in giving new impetus to the development of operationally oriented export programmes.

12. The spokesman for the Latin American Group (Brazil) expressed confidence that the current session of the Ad Hoc Working Group would produce results as positive as the first session. The documents prepared for this session, concerning the problems and potentials of SMEs, had great utility for policy-makers in both the economic and social fields in the countries of the region. His Group fully supported the work in this area and he stressed that it was well known that the success of development programmes depended on the vitality of SMEs.

13. The representative of the Czech Republic, before turning to the country's current financial institutions for financing small and medium-sized enterprises, referred retrospectively to the externally imposed factors which had had a long-term detrimental impact on the economic development of the former Czechoslovakia, a country once renowned internationally for the quality of its industrial products. However, since the beginning of the economic transition in November 1989, and particularly since the division of former Czechoslovakia in 1993, the Czech Republic had pursued economic reforms which also recognized the importance of SMEs to economic development. A detailed description of the support measures in favour of SMEs was contained in the country presentation which had been made available to the session. Principal financial institutions for SMEs were the Czech-Moravian Guarantee and Development Bank and the Czech Export Bank. The former provided financial assistance to SMEs in the form of price-support guarantees and contributions to interest payments, while the latter financed export credits for SMEs and other firms at more favourable terms than the prevailing market rates and conditions. In conclusion, he stressed that State support must stimulate not supersede entrepreneurial efforts. Such efforts should aim to encourage potential entrepreneurs to start their business and help existing ones to innovate and grow, hence the need for strict rules to assure the most effective use of limited State means.

14. The representative of Nigeria began by congratulating the Chairman on his conduct of the previous session and commended all who had participated in the work already accomplished, as reflected by the summary of that session. He then introduced Nigeria's country presentation, which was being made available. It covered his country's experience as well as issues discussed by the Working Group at its first session on the question of mobilizing domestic savings for financing SMEs. He mentioned various sources of SME financing in Nigeria, including personal equity, local (family) lending, development finance institutions, special national funds and banks. Nevertheless, credit delivery to SMEs had not been overwhelming. Since the introduction of the Structural Adjustment Programme, in 1986, public sector funding was handled by private financial institutions. However, the commercial and merchant banks often chose to pay

penalties for non-observance of the rules rather than commit 20 per cent of their loanable funds to SMEs, seeking to avoid high risk debt. Moreover, the performance of development finance institutions in providing financial and related services had been inadequate. He then enumerated the obstacles to SME financing, resulting from weaknesses in their structural conditions. To make SMEs more attractive to financial institutions, a Credit Guarantee Scheme was being established in Nigeria. The Privatization and Commercialization Programme had been designed to transfer securities held by the federal Government to private individual and corporate hands, and had significantly boosted the creation of new equity securities on the Nigerian Stock Exchange, stimulated growth of the capital market and enlarged the share owners base. Owing to huge losses incurred by the Government, the sale of shares in public enterprises had been suspended since January 1995 and a new policy of contract-leasing had been introduced, by which assets of 20 public enterprises would be leased to local and foreign entrepreneurs on a "as-it-were" basis. The SME Development Programme for Technical Cooperation had been designed in the framework of the fourth UNDP country programme for Nigeria. It had five sub-programmes covering national development and institutional capacity-building with the aim of enhancing and strengthening the institutional and regulatory framework for promoting, planning and monitoring economic development, particularly through SMEs. Nigeria had initiated actions geared towards strengthening democracy in its political system and appreciated the spirit of understanding and support of the international community in this endeavour. To this end, the financial, technical and other forms of cooperation from the international community and particularly from the World Bank were greatly appreciated.

15. The representative of Egypt said that finance was one of the most important hurdles for SMEs development. Although SMEs could play a major role in advancing economic development and in creating employment, they needed finance to constitute their capital and to begin their activities. Hence, it was vital that they have access to financial resources. In Egypt, four public banks had provided 10 million Egyptian pounds each for SMEs. Banks had also participated in a Loan Guarantee Scheme worth some 228 million Egyptian pounds and cooperated with the Social Development Fund to cover risks faced by SMEs that had set up their operations in underdeveloped regions of the country so as to capture the development-enhancing potential of such enterprises.

## Chapter II

### **ORGANIZATIONAL MATTERS**

#### **A. Opening of the session**

16. The second session of the Ad Hoc Working Group was opened on 3 July 1995 by the Chairman.

#### **B. Election of officers**

(Agenda item 1)

17. The Chairman recalled that at its first session in April 1995 the Ad Hoc Working Group on the Role of Enterprises in Development had elected a Bureau consisting of a Chairman, five Vice-Chairmen and a Rapporteur, on the understanding that they would remain in office for the entire duration of the Ad Hoc Working Group. Thus the officers of the second session were:

<u>Chairman:</u>	Mr. Anthony Hill	(Jamaica)
<u>Vice-Chairmen:</u>	Mr. J. Yambao	(Philippines)
	Mr. R. Weber	(Switzerland)
	Mr. V. Skliarov	(Russian Federation)
	Mr. M. Mohammed Salem	(Egypt)
	Ms. V. Fonseca	(Venezuela)
<u>Rapporteur:</u>	Mrs. H. Booth di Giovanni	(United Kingdom of Great Britain and Northern Ireland)

#### **C. Adoption of the agenda and organization of work**

(Agenda item 2)

18. At its 5th opening plenary meeting of its second session, the Ad Hoc Working Group adopted its provisional agenda (TD/B/WG.7/5) as follows:

1. Election of officers
2. Adoption of the agenda and organization of work

3. Interactions between the development of SMEs and of capital markets and banking systems:
  - (a) Generation of domestic savings
  - (b) Access to capital markets and other sources of financing
4. Identification of areas where technical cooperation in support of policy development to enhance the role of SMEs could be strengthened
5. Other business
6. Adoption of the report of the Ad Hoc Working Group to the Trade and Development Board

**D. Other business**

(Agenda item 5)

[To be completed as appropriate]

**E. Adoption of the report of the Ad Hoc Working Group  
to the Trade and Development Board**

(Agenda item 6)

[To be completed]