Business Access to Global Value Chains and Financing SMEs

A BIAC-B20 Turkey contribution to the G20 agenda in 2015

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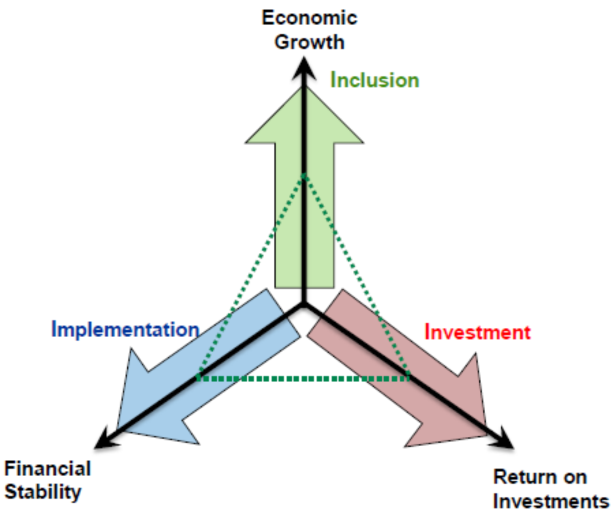

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This BIAC-B20 Turkey publication presents a compilation of chapters by leading thinkers on the financing of small- and medium-sized enterprises (SMEs) and their participation in global value chains. It contributes relevant expertise and identifies priorities to the G20 Turkish Presidency in 2015.

The opinions expressed and arguments employed herein represent those of the individual authors and do not necessarily reflect the consensus views of BIAC or B20 Turkey.

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About BIAC
The Business and Industry Advisory Committee to the OECD (BIAC) represents national business, industry and employer associations from OECD member and observer countries, as well as international sector-specific associate experts. The OECD is the world's foremost purveyor of cross-cutting statistics and fact-based policy recommendations. See www.biac.org

About B20 Turkey
B20 Turkey is supporting dialogue between the business world and global policymakers / G20 leaders. Building on the successes of prior B20 processes in Korea, France, Mexico, Russia and Australia, in 2015 the B20 is developing comprehensive and tangible recommendations to promote global growth and job creation, and support cross-country economic collaboration. B20 Turkey also aims to bring a new impetus to the B20 process by developing an inclusive approach to support global recovery and robust growth. See http://b20turkey.org/

Diagram inside cover: Developed by Gianluca Riccio, CFA, as part of BIAC (2014) "The case for a more coordinated approach to financial regulation: A BIAC discussion paper".

Preface

As businesses seek to serve their clients in an ever-globalizing world, their entire production processes for goods and services are increasingly carried out across different countries and regions in order to secure competitiveness and productivity. These global value chains (GVCs) have become a centerpiece of world trade and investment, encompassing developing, emerging, and developed economies alike.

However, unlocking the full potential for business participation in GVCs relies on an ability to make the most effective use of financial services. Firms do not require just loans, but also advice and more sophisticated forms of financing (including risk hedging solutions) to ensure that their specific financial needs are met.

Challenges in accessing appropriate financing are often most acute for small- and medium-sized enterprises (SMEs). This is due in part to their limited financial and human resources, as well as relatively higher costs related to regulations, financial management, and record keeping. Recognizing that SMEs account for about 60 to 70 percent of employment and over 50 percent of value-added in OECD countries, it is particularly concerning that their access to finance continues to weigh on their participation in GVCs more than seven years after the 2008 global financial crisis.

SMEs' access to financing, and thus their ability to participate in and across world markets, has worsened since the onset of the crisis. As banks have deleveraged to meet new regulatory requirements, SMEs have struggled to obtain sufficient finance through bank lending. Meanwhile, alternative financing instruments – such as venture and growth capital, business angel investment, mini-bonds, mezzanine finance, and crowdfunding – still represent only a very small source of SME funding globally and cannot compensate for the slowdown of bank lending in many economies.

Conscious of the financing challenge described above, and building upon the Australian G20 Presidency last year, the 2015 Turkish G20 Presidency is giving special importance to the better integration of SMEs into GVCs, tackling the bottlenecks to growth, and analyzing financial regulatory outcomes to address possible unintended consequences.

Business-20 (B20) Turkey and the Business and Industry Advisory Committee to the OECD (BIAC) are cooperating closely to support and contribute to G20 activities in these areas. On 4 June 2015 at the OECD Headquarters in Paris, BIAC and B20 Turkey hosted an invitation-only roundtable on *Business Access to Global Value Chains and Financing SMEs.* Participants included senior representatives from SME associations, financial firms, multinational companies, governments, international organizations, and business federations. The event demonstrated the virtues of bringing together the worlds of government, finance, and business, to find solutions that will unlock the full potential of GVCs for our economies and societies. Participants identified priorities and sought to pave the way for actions to support SMEs, in contribution to the G20 ahead of the Leaders' Summit in November 2015 in Antalya, Turkey.

Through its various chapters authored by leading thinkers on GVCs and SME financing issues, this publication aims to support and reinforce the discussions held at the BIAC-B20 Turkey event. The final chapter pulls together the recurring themes across the recommendations of B20 Task Forces, and discussions at the BIAC-B20 Turkey special event on 4 June, to present priorities to the G20 on business access to global value chains and financing SMEs.

We trust that the following pages should prove valuable to governments, regulators, and the private sector, in preparation for the G20 Leaders' Summit.

Bernhard Welschke
BIAC Secretary General

Rifat Hisarcıklıoğlu
B20 Turkey Chair

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Section 1

Current economic challenges and the need for growth: The importance of global value chains and financing SMEs

Chapter 1 - In search of financial stability, economic growth, and returns on investment

BIAC Finance Task Force

Introduction

Gathering in the midst of the 2008-09 global financial and economic crisis, G20 Leaders demonstrated common resolve to strengthen financial stability and avoid a repeat of the crisis in the future.[1,2] The result was the formulation of the internationally-agreed upon Basel III reforms in the areas of capital, liquidity, and leverage, as well as other major regulatory initiatives.

However, while internationally-agreed upon regulatory approaches aim to make the financial system safer, a paper by the BIAC Finance Task Force in March 2014 drew attention to possible **unintended consequences and cumulative impacts** on economic growth and investment, particularly where the G20-led regulatory effort is combined with diverging and uncoordinated national or regional measures.[3] This concern has since been echoed on numerous occasions, including by the Turkish G20 Presidency which points to the importance of "analyzing regulatory outcomes and effects with a view to drive potential improvement areas and address unintended consequences, if any".[4]

In contribution to the G20 Turkish Presidency, and to help understand the issues described throughout the rest of this publication, this chapter explores the stability-growth-investment nexus. In doing so, the goal is to help identify and maximize synergies, while also reducing trade-offs, between the objectives of financial stability, economic growth, and returns on investment. Realizing the full potential of such coordination will be crucial for strengthening the ability of SMEs to participate in global value chains (explored in other chapters of this publication).

[1] G20 (2008) "Declaration: Summit on Financial Markets and the World Economy", 15 November 2008.
[2] G20 (2009) "London Summit – Leaders' Statement", 2 April 2009.
[3] BIAC (2014) "The case for a more coordinated approach to financial regulation: A BIAC discussion paper".
[4] Turkish G20 Presidency (2015) "Turkish G20 Presidency Priorities for 2015", p8.

The stability-growth-investment nexus: A conceptual framework

Where financial regulations and economic policies are poorly coordinated, our economies and societies run the risk of regulatory arbitrage, competitive distortions, fragmented policies, unintended side-effects, and potentially-destabilizing bubbles.[5]

Strengthening coordination is therefore of critical importance not only to the financial sector, but also to the rest of our economies, and this remains a key theme throughout this publication.

To foster greater understanding about the forces at play, the BIAC Finance Task Force points to three factors whose coordination is necessary for sustaining our economies and societies in the longer-term: **(1) economic growth, (2) financial stability, and (3) returns on investment.**[6] Imagine these three variables along three axes,

[5] BIAC (2012) "Discussion Paper on Financing Small- and Medium-Sized Enterprises".
[6] BIAC (2014) "The case for a more coordinated approach to financial regulation: A BIAC discussion paper".

as in Figure 1[7], where a truly coordinated approach for sustainable growth can be represented by paying equal attention to each axis (forming an equilateral triangle).

Where actors (governments, regulators, and the financial industry) focus only on one or two of the variables to the neglect of the other(s), there is a risk that the unintended consequences of doing so could lead to shocks or slowdowns. For example:

a) Where attention is only devoted to economic growth and returns on investment to the neglect of financial stability, conditions may at some point lead to financial and economic crisis (as was the case in the lead-up to the 2008 financial crisis).

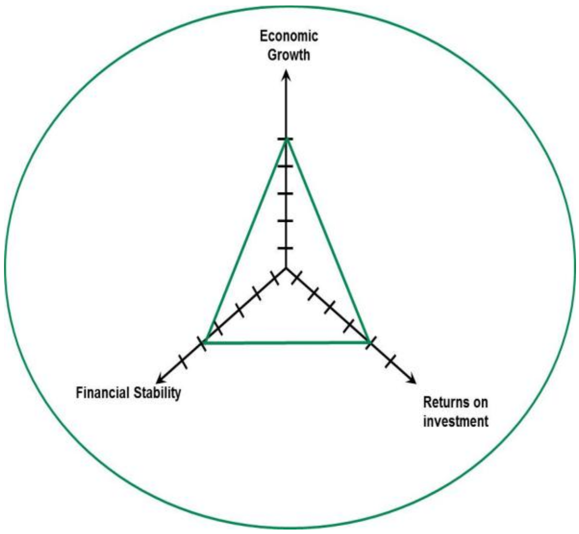
b) Conversely, where attention is only devoted to financial stability (i.e. to regulation) without economic growth or returns on investment, it is possible that the result may be a very safe financial system but with economic stagnation.

c) Where attention is only devoted to economic growth and financial stability to the neglect of returns on investment, it is possible that growth will be short-lived as ultimately investments are not paying returns and are therefore not sustainable.

Consider what each of the three situations described in paragraph 6 mean for the illustration shown in Figure 1. They would be represented *not* by an equilateral triangle pulled equally along the three axes (Figure 1), but rather by a skewed triangle pulled only along one or two of the three axes.

The diagram shown in Figure 1 is a simple visual aide designed to communicate one key message: government policies for growth, regulators' approaches for financial stability, and the financial industry's need to generate returns on investment, are all *interlinked*. To properly address any issue in this 'triangle', **a coordinated and comprehensive approach involving all actors is needed.**

Figure 1: Visualizing three factors necessary for sustainable economic growth: economic growth, financial stability, and returns on investment



The current state of play

The key question that should be asked on a regular basis by all actors is: *What is the shape of the 'triangle' today?* – i.e. **are objectives for financial stability, economic growth, and returns on investment, sufficiently aligned in order to sustainably support our economies and societies?**

There is little doubt that financial stability has been significantly strengthened since the 2008 financial crisis. The title of a February 2015 letter by Mark Carney, Chairman of the Financial Stability Board (FSB), to G20 Finance Ministers and Central Bank Governors, neatly summarizes

[7] The 3-axis (Economic Growth, Financial Stability & Return on Investment) equilibrium concept was developed by Gianluca Riccio in 2013 as part of the BIAC work on unintended consequences of Financial Regulation – BIAC (2014) "The case for a more coordinated approach to financial regulation: A BIAC discussion paper".

the current state of progress: *"Financial Reforms – Finishing the Post-Crisis Agenda and Moving Forward"*.[8] This suggests that a watershed may have been reached in terms of post-crisis financial stability.

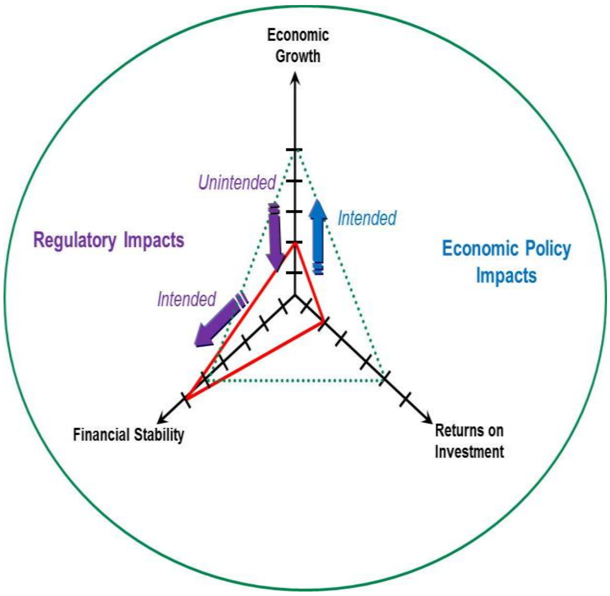
However, the world economy still has not broken free from the legacy of the crisis. Both trade and investment – key cylinders of the engine of economic growth – continue to perform sluggishly. In fact, the OECD Economic Outlook (June 2015) highlights that the current post-crisis investment recovery is by far the slowest compared to the world's four major recessions since 1973. Persistently high unemployment and weak demand across a number of OECD economies raise concerns about a protracted period of stagnation and low productivity, while some emerging markets (such as China) are adjusting to a 'new normal' of relatively lower growth.

One possible explanation for the relatively poor growth in many markets is that pro-growth policies are in effect compensating for the unintended consequences of financial regulations. Clearly there are many complex interactions that continue to weigh on the global economy, but it is important to ask to what extent has the regulatory drive towards financial stability been sufficiently coordinated with objectives aimed at strengthening growth and investment?

As highlighted in a speech by Jonathan Hill, European Commissioner for Financial Stability, Financial Services and Capital Markets Union: "*Regulation was needed to respond to the threat to financial stability posed by the financial crisis. But today there is a new threat to financial stability: the lack of jobs and growth. So now is a sensible time to take stock of the overall impact of regulation*".[9]

Recalling our conceptual framework, Figure 2 illustrates what the BIAC Finance Task Force believes might be the current state of play. It suggests that G20 and national/regional efforts to strengthen financial stability (left axis) may in some respects, and/or in some jurisdictions, unintentionally result in a drag on policies for economic growth (vertical axis) and efforts to boost investment (right axis). Thus the 'triangle' is unbalanced. Policymakers need to therefore focus more on both growth and investment.

Figure 2: The current state of play?



If only one of the variables is addressed in a silo approach, uncoordinated financial regulations can lead to unintended consequences. Pro-growth economic policies may then simply act to offset the effects of regulatory measures, rather than achieving their full growth potential, as has been experienced in recent years.

The current challenge is not to reverse the greater financial stability achieved in recent years, but rather to ensure during the

[8] FSB (2015) "Financial Reforms – Finishing the Post-Crisis Agenda and Moving Forward", Letter by FSB Chairman to G20 Finance Ministers and Central Bank Governors, 4 February 2015.

[9] Hill, J. (2015) "How to restart growth", speech of 17 March 2015 delivered at the Frankfurt Finance Summit.

implementation phase that stability can proceed hand-in-hand with economic growth and returns on investment.

Future directions

There is too little known about the unintended consequences of financial regulatory approaches and their cumulative impacts. The ongoing and future work of organizations such as the FSB, IMF, and OECD should help to overcome the knowledge gaps and propose solutions. However, in our view the starting point is that policies are developed as part of a comprehensive approach, built on close dialogue between regulators, governments, and the private sector, both at national and international levels. The Turkish G20 Presidency, equipped with its three pillars on ***Implementation***, ***Investment***, **and** ***Inclusion,*** presents an opportunity to make this happen and corresponds closely with our conceptual framework (see Figure 3):

a) **Implementation** of financial regulation in order to build enduring financial stability has been largely achieved with the efforts since the 2008 financial crisis. Now the implementation process is vital to ensure that cross-border discrepancies are avoided and that the regulatory framework is consistent globally, and in the G20 *in primis*.

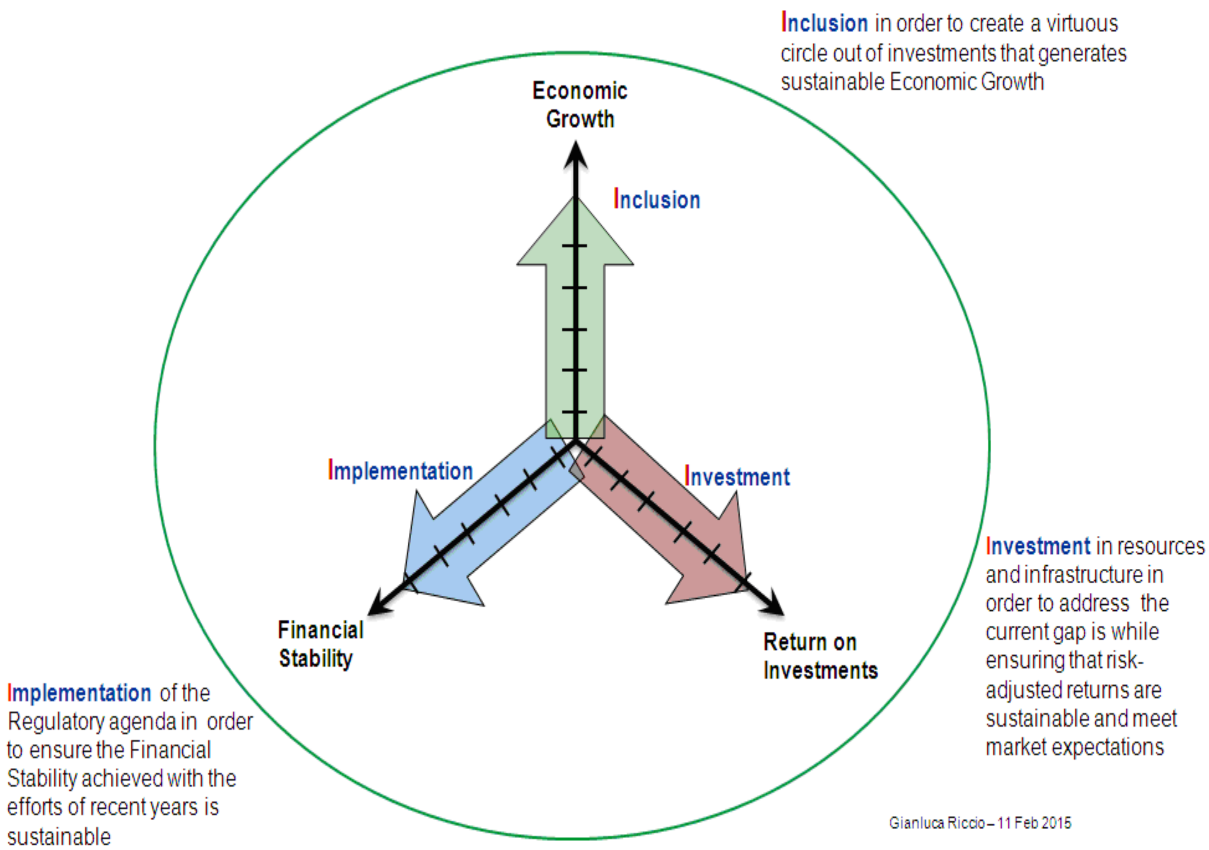
b) **Investment** must deliver a sufficient return that makes it worthwhile to invest in the first place. Regulatory inconsistencies can increase the cost of funds and the cost of business, both directly and indirectly, thereby hampering investments.

c) **Inclusion**, particularly financial inclusion to ensure financial access for SMEs, is a key driver for sustainable economic growth. SMEs are the lifeblood of our economies' growth. Policies aimed at strengthening the growth of SMEs will only deliver if well-coordinated with financial regulations, rather than simply offsetting their impacts.

Actions taken by the G20 Turkish Presidency in 2015 and future G20 Presidencies should be considered in combination with all elements described in Figure 3.

The three G20 pillars and the three aspects of the stability-growth-investment nexus are all essential for supporting SMEs in our economies, and – as explored in later chapters – their inclusion in global value chains (GVCs). Offering a bridge to new markets, the proper development of GVCs is of crucial importance for SMEs. In turn, SMEs can enhance their participation in GVCs through appropriate financing, thereby leading to stronger, more sustainable and more inclusive growth.

Figure 3: Merging the G20 Turkish Presidency priorities and the stability-growth-investment nexus



Chapter 2 - How to restart growth

Jonathan Hill

Member of the European Commission, responsible for Financial Stability, Financial Services and Capital Markets Union

European Commission

The financial crisis was a shock to policymakers everywhere. It was a "reality check" of sorts, to which governments across the world reacted. However, we need other "reality checks" on a number of fronts precisely because of the responses to the crisis.

Three new reality checks: Regulation, Risk, and Growth

The first "reality check" is on the regulations we now have in place. Since the financial crisis we have done a huge amount of work to ensure that we have a safe, stable financial system, robust enough to cope with challenging times. The bulk of our new legislation which is now coming into force brings with it better supervision, greater transparency, stronger financial institutions and a means to deal with problems if they arise. In Europe, we now have the Banking Union which will help break negative feedback loops between national finances and banks.

Regulation was needed to respond to the threat to financial stability posed by the crisis. **But today there is a new threat to financial stability: the lack of jobs and growth**. So now is a sensible time to look at the overall impact of regulation, in particular the legislation of the last five years, through the prism of jobs and growth - to make sure that we have the balance right between reducing risk and fostering growth. We have to be ready to ask: Do those rules achieve what they set out to do, and do they do so in a way which poses minimum burdens? But we also need to understand the combined impact of our rules and the consequences, sometimes unintended, of interactions between different pieces of legislation, as well as the cross-border inconsistencies in rules or in their implementation.

This does not suggest throwing our hard-fought recent reforms overboard. However, if the rules on the ground are in practice impeding the capacity of the financial industry to lend and invest, then we should be prepared to look at them again.

In the same vein, we need to be careful to take into account that our rules must be proportionate to the risks posed; and to ensure that they take into account different business models – for example of banks. Proportionality must be a key principle in global rule-making. Looking to the future, we must provide a greater degree of regulatory stability so that businesses are able to plan ahead.

My second "reality check" is that we need to keep our eyes open to new sources of risk. That is why we must bring various legislative files still in negotiation to a swift conclusion, notably on Money Market Funds, benchmarks and bank structural reform. Looking forward, we must have an effective resolution regime for non-bank financial institutions, and for clearing houses, or CCPs, in particular.

Thirdly, we need a reality check on how our economies are faring. The forecasts are improving, with the latest ECB numbers suggesting 1.5% GDP growth for the euro area this year, increasing to 1.9% in 2016 and 2.1% in 2017. This is a positive signal. But we are a long way from a healthy level of growth, or an uptick in the number of jobs, as 24 million people are out of work across Europe.

That is why the Commission's first act was to launch a 315 billion euro Investment Plan to support investment in long-term infrastructure projects. EU finance ministers have approved the legislation to set up the European Fund for Strategic Investments.[10] Germany has pledged €8 billion to the fund, a sum matched by France and Italy.

The Investment Plan will give a welcome shot in the arm to investment in Europe. But if we want it to be more than a one-off, then **we need more structural change.** We need to remove obstacles currently standing between companies or projects and the financing they need, and to increase the range of options available to investors so that Europe's savings, pension contributions and investment premiums can be put to more productive use. This is what we want to achieve with the Capital Markets Union (CMU).

Free movement of capital was one of the four fundamental principles on which the European Union was built. However, fifty years on from the Treaty of Rome, there still is not a fully functioning single market for capital. The market remains fragmented, largely along national lines. In many parts of Europe, SMEs and start-ups simply cannot access the financing they need from banks to grow. Think of all the high-potential technology companies that move to the US in order to have access to a more suitable range of funding options for their needs.

[10] http://europa.eu/rapid/press-release_STATEMENT-15-5064_en.htm

Our goal with the CMU is to create more financing opportunities for SMEs and infrastructure projects by spreading the risk more effectively to those who can bear it. If we can make progress on building that single market, the prize would be considerable.

Just to take one example: If our venture capital markets were as deep as the US, as much as 90 billion euro more in funds would have been available to companies between 2008 and 2013. Think of the innovation, the new services, the new jobs that could have been created if that funding had been there.

Next steps

Behind the label of CMU are a number of pragmatic, incremental steps to get funding to where it is needed most: in long-term investment projects; in infrastructure; and in our SMEs.

Getting the market for **securitization** going again in Europe will make a real difference to long term investment by broadening the investor base to include more long term investors such as insurers and asset managers. We want to achieve a differentiation of high quality securitization products across all financial sectors, indeed to set up a framework for the development of an EU market that singles out a category of highly transparent, simple and standardized products.

CMU can also help SMEs to get **access to finance.** Member States have been active in a number of areas. Some have taken initiatives to try to channel funding more effectively to SMEs. If we can get it right at the European level, the benefits could have multiplier effects.

We have supported bank lending to SMEs by setting lower bank capital requirements, relative to Basel rules, for lending to certain SMEs. We will also be focusing on **SME lending** in our forthcoming assessment of the impact of capital requirements. Internationally, we will argue that particular attention should be paid to the appropriate calibration of SME lending capital requirements. But banks could help in one area, namely in giving better feedback to SMEs and pointing small businesses towards alternative types of financing when they consider a loan is not right for them.

Other SMEs may want options, such as listing on a growth market or attracting venture capital. We need to help raise SMEs' awareness of **alternative financing opportunities.** Companies that decide to offer securities on a market should not be deterred from doing so simply because of the paperwork involved. That is why we want to revise the Prospectus Directive so that it becomes easier for SMEs to fulfil their listing obligations, but in such a way that investors are still well informed about what they are buying.

Although there is good basic information out there on companies and what they do, potential investors cannot easily assess the credit risk that they might present. So we will look at whether there is a way of increasing **standardized data for credit assessment** – without tying all SMEs up in a new tangle of red tape.

And finally, we are considering how we could boost the "ecosystem" in Europe for **venture capital.** This might include adapting the rules for European Venture Capital funds and European Social Entrepreneurship Funds to expand the categories of fund managers able to offer these funds.

To sum up, what the CMU project offers is opportunity, for:

- banks as important intermediaries of market-based funding,
- investors to increase their options for investment,
- Europe to widen access to new channels of funding for SMEs and infrastructure projects, and
- finance to foster growth.

One last "reality check" is the following: It will not be politicians, regulators and supervisors who will create growth; instead, that will be done by businesses and companies who innovate, who take risks, who expand into new markets, and who create jobs.

Policymakers must remember to regulate proportionately and to always take into account the effect that rules have on the marketplace. If we really mean it when we say that our top priority is jobs and growth, then that, I believe, is the reality check we should apply to all that we do.

Chapter 3 - Recent trends in financing SMEs

Stefan Kapferer

Deputy Secretary-General

Organization for Economic Cooperation and Development (OECD)

Access to finance is a longstanding structural barrier to entrepreneurship and SME growth, which the recent financial and economic crisis exacerbated. While SMEs can experience difficulties in obtaining financing during 'normal' times due to information asymmetries and risk aversion by lenders, credit sources tend to dry up more rapidly for small firms than for large companies during economic downturns.

Recent developments

The *OECD Scoreboard on Financing SMEs and Entrepreneurs*, published annually, shows that six years after the start of the financial crisis, bank lending to SMEs and credit conditions have still not recovered to pre-crisis levels in many countries. This is the case in the countries most affected by the financial crisis. In Spain, for instance, new lending to SMEs fell by almost 65% between 2007 and 2013. Credit tightening for SMEs was observed also in countries that experienced sustained recovery and high GDP growth in recent years. In the United States, SME loans represented 22% of all business loans in 2013, down from 31% in 2007. In the United Kingdom, growth in SME lending remained negative over 2009-13, which, combined with a pick-up in new loans in 2013, suggests a persistent running-off of loan facilities provided pre-crisis.

Credit conditions also tightened significantly in the years after the crisis, and despite a recent loosening, largely due to the unprecedented monetary easing in many regions, they remain tighter for SMEs than for large enterprises. In 2013, aside from the decrease of SME interest rates, in many countries there was a moderate easing of collateral requirements and a fall in the relative number of loan applications that were rejected. Nevertheless, credit conditions remained tight compared to the pre-crisis period.

"Credit restrictions for SMEs will likely persist for the foreseeable future."

As banks face more rigorous prudential rules and continue to deleverage, credit restrictions for SMEs will likely persist for the foreseeable future. The rise in non-performing SME loans constitutes an additional barrier to SME lending, especially in the countries most affected by the financial crisis. In Greece, for example, 31.8% of all SME loans were non-performing in 2013, up from 4.1% in 2007.

Lackluster macro-economic performance weighs on the availability of internal funding for businesses and on investment plans. Indeed, the recent more accommodating credit conditions occurred alongside a drop in SME lending, suggesting possible weaker demand for credit. On the other hand, an easing of credit conditions might require some time to translate into increased SME lending. It is also possible that credit access and conditions have improved only for some SMEs, while others are finding it even more difficult to access credit than in the past.

Next steps and actions

In this framework, a two-pronged approach is needed to improve access and conditions for SME finance:

On the one hand, bank financing will continue to be crucial for SMEs, and it is essential to restore banks' health to improve lending.

On the other, it is necessary to enable SMEs to diversify their sources of finance towards non-bank instruments to support private investment. In fact, with the crisis and the regulatory evolution in financial markets, the vulnerability of SMEs to changing conditions in bank lending has become more evident, as have the limitations of traditional debt for new, innovative and fast-growing companies. Yet, at present, financing instruments alternative to traditional debt, including asset-based tools, alternative debt instruments, hybrid instruments and equity finance, still represent a small source of SME funding globally and cannot compensate for a retrenchment in bank lending. Although alternative finance instruments, such as venture and growth capital, business angel investment, mezzanine finance and crowdfunding, are garnering increasing attention by policy makers, their uptake by SMEs is still relatively small.

"A diverse set of actions is needed to overcome challenges and develop markets for SME finance."

In its work on "New approaches to SME and entrepreneurship financing", the OECD shows that there is a broad range of external financing alternatives which have the potential to finance SMEs in the post-crisis context. Capital market financing is particularly promising, as it opens the possibility to draw on the large amounts of capital available from institutional investors. However, fostering the expanded use of these instruments requires a different policy approach to SME financing than in the recent past, when the policy mix was largely composed of supply-side measures.

A diverse set of actions is needed to overcome challenges and develop markets for SME finance, including:

Implementing regulation that navigates potential trade-offs between financial stability, investor protection and the opening of new financing channels for SMEs;

Developing information infrastructures for credit risk assessment to increase transparency in the markets for business finance;

Implementing policies that leverage private resources to finance innovative and high-growth SMEs; and

Addressing SME skills gaps in finance, to improve their understanding about alternative finance instruments and ability to access them.

These actions will be at the heart of the *voluntary high-level principles on SME financing* being developed for the G20 at the request of Finance Ministers and Central Bank Governors. The development of such principles marks an important step in ensuring due policy attention to this important issue at the highest levels, and in providing a stable benchmark by which to measure progress in meeting the needs for SME finance.

Section 2

Defining the issues: Global value chains and SMEs’ financing needs

Chapter 4 – Pulling together: Strengthening supply chains for economic growth

Confederation of British Industry

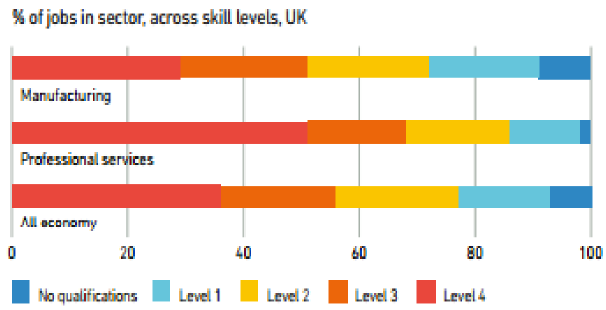
Stronger and more collaborative supply chains can help make economies more resilient, increase the value we derive from products and attract inward investment. In an increasingly global economy, competition for business investment is fierce, but success can be achieved with the right strategy for supply chain growth built on innovation, quality and service.

A balanced economy needs stronger supply chains

Businesses want to improve the supply chains they are a part of. In a survey of UK businesses, 78% of companies view this as important or very important to their future growth.[11] A stronger domestic supply chain helps to guarantee security of supply, makes it easier to advance technology through collaborative innovation, and enables a faster response to changing market conditions and customer needs. As a result, both sectors and individual companies are looking to increase the proportion of products and services sourced from their home country.

Building stronger supply chains has a number of benefits. It can help countries improve a country's balance of trade and strengthen productivity by making sure they gain maximum value from the presence and success of the larger or higher-profile companies that form 'anchor points' of manufacturing activity, companies that are so important to local economies and can nurture mutually beneficial relationships with their local suppliers. Stronger supply chains will also benefit people, as well as businesses, because the diversity of activities they support create a more evenly distributed range of jobs across all skills levels compared with other sectors (Figure 4).

Figure 4: Manufacturing supply chains offer opportunities for all

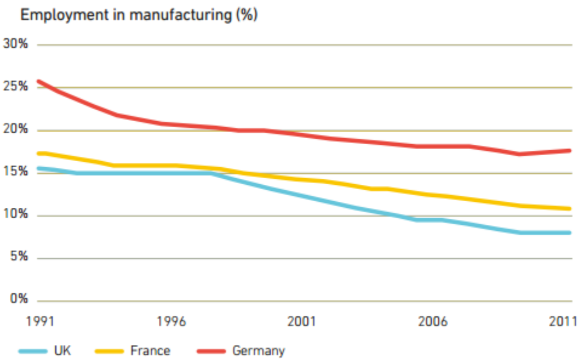


Source: Manufacturing Sector Skills Assessment 2012, ONS Labour Force Survey 2010.

For economies looking to rebalance, geographically or sectorial, improving supply chains can also offer a benefit of rebalancing the economy by boosting growth in the manufacturing sector, a key hub for supply chain activity. The UK is a good example (Figure 5), where stronger supply chains could foster growth across all the UK's regions, particularly those outside London and the greater south east. To gain these benefits in countries with weak supply chains, a substantial comeback is needed. However, with the right strategy for supply chains, a rebound can be achieved.

[11] CBI (September 2013) *Raising the bar*.

Figure 5: Like other Western economies, the UK industrial base has reduced

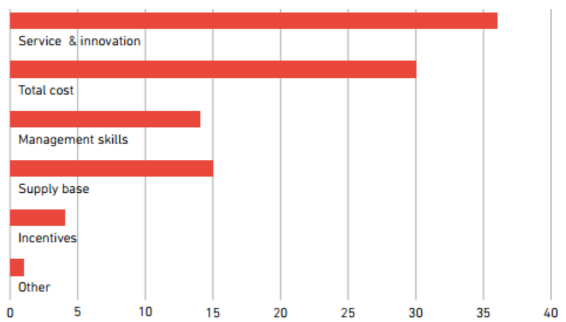


Source: ONS, De Statis, INSEE, CBI/A.T. Kearney Analysis

Innovation and service: the focus for a supply chains comeback

Firms are increasingly reappraising their supply chains in the wake of changing global dynamics. While cost considerations were the critical driver of supply chain location decisions in the past, driving a trend to offshore production, there is a growing recognition that other factors – such as the ability to innovate, increase quality and reduce product lead times – can be just as or even more important (Figure 6).

Figure 6: Service and innovation factors will influence future supply chains alongside cost



Source: CBI/A.T. Kearney survey, 2014

This is not to say that cost is no longer a consideration. Countries must ensure costs – including energy and logistics – remain in line with other competing economies. This is particularly important as the hidden costs of offshoring become apparent to firms (Figure 7) and high wage inflation in emerging economies tip marginal decisions in favor of local production.

Figure 7: Offshoring has hidden costs

Source: A.T. Kearney analysis, 2014

Instead it means that for higher cost countries, while it must remain cost competitive, they do not have to aim to be low cost economies. What it can and should aim to be, however, is the destination of choice for supply chains driven by innovation, quality and service. Beyond price there are other ways to attract and support supply chains.

One of these is having as a strong 'ideas environment', underpinned by world-class research institutions and protection of IP. Research suggests that R&D productivity increases by a factor of 2.5 when R&D and manufacturing facilities are co-located.[12]

[12] The Location of Industrial Innovation: Does Manufacturing Matter, Isabel Tecu, Brown University, USA, September 2011

A second advantage is improving the country's reputation for shorter lead times and better quality. Customer expectations of total order-to-delivery times have undergone a significant change since the dawn of the internet age.

New and emerging developments in technology, such as additive manufacturing and the 'Internet of Things', permit increased dynamism in response to product demands and customer needs, and require a closer relationship between customer and supplier. This change in customer expectations, coupled with a need to maintain lower inventories, has placed a premium on shorter lead times across most tiers of the manufacturing supply chain.

Business feedback substantiates this point. An EU-wide survey on re-shoring, carried out by the CBI earlier this year, revealed that 54% of companies that had re-shored to the EU were motivated by a need for faster market responsiveness.[13] A similar survey, carried out by the Manufacturing Advisory Service (MAS) in September 2013, found that the third highest cause for re-shoring decisions was to improve lead times.[14]

In addition to lead times, the MAS survey, found that quality considerations were the second highest driver of re-shoring decisions.[15] This is also supported by our own numbers from the UK, where our survey found that quality considerations were of major importance around re-shoring decisions, with 71% of respondents that had already re-shored citing better quality in their home market as a critical factor in their decision.

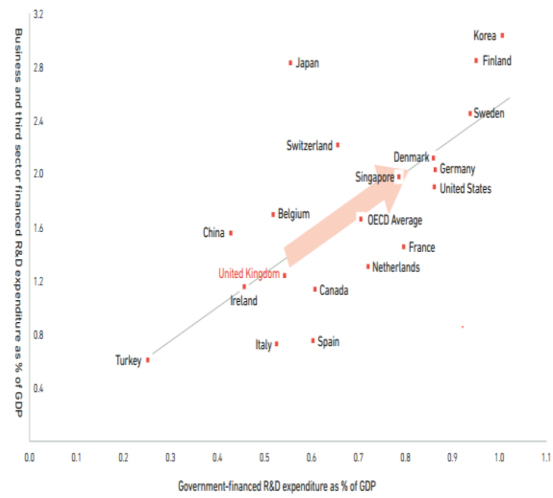
[13] CBI EU Reshoring survey, March 2014
[14] MAS Barometer Survey, September 2013
[15] Ibid.

A targeted supply chains strategy to deliver lasting economic benefits

Based on our research and consultation with UK-based businesses we have arrived at 6 areas that require attention to strengthen supply chains along the lines described above.

Firstly, the public and private sectors must invest in R&D and focus attention on commercialization of ideas to derive returns from research (Figure 8).

Figure 8: Business and government are under-investing in R&D – and the two are correlated



Source: OECD Main Science and Technology Indicators, 2014

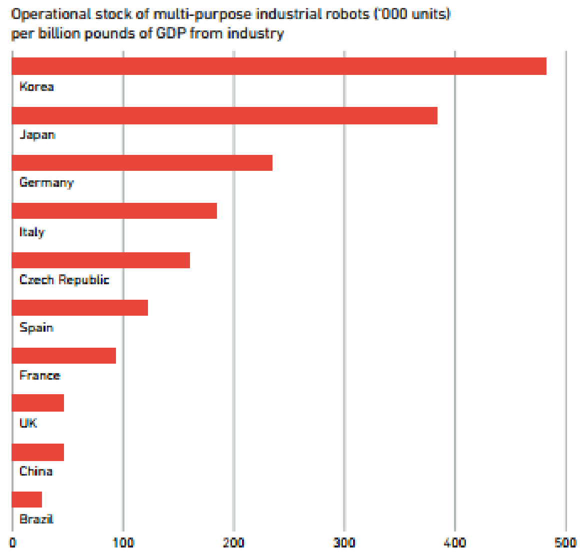
Secondly, the education system must be able to underpin a country's supply chains strategy to ensure businesses have access to the right skills. Often the barrier to strengthening supply chains are technical skills shortages, which could be counteracted by businesses upskilling new or existing employees through training schemes, but smaller companies tend to find this harder. Beyond technical skills, managerial skills shortages can also hold firms back as the challenge of expanding a business from 50 individuals to one of 500 or more can require greatly different skillsets and management structures, both of which may require external assistance to secure. This challenge was reflected in survey responses to the CBI's 2011 Future Champions report, with 54% of respondents from companies with an annual turnover of between £10 and £250 million selecting better senior management skills as the most important amongst a range of growth drivers.

Thirdly, the general business environment must be flexible and dynamic, particularly on measures related to setting up and growing a business, such as getting electricity, registering property and dealing with construction permits.

Fourth, great attention is needed to ensure countries retain capabilities in producing the critical materials that underpin our industrial supply chains, both in existing foundation industries such as plastics, metals and chemicals, as well as new and innovative materials technologies that will be used in productive supply chains of the future.

Fifth, businesses need to prioritize investment, taking a longer-term view to prioritize this. Lack of investment will over time act as a drag on productivity throughout supply chains, making them less competitive internationally. As an example of this, the UK is significantly underinvesting in robots and automation, not only in comparison to leading economies in Asia, but also European economies, such as France, Germany, Italy and Spain (Figure 10).

Figure 10: UK firms invest less in robotics than other countries



Source: World robotics 2013, International Federation of Robotics, 2013

Sixth, companies and public bodies need to buy in to the importance of value, not just cost. The public sector can make better use of procurement to shape markets and stimulate supply chain growth, focusing beyond a narrow definition of 'value for money' towards value generated to the country through, for example, expanding the tax base.

Figure 9: CBI business environment scorecard (CBI assessment)

Theme	Indicator	UK	France	Germany	US	Japan	World leader
Education & Skills	PISA ranking[29]	26	25	16	36	7	Shanghai, China
Research & Innovation	Quality of science research institutions[30]	2	12	8	4	7	Switzerland
	R&D expenditure, % of GDP[31]	1.7	2.3	3.0	2.8	3.4	Korea
Infrastructure	Quality of overall infrastructure[32]	27	10	11	16	9	Switzerland
Energy costs	Average industrial electricity prices[33]	8.9	8.1	10.8	4.4	10.6	USA
Tax competitiveness	Headline corporation tax rate %[34]	21	33.3	29.6	40	35.6	Russia, Turkey, Saudi Arabia
	Effective marginal tax rate,%[35]	18.9	17.5	18.2	23.2	24.7	Italy
Regulatory burden	Burden of government regulation[36]	37	121	55	82	64	Qatar
Access to finance	Ease of access to loans[37]	82	17	34	14	19	Qatar
Investment & trade	Openness to trade (Trade to GDP ratio)[38]	46.7	47.6	75.1	23.9	28.4	Hong Kong

This scorecard has been compiled to reflect key factors determining the attractiveness of the UK's business environment. The data in the scorecard is wide-ranging, drawing on figures from organisations such as the World Economic Forum, the World Bank and the OECD, with detail on the sources set out in the reference. It represents a snapshot only, using data based on the latest figures official figures available.
The CBI's assessment is based on relative performance compared to other countries in key indicators, and has been determined according to the following rules:

- For ranked variables, countries are green if they fall in the top ten, yellow if between 11-20 and red if over 20
- For all other indicators, the assessment has been made based on where countries sit relative to the mean of the indicator

Chapter 5 - Different types of supply chains

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Secretary-General

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What is a supply chain?

A value chain is a chain of activities that a firm performs in order to deliver a valuable product or service for the market. This concept was analyzed, first described and then popularized by Michael Porter in 1985.

The idea of "value chains" is based on seeing a manufacturing (or service) organization as a system, made up of subsystems each with inputs, transformation processes and outputs. *"Inputs, transformation processes, and outputs involve the acquisition and consumption of resources - money, labor, materials, equipment, buildings, land, administration and management. How value chain activities are carried out determines costs and affects profits".*[16]

In a global supply chain many partnering firms are normally SMEs supporting a focal firm in the process of supplying raw materials to the delivery of final products and services to end customers. In context to the supply chain of the focal firm, SMEs play *"a very crucial role in attaining cost efficiencies in procurement and production processes, and accurate & timely delivery of products and services to the end customers. But this requires a close and trustworthy relationship between the focal firm and associated SMEs".*[17]

The concept of value chains as decision support tools, was added onto the competitive strategies paradigm developed by Porter as early as 1979. In Porter's value chains, Inbound Logistics, Operations, Outbound Logistics, Marketing and Sales and Service are categorized as primary activities. Secondary activities include Procurement, Human Resource management, Technological Development and Infrastructure.

According to the OECD Secretary-General (Angel Gurría, 2012), the emergence of global value chains in the late 1990s provided a catalyst for accelerated change in the landscape of international investment and trade, with major, far-reaching consequences on governments as well as enterprises.[18]

Micro, Small and Medium Enterprises are the backbone of the global economy and there is overall consensus that they guarantee employment and contribute heavily to the GDP generation of the single countries.

However, as UNCTAD points out: "there are obstacles that affect SMEs' ability to enter global

[16] "Decision Support Tools: Porter's Value Chain", Cambridge University: Institute for Manufacturing (IfM) on http://www.ifm.eng.cam.ac.uk/research/dstools/value-chain-/. Retrieved 24 March 2015.

[17] "Aligning interests of SMEs and a Focal Firm (MNE) in a Global Supply Chain Setup", K.K. "SMEs and MNEs in Global Supply chain setup" on www.academia.edu. Retrieved 24 March 2015

[18] "The Emergence of Global Value Chains: What Do They Mean for Business?", Remarks by Angel Gurría, OECD Secretary-General at the G20 Trade and Investment Promotion Summit. http://www.oecd.org/about/secretarygeneral/theemergenceofglobalvaluechainswhatdotheymeanforbusiness.htm. Retrieved 24 of March 2015

value chains (GVCs) both in developed and developing countries."[19] These include:

(a) the need to upgrade technology and innovation capacity;

(b) the lack of adequate finance and human capital for this process;

(c) the inability to meet standards and certification requirements;

(d) the necessity to better manage intellectual assets, including the protection of intellectual property rights (IPRs) when appropriate;

(e) the difficult bargaining position SMEs face with large contractors; and

(f) the need for diversification to reduce dependence on one or a few customers.

As mentioned, value chains today are not limited geographically and micro entrepreneurs (91% of European enterprises) play a role of paramount importance. Nearly all products and services are "born global" and international partnerships, exchanges of opinions, market analysis and feasibility studies require therefore global expertise, experience and knowledge.

Growth ambition, innovation opportunities' awareness and loyal leadership skills to afford internationalization challenges are characteristics of a successful entrepreneur in a globalized competitive environment. The latest "Global Entrepreneurship Monitor" Report (GEM), issued in January 2015, mentioned four important entrepreneurial preconditions:

(a) entrepreneurial connections;

(b) awareness of opportunities;

(c) inherent entrepreneurial skills;

(d) risk taking culture.[20]

Diverse stakeholders of the innovation eco-system came up with interesting initiatives that INSME collects with the aim to inspire others to adopt some of those as good practices.

An example from Brazil: the Business Linkages Strategy - ENCADEAR

For the purpose of reducing the asymmetry of productivity between small and large enterprises, the Brazilian Service of Support for Micro and Small Enterprises (SEBRAE) has adopted the Business Linkages Strategy, inducing the inclusion of small businesses in the value chains of large enterprises, in order to contribute to the improvement of competitiveness.

The logic of operation clearly maps the demand from large enterprises and the offer from small companies to overcome the competitive gap by considering the technology skills of the small entrepreneurs and the requirements from large players considering three factors: management, products and processes.

The strategy is articulated around three main strategic goals (competitiveness, sustainability and innovation).

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[19] Enhancing the participation of small- and medium-sized enterprises in global value chains", report 2007, page 8 on http://unctad.org/en/Docs/c3em31d2_en.pdf. Retrieved 24 March 2015

[20] "Leveraging Entrepreneurial Ambition and Innovation: A Global Perspective on Entrepreneurship, Competitiveness and Development ", Global Entrepreneurship Monitor, Report 2015, Executive Summary, page 2 on http://www.weforum.org/reports/leveraging-entrepreneurial-ambition-andinnovation-global-perspective-entrepreneurship-compe. Retrieved 24 March 2015

The business linkages between large enterprises and small businesses may occur in the upstream (suppliers) or downstream (distributors, retailers, consumers, after sales and recycling) supply chain of a large company, which establishes the lead mechanisms to induce managerial improvement, technological development and innovation from its power as a purchaser and/or supplier.

A focus on current achievements

SEBRAE can count on a portfolio of more than 84 projects as of today, reaching over 15,482 companies thanks to an investment of USD 46.6 million. The involvement of big industry players includes international brands as Nestlé, l'Oréal, Petrobras, BASF, as well as Bosch and many others.

In the near future, the project foresees an increase of investments, especially from the large industrial players as they report measurable financial benefits from the initiative.

Main advantages reported by large industries are:

- Best price guarantee;
- Increased flexibility for timely delivery;
- Visibility on a national level thanks to sustainability (economic, environmental, and social);
- Cost reduction concerning transport and logistics;
- Investment optimization;
- Increase of innovation potential and related capabilities.

Human capital plays a vital role. According to Deloitte's annual research on "Global Human Capital Trends", companies need to manage people in a different way and be able to innovate and transform human capital. Twelve trends are described that can be split into three key areas of strategic focus:

(1) Lead and Develop;

(2) Attract and Engage; and

(3) Transform and Reinvent.[21]

In addition crowd funding and crowd sourcing on common challenges might enable micro, small and medium sized enterprises to have their say in global value chains and may reserve a niche leadership position by exploiting international visibility and recognition to grow further and scale up accordingly.

Investing in the right skillset is a crucial success factor. Support through virtual acceleration, including the adoption of open innovation and innovative ways of mentoring by implementing the "network-centric approach" [22] needs to involve all players of the "innovation game" to achieve and pursue inclusive growth for a future world based on sustainability by coping with a 4.9 billion middle-class population by 2045.

[21] "Global Human Capital Trends 2014: Engaging the 21st-century workforce", Deloitte University Press, 2014, page 25 – 144 on http://www2.deloitte.com/global/en/pages/human-capital/articles/human-capital-trends-2014.html. Retrieved 24 March 2015

[22] "Larta's Global Innovation System", Larta Institute 2014 on https://www.larta.org/model. Retrieved 24 March 2015

Chapter 6 – Factors holding back SME financing in global value chains

Matthew Gamser

Chief Executive Officer

SME Finance Forum, International Finance Corporation (IFC)

While global value chains hold great opportunities for SMEs, establishing and sustaining these global relationships generally requires investment that stretches the means of entrepreneurs, their families and friends. External financing can be the key difference maker in whether significant numbers of SMEs can realize these cross-border opportunities. Getting this finance to SMEs requires overcoming many obstacles, however.

Challenges posed by traditional financing practices

The first set of obstacles has nothing specifically to do with value chains, but they make banks and many financial institutions reluctant to lend to SMEs.

The way banks, in particular, approach credit underwriting and portfolio management makes SMEs expensive and difficult to acquire as clients, and equally expensive and difficult to serve. SMEs' business is too small to support the heavy hand-holding approach banks use for corporate finance, and they don't have the Bloomberg screen-ready third party rating and other information corporate bankers need to see, nor audited accounts (nor any decent accounts, in many cases).

Yet SMEs are too complicated to serve by the almost "no touch" consumer approaches another part of the bank is comfortable with. In most emerging markets (and in many OECD markets), they and their entrepreneurs, have no credit report, because they've never borrowed from a formal financial institution. Neither can they show salary payment data, as few have employment in larger firms that can present such data. So consumer bankers also lack the core information they rely upon.

SMEs end up falling between two pillars of what bankers are comfortable with. It's not politically possible to say that the institution can't lend to SMEs, so SME departments exist in most institutions, placed either in Corporate or Consumer Banking. Their staff ask applicants to present good business plans and accounts, and all information on "hard" assets the entrepreneur possesses – basically land, property, and cash on deposit. Most SMEs have limited fixed assets, or are reluctant to pledge such assets, which often are not related to the business activity.

The end result is that many SMEs get deterred trying to find the right staffperson. Of those that succeed in this first step, many struggle with the required paperwork. Those who survive this challenge then find that either that they don't have sufficient assets to be considered for anything like the financing they believe they require, or they are asked to put their homes or land at risk to get a fraction of their value in a loan.

Given this traditional practice, it is no wonder that so many SMEs report that they cannot get the financing they need to grow their businesses and create new jobs. The tragedy is that the practice is based on mythology about what information gives a financier the best sense of whether an SME is capable and willing to honor loan obligations.

Dispelling myths and learning lessons

The first myth is that statements of accounts and business plans are central to creditworthiness. While they may say something about the organizational skills of the entrepreneur, they are largely worthless in this regard. Accounts are almost always incomplete, often deliberately so; and they don't reflect the dynamics of the firm, as the most important part, the cashflow statement, is usually the most deficient. The more beautiful the plan looks, the less likely the entrepreneur actually wrote it and understands what's in it. What counts the most is what is going in and out of the businesses' and the entrepreneurs' accounts, not their accounting statements. This is where the minority of savvy SME financiers focus their attention, as this is what determines the ability to take on and service new debt.

The second myth is that getting as much fixed assets as collateral is the best way to minimize defaults and losses given default. As has already been noted, these assets often play no part in the business. Tying them up in the business, when other assets might be available, creates the wrong dynamic between the banker and the entrepreneur.

In emerging markets, actually seizing land or property often is politically and practically impossible anyway, particularly (but not exclusively) in rural areas. By contrast, movable assets, particularly accounts receivable and inventory/warehoused product are by definition linked to the business, and involving them in the transaction aligns banker and entrepreneur interest. SMEs tend to have a far higher percentage of movable to immovable assets related to the business.

Moreover, seizing such assets, particularly when the banker can make prior arrangement of control (through payments systems, warehouse agreements, etc.) is easier if the transaction runs into difficulties. In emerging markets, the limitations in commercial process/justice systems that make realizing fixed asset transfers difficult, work to the advantage of the movables-based financier. It's the entrepreneur that has to seek recourse when the financier garnishes the payments, or seizes the goods in the warehouse.

The final myth is that keeping track of key information about SMEs' business activity and managing their portfolio relationship can only be done through costly, labor intensive approaches – namely, having SME officers who literally stay out in the field literally kicking clients' tyres. This myth was true, particularly in emerging markets, until recently, but this no longer is the case.

Few SMEs in such markets have borrowing relationships with formal financial institutions to contribute to credit reports, even if there is a credit bureau, and that bureau stores both positive and negative credit information.

However, many SMEs have regular payments information with a host of larger entities, be they utilities (particularly mobile phone companies) or buyers and sellers from value chains – and more and more of these payments relationships have moved from paper records (if any) to electronic platforms.

More and more non-financial information is also moving onto these platforms, particularly social networks like Facebook, LinkedIn, TenCent, Alibaba, etc. While kicking the tyres works, and will always work, it doesn't scale very well. The new breed of SME financiers seeking scale focus on grabbing and analyzing data from computer terminals, not from shop floors.

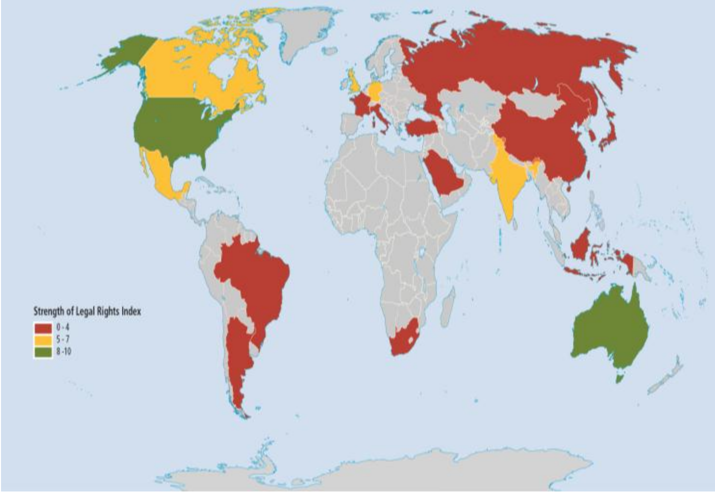
The impacts of policy and regulation

SMEs in global value chains should, given all the above, be one of the segments of this market most likely to overcome traditional banking reluctance. Value chains, increasingly managed with electronic information systems, present precisely the comprehensive, easily accessed, easily processed data sources the new banking options need. Unfortunately, some longstanding policy/regulatory constraints, as well as some doubly unfortunate new ones – unintended consequences of recent financial sector reforms and the Edward Snowden/NSA fallout– continue to inhibit progress in this area.

Limitations to securing movable assets in financial transactions pose a fundamental obstacle to value chain finance development in many countries, including many G20 nations. The Financial Stability Board designated the World Bank's ICR standard and the UNCITRAL Legislative Guides as best practices for protecting creditor rights. However, as Figure 11 illustrates, many G20 nations fall short of best practice standards in this area.

Some G20 countries still use document registration, requiring delivery and recording of pledge agreements (and sometimes other documents) at the registry, instead of the recommended "notice" system. Other countries don't use a centralized registry or single registry for all types of movable assets. Some European Union countries still require physical appearance by one or both parties before the registry in order to register security interests. Even within the European Union and other regional economic entities, there has been little harmonization of practice to date in this area. Given the limitations of G20 and developed country regimes, it is small wonder that few emerging market countries present encouraging environments for using movables as collateral.[23]

Figure 11: Opportunity for Improvement – Secured transactions systems in G20 countries



Score 0-4 – Low compliance with international standards on secured transactions (UNCITRAL)

Score 4-7 – Moderate compliance with international standards on secured transactions (UNCITRAL)

Score 7-10 – High compliance with international standards on secured transactions (UNCITRAL)

* Source: World Bank Group Doing Business 2015. The DB index ranges for indicators has been adjusted to a base of 10

Banks and other financial institutions' comfort with supply chain financing will increase as they gain greater information on transactions in those chains, reducing information asymmetries in the SME market. This necessitates access to such non-conventional financial/credit information – not always supported in countries' credit information regimes, particularly in countries which have a dominant central registry operated by a government agency. This agency, often the central bank, can face political obstacles as it seeks to add new supply chain

[23] Data in this section taken from 2 reports from the World Bank Group. G20 analysis is from a report to the Global Partnership for Financial Inclusion and the Investment and Infrastructure Working Group, 23 April 2015. EU findings are from a World Bank presentation to the European Commission with regard to its Green Paper on Capital Markets Integration, 30 January 2015.

data which may fall under the purview of a different ministry (Industry and Trade, Economy, or Commerce, for example). Even in countries where private credit information aggregators are present, new post-Snowden regulations have been tightening conditions for data access. While consumer privacy rights must be protected, care should be taken to ensure an appropriate balance between this protection and the economic/employment benefits of greater SME access to financing.

The implementation of Basel II/III, which already caused a ripple in trade finance systems before the European Union Capital Requirements Directive IV allowed for more appropriate credit conversion factors, will pose additional challenges to banks looking to increase supply chain financing. The World Bank Group's February-March 2015 survey of 53 emerging market regulators for the Basel Consultative Group found that most believe the Basel II revisions on credit risk will have an adverse influence on lending to SMEs. The regulators felt that treatment of SME exposures not qualifying for inclusion in retail portfolios is one of the main areas worthy of rethinking and possible revision.[24]

Regardless of the outcome of Basel II/III implementation, which is some years away in many emerging market countries, **few supervisory regimes recognize movable assets in determining lending reserve requirements.** This ignores the practical utility of realizing securities in movables-based financing discussed earlier – particularly in receivables financing done on electronic payments platforms – and discourages bankers from considering alternative movables-backed financing options.

[24] World Bank Survey March 2015, Basel II – *Proposed Revisions to the Standardised Approach to Credit Risk.*

All these inhibiting factors can be overcome. A number of specialized non-bank financial institutions have entered the supply chain financing market. From Alibaba in the east, to OnDeck Capital, Kabbage and others in the west, they are a recognized and growing presence in this area.[25] They can ignore many of the regulatory and supervisory issues, and can adjust their business practices to minimize other obstacles, while they maximize access to the growing electronic data streams that underlie their lending models. At the same time, being non-banks, they are constrained in many markets in fundraising, and in all markets in the range of financial products and services they can offer.

Policymakers should strive to improve their enabling environments to remove barriers for banks wishing to compete in supply chain finance, particularly if they want to see longer-term financing based on supply chain relationships. Such longer term financing will be critical to SMEs' abilities to increase productivity and efficiency (including resource and energy efficiency), which are vital to keeping up with raising quality and sustainability standards in global supply chains.

[25] Alibaba, having received a banking license for its Ant Finance subsidiary, will no longer be able to ignore regulatory issues as it continues to grow its portfolio. At the same time, they will gain greater flexibility in the fundraising and in the financial products/cross selling they can offer.

Section 3

Challenges and barriers to the financing of SMEs in global value chains, and lessons learned

Chapter 7 – Government support for SMEs: The case of Canada

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Background

SMEs are significant drivers of employment and economic growth. In fact, in 2014, there were more than one million businesses in Canada: 99 percent of which had fewer than 500 employees; 75 percent with fewer than ten; and 55 percent with one to four employees. In 2014, SMEs accounted for roughly 90 percent of the private sector labour force. In terms of economic impact, SMEs contribute 39 percent to Canada's gross domestic product (GDP).

Government support to help address challenges facing SMEs

The Government of Canada invests in Canadian small businesses by ensuring that they have the **right conditions in place** for them to succeed.

The government helps small businesses grow and foster entrepreneurship by, among others:

- providing an estimated $2.2 billion in **tax relief** in 2014 alone;
- **reducing the small business tax rate** from 11 per cent to 9 per cent by 2019;
- increasing the **Lifetime Capital Gains Exemption** to $1 million for owners of farm and fishing businesses;
- **increasing access to venture capital financing** to help innovative, high-growth companies grow and create jobs;
- providing $14 million over two years in support of **young entrepreneurs;** and
- supporting the Action Plan for Women Entrepreneurs to **help women business owners succeed.**

In addition, the government **reduced small businesses' Employment Insurance premiums** by introducing the Small Business Job Credit. This credit is expected to save small businesses more than $550 million over 2015 and 2016.

The Government of Canada is also helping to **cut red tape** through the Red Tape Reduction Action Plan, which improves service to entrepreneurs so they can focus on investing in jobs and growth. This plan commits to reducing onerous duplication of regulation among government departments, introducing service standards for high volume licenses and permits, and harmonizing cross-border trade. The plan addresses 90 department-specific reforms and encompasses six systemic changes to the way government designs, implements and administers regulation, under three areas of action: (i) reducing administrative burden on business; (ii) making it easier to do business with regulators; and (iii) improving service and predictability.

Navigating government information when starting and growing a business can be a challenge. The Canada Business Network (CBN) ensures the information on government programs and services to start, run, and grow a business is available and easily accessible. The

CBN is a collaboration of lead federal departments and agencies, provinces and territories, and not-for profit entities. Launched in 2006, BizPaL is a free online service that significantly reduces the red tape burden on small business owners by allowing them to quickly and efficiently create a tailored list of permits and licences that are required from all levels of government to operate their specific business.

Access to capital is another area where the government provides programs to support SMEs. The Canada Small Business Financing Program (CSBFP) helps thousands of SMEs to access financing. It does this by encouraging financial institutions to make additional loans available to small businesses and by sharing in losses resulting from those loans. Small businesses can use CSBFP loans obtained from private sector financial institutions to purchase property and equipment and make leasehold improvements. The program delivers benefits to Canadians and small businesses by helping firms invest in the economy and create jobs. From 1999 to 2014, the program registered nearly 148,000 loans worth over $15 billion. A 2014 cost-benefit analysis shows that between 2004 and 2012 the program provided $4.5 billion of net benefits to the Canadian economy.

Venture capital plays an important role in funding and growing high-risk, innovative small and medium-sized enterprises. These SMEs are usually young, R&D-intensive and high-risk, but have few tangible assets to provide as collateral for debt financing. The Government of Canada has committed $400 million for the Venture Capital Action Plan to increase private sector investment, while supporting economic growth; $100 million through the Business Development Bank of Canada to invest in high-growth firms and firms graduating from business accelerators; and $100 million over five years for Canadian incubators and accelerators to expand their services to entrepreneurs to help them become investment-ready.

The Business Development Bank of Canada (BDC) has a mandate to support Canadian entrepreneurship, with a particular focus on SMEs. It offers direct lending, growth and transition capital, venture capital, securitization and consulting services. BDC has two key objectives: to serve as a catalyst for Canada's entrepreneurial ecosystem and to support the competitiveness of Canadian SMEs. It plays a complementary role by offering support that fills out or completes services available from private sector providers.

Canada is also supporting its **young entrepreneurs.** Futurpreneur Canada is a non-profit organization supported by various levels of government that provides young entrepreneurs with loans and mentoring services. Under the Futurpreneur Canada loan program, young entrepreneurs can obtain up to $15,000 in start-up capital. Loan recipients must agree to work with an experienced business volunteer drawn from a pool of mentors assembled by Futurpreneur Canada.

In terms of **research,** the National Research Council of Canada's Industrial Research Assistance Program (NRC-IRAP) provides a range of technical and business-oriented advisory services, as well as necessary financial support, to qualified innovative SMEs in Canada. It engages in cost-shared research and development (R&D) projects with its clients. Firms helped by NRC IRAP are better equipped to perform basic R&D, commercialize new products and processes, and access new markets.

With regard to **export support,** the Government of Canada has proposed a new export market development program that will help SMEs develop export opportunities by providing direct financial assistance to entrepreneurs seeking to develop new markets, especially in high-growth emerging markets. This initiative will be particularly helpful in supporting SMEs finance activities such as market research, participation in trade fairs and missions, shipping prototypes and pilot projects to create new business opportunities. The program is targeting between 500 and 1,000 Canadian exporters per year across the country. The program will also ensure coordination with other Canadian partners (governments, agencies and private sector organizations) in order to maximize the support for new exporters.

Directions for the future: Coordination, awareness, and access

Canada has a number of programs that support businesses at all stages of their development – in fact there are 250 programs across 20 departments at the federal level alone. Going forward, businesses need improved awareness and access to these programs.

No one department, or level of government, is responsible for supporting SMEs in Canada, and it can be difficult and sometimes overwhelming for a business to navigate these programs.

As a result, the focus needs to shift to:

- **Improving collaboration** with institutions at all levels of government, including the private sector (financial institutions)

- **Increasing awareness and facilitating access** to the programs that are already available to SMEs.

Chapter 8 – Current trends and challenges experienced in financing SMEs

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Background

In the years leading up to the crisis, European banks experienced a slowdown of their lending activity. The persistence of the recession and the sovereign debt crises caused a worsening of the credit quality, especially for business loans, which undermined banks' balance sheets. The increase in the amount of non-performing loans had, as a consequence, a tightening of bank credit to the private sector and especially to SMEs (traditionally more dependent on bank lending).

SMEs with less than 250 employees are a key feature of the European economy. In 2013, the EU28's 21.6 million SMEs in the non-financial business sector employed 88.8 million people and generated €3.6 trillion in value added (28% of EU GDP). They accounted for 99.7% of all firms, about 67% of total employment, and 58% of business value added.

Current trends in SME financing

The slowdown of bank lending and the SME funding gap

Recent data show that the contraction in bank lending to the private sector in the Euro area is moderating, and in particular the decline in loans to non-financial corporations. In February 2015, the annual growth of credit to non-financial corporations in the Euro Area was -0.7%, with heterogeneous trends among countries (+1.9% in Germany, + 2.9% in France, -3.1% in Italy, -6.5% in Spain). Between 2008 and 2014, the overall lending to non-financial corporation decreased in the Euro area by €553 bn. The slowdown has been more pronounced in Spain (€-410 bn), though less in Italy (€-66 bn) and Germany (€-57 bn), while in France the amount increased by €+44 bn.

Policy actions

a) **The timing and calibration of ongoing reforms, in particular the Net Stable Funding Ratio (NSFR), the leverage ratio and the total loss absorbing capacity (TLAC), should be carefully assessed.** If it is not the case, it will inevitably trigger a new wave of bank deleveraging which would be detrimental notably to SME financing.

b) In a context characterized by low interest rates, shrinking margins on traditional intermediation, and the need to contain leverage setting limits on loan growth, **banks should work to develop their ability to offer more diversified financial services to firms, especially SMEs.** Moving the bank-firm relationship in this direction would be profitable and beneficial both for banks and for non-financial firms.

c) In the short term, no more than a fraction of bank credit can be replaced by other sources of funding. Improvements in SME financing can be achieved by moving towards two different lines of action: **1) supporting bank credit with market-compatible public interventions** (government guarantees and securitization); and **2) developing**

complementary sources of debt financing for SMEs such as private placements, private equity, and venture capital.

d) **Maximizing the benefits from the Juncker Plan for investments.** With an initial injection of €21 billion, the Juncker Plan aims to generate €240 billion for long-term investments and €75 billion for SMEs and mid-cap firms over the period 2015-2017. These include new venture capital injections, loan guarantees, securitizations, and seed financing designed to offer micro-loans to SMEs, to fund start-ups or offer mid-cap companies venture capital.

e) As regulators, through higher capital ratios, want to transfer part of the companies' financing from bank debt to capital markets, **public authorities should avoid conflicting measures,** such as the financial transaction tax, that would endanger the development of European capital markets.

f) The European Commission wants universal banks to separate their financial market activities, including market-making activities. Without market making, companies, including SMEs, could find it more difficult to issue shares or bonds under satisfactory terms. **The banking structural reform currently under negotiation presents significant margins to be reconsidered** in order not to limit the development of this market segment.

Challenge 1: Supporting SMEs bank credit

Reviving the securitization market in Europe

Securitization is one of the instruments which could help bank lending to smaller firms with limited credit histories. During the economic crisis, the securitization market in Europe experienced a severe slowdown due to the investors' fears following both the subprime crisis and changes in the regulatory framework. Securitization issuance in Europe amounted to €216 billion in 2014, compared to €594 billion in 2007.

Policy actions

a) **Defining common standards to distinguish high-quality securitizations.** The European Commission, while recognizing that risky securitizations are a thing of the past, acknowledges that high quality securitizations could create around €20 billion of additional funding.

b) **Improving credit information:** The definition of a common minimum set of standardized information for credit reporting and assessment could help to attract funding to SMEs. Comparable credit quality information could help the development of financial instruments to refinance SME loans, such as SME securitization.

c) **Enhancing transparency:** While opaque, complex, multiple-stage securitizations have shown their potential for financial instability, on the other hand simple, transparent and standardized securitization instruments can be useful to the growth of lending.

d) **Overhaul the securitization credit risk framework:** A key issue would be the introduction of appropriate risk mitigating features of high-quality transactions.

e) **Develop instruments to boost mortgage securitizations:** This could be a critical catalyst to develop a well-functioning securitization market. Such a market would also free up capacity in bank balance sheets which banks could use to lend to SMEs instead.

Strengthening Credit Guarantee Schemes

Credit Guarantee Schemes are a common feature of financial systems across the world. More than 2,250 guarantee schemes exist in over 100 countries worldwide. By reducing the financial loss suffered by the financial institution in the case of default, Guaranteed Funds reduce the lender's credit risk. Guarantee schemes vary across Europe. They differ in terms of operational structure, type of instruments offered, and extent of usage.

Policy actions: the case of Italy

a) In response to the crisis, in Italy the **Central Guarantee Fund for SMEs has been reinforced** through an increase in its endowment, the widening of the range of potential beneficiaries, and the broadening of the eligibility criteria.

b) **A government backstop guarantee was introduced,** relieving banks from capital charges for loans covered by the Fund. In the last five years the flow of loans guaranteed by the Fund has risen rapidly. Between 2009 and 2012, guaranteed loans amounted to €31 billion and were assigned to 127,000 firms, most of them of a small size.

c) **During the first 10 months of 2014, €6.5 billion of guarantees were granted** supporting a loan volume of €10.2 billion. More than 80% of the loans concerned were contracted by micro- and small firms. A recent analysis of the Central Guarantee Fund's activities suggests that firms which access the Fund have mainly benefitted from increased loan size rather than a lower interest rate.

Challenge 2: Broadening the range of financing sources for SMEs

Developing a European market for private placements

Private placements are mainly used by medium-sized companies, unable to access the public bond market, to be financed by large institutional investors. Private placements compared to public offering present: a) lower issuance costs; b) greater contractual flexibility; c) smaller size and lower secondary market liquidity; d) in-depth information sharing between investors and issuers.

The growth of private placements has accelerated since the onset of the financial crisis. In 2014, private placement issues in Europe amounted to €6.6 billion vs. $50 billion in the United States. The development of a market for private placements in Europe is one of the European Commission's goals for the Capital Markets Union.

Policy actions

a) **Creating common market standards and best practices** is essential for the development of a European private placement market for corporate debt. Differently from the US, the European market regulations and market practices are not yet sufficiently harmonized across different countries. Recently a Pan-European Corporate Private Placement Market Guide has been issued with the aim to support the development of this market.

b) **Developing private placement markets in Europe.** Medium-sized European enterprises have been accessing the US private placement market for many years. In 2013 they raised $15.3 bn. During the financial crisis, the popularity of private placements has accelerated in Europe. In Germany and in France, domestic private placement markets provided €15 billion of debt in 2013.

c) **Involving other institutional investors in SMEs financing.** The role of institutional investors in capital markets has been growing significantly. With assets under management of more than €17 trillion, the European asset management industry plays a key role in channeling investors' money into the economy. Moreover the pension and insurance sectors also hold significant assets of around €12 trillion which can help to fund investment.

d) **Developing a business model based on a co-lending approach, where banks and non-banks lend alongside each other.** In most cases, commercial banks could retain the primary customer relationship and continue to provide less capital intensive products and services. However private banks and investment banks could also use non-bank lending partners to meet their customers' credit needs without using capital. For banks, the effect would be to move their corporate lending function closer to a debt capital markets model.

Challenge 3: Promoting the role of capital in SME financing

Increasing equity in SME balance sheets would enhance the capital structure of firms and lead to a sounder SME sector. Traditionally banks are more likely to provide credit to firms with higher levels of equity. As a complementary form of funding to traditional bank loans or issuing debt or equity, private equity and venture capital play an important role in the European economy. In the EU, venture capital funding has high, but largely unexploited, potential for development of SMEs. Europe accounts for only 15% of global venture capital activity vs. 68% of the US economy.

In 2014, European venture-backed companies attracted €7.9bn through 1,460 deals: a fall of 11% in the number of deals completed from 2013 but an improvement of 25% in euros invested. It was the biggest amount invested since 2001 when companies raised €10.6bn. The private equity and infrastructure industries are already playing their role in helping those businesses to expand and grow. Private equity backs over 25,000 companies in Europe, 83% of which are SMEs.

Policy actions

a) **Promoting cross-border venture capital investments:** At present, there is no integrated European venture capital market and the market is fragmented along national lines. Member States' differing tax treatments of investment funds cause uncertainty over tax liabilities and risks of double taxation of investors. This acts as a disincentive for global investors wanting to invest in Europe.

b) **Creating incentives for institutional investors.** Despite the huge size of the asset management industry in the EU, no specific provisions in current EU legislation have been designed to channel equity funds to SMEs. Institutional investors, in particular insurance companies, are potential investors in VC funds.

c) **Introducing a third-country passport.** EU Venture Capital Regulation (EuVECA) provides European venture capital firms with a passport, enabling them to seek investment across Europe while applying standards that are appropriate to the size and characteristics of venture capital. In 2015, EuVECA should be made available to venture capital funds located outside the EU to provide European professional investors with full access to global investment opportunities.

Chapter 9 – Financing SMEs in developing economies: Experiences from a multinational enterprise and lessons learned

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Chairman

BIAC Development Task Force

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Heineken

Background

Large companies expand their operations into foreign markets in order to follow investment opportunities, enhance production, seek cost efficiencies, facilitate access to resources, and foster a larger consumer base. The benefits accrue not only to the multinational company: as their value chains also need to grow and diversify, new business opportunities are created for SME suppliers in domestic and foreign markets alike. Advantages include more jobs, investment, trade, and innovation, with knock-on benefits for economies and societies more broadly.

The importance of a well-functioning value chain is frequently overlooked, though perhaps most visible when a multinational invests in a developing country, in which suitable local suppliers perhaps do not exist yet. In the absence of local supply chains, there is a good business case for a multinational to rely on its existing importation of supplies from its home country or from other more developed economies. However, there can often be a better business case for also building local value chains in the developing country, sometimes from scratch, helping to reduce costs and also contribute to local development. This is nevertheless a challenge and requires a combination of many factors in order to be successful, including financing and capacity issues, but it can result in significant long-term advantages for all parties.

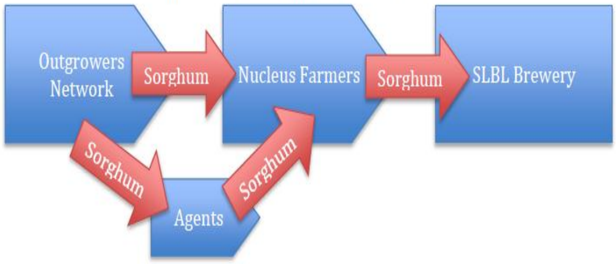
Drawing upon Heineken's experience in Sierra Leone, this chapter presents the perspective of a multinational and the challenges involved in engaging and financing local SMEs (in this case farmers), lessons learned, and recommendations for the G20 and other fora.

Local sourcing of sorghum in Sierra Leone

In the early 2000's, Heineken began contemplating possibilities for local sourcing of ingredients needed to produce beer at the Sierra Leone Brewery Limited (SLBL) – a company majority-owned by Heineken. Previously, SLBL had been importing the key ingredients needed to produce beer, including malted barley. Heineken considered that sorghum, produced and sourced locally, could partly substitute for the imported malted barley used in its local brands. In doing so, it could cut company costs (local sorghum is cheaper overall when taking into account exchange rates and import cost of malted barley) and reduce price volatility (local sorghum is more stable in price). At the same time, local sourcing could also contribute to Sierra Leone's development – creating jobs and livelihoods. When Heineken was then asked by the former President of Sierra Leone whether it could involve more local farmers and people in the brewing process, the company moved ahead in 2005 to begin **the creation of a local supply chain of sorghum.**

The plan was to create a number of 'nucleus farmers', who have a direct relationship with the brewery and other support agencies.[26] Each nucleus farmer in turn would manage relations with a bigger network of outgrower farmers in their areas, directly or through their own agents, who would supply the nucleus farmers with sorghum in exchange for cash and training (Figure 12).

Figure 12: Sorghum supply chain in Sierra Leone



One major challenge facing the project was the need to attract local farmers to engage in the commercial production of sorghum, bearing in mind that many were engaged in subsistence farming and many were skeptical of the project's potential success given that other NGO projects had failed in the past. A second challenge was the need to improve local farmers' agricultural and financial education in order to ensure a reliable functioning of the chain. A third challenge was selecting a suitable sorghum variety for brewing purposes, matching the specific climate conditions in Sierra Leone.

In order to meet these challenges, a key part of the solution was to ensure **fit-for-purpose financing and financial education:**

Nucleus farmers need financial capital to pre-finance the first load of sorghum received from their outgrowers. Nucleus farmers also need financing to make investments in storage facilities, transport, and communication activities to reach more outgrowers. Furthermore, nucleus farmers require training to learn how to account for all crops and how to calculate costs of investments and profits, in addition to agricultural training about sorghum and communication with outgrowers.

Outgrowers seek direct cash for the sorghum they deliver to the nucleus farmer. Outgrowers are also sometimes in need of cash before harvesting (such as for sowing seeds, fertilizers, labor costs, buying tools, etc.).

A blend of public-private financing and cooperation proved essential to help mitigate risks, pool expertise, and thus design and kick-off the project for the initial five years until it would become commercially viable. One key actor was the Common Fund for Commodities (CFC) – a UN organization with the aim of promoting commodity trade – which helped in the project design and contributed a significant grant. An NGO – the European Cooperative for Rural Development (EUCORD) – was appointed as an implementing agent. Through partnering with the CFC and EUCORD, SLBL was able to cover part of the total costs for committing farmers to sorghum production through publicly-funded capacity building activities. Involvement of local staff and a local consultancy was moreover extremely important in building trust with the farmers.

Once the project began, nucleus farmers became able to access finance from a microfinance bank called Finance Sierra Leone – whereby loans are guaranteed by the SLBL brewery. The loans can cover capital investments into storage and transport, but also pre-financing for outgrowers if needed. Through the packaging of a loan with the SLBL guarantee, the bank is able to give out loans with a low risk of failure. When the nucleus farmers then deliver the sorghum 2 or 3 months

[26] Nucleus farmers would be selected by the brewery on the basis of their education level and literacy, financial capital, and networks, among others, but would also receive training to upgrade their skills. This selection process was necessary since nucleus farmers would need to be responsible for their financial management and networks of outgrowers.

later and receive payment from the SLBL brewery, the outstanding amount they owe to the bank is deducted from their pay slip and paid directly to the bank.

In effect, **a reverse financing and training chain has been create**d in parallel to the sorghum supply chain, to ensure the needs of each actor were met (Figure 13).

Lessons learned and scaling-up

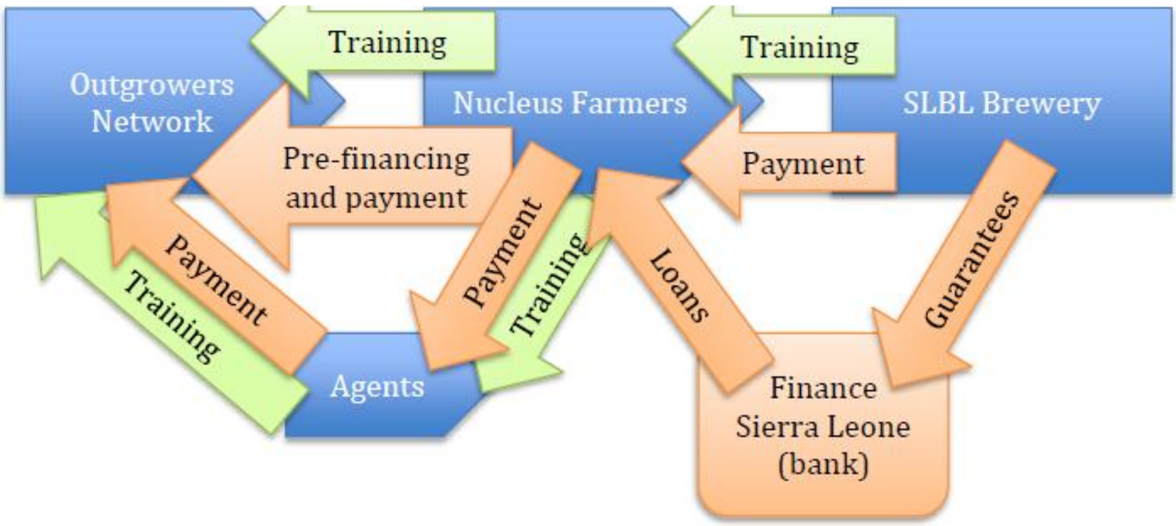
This local sorghum project took six years to become cumulatively profitable and sustainable for SLBL brewery.

It took this long because it involved: building trust and managing relationships with many new stakeholders; gathering the necessary funding to kick-off the project; overcoming cultural differences and understanding local farming; building up an extensive network of farmers to produce sorghum; and also selecting the suitable variety of sorghum. **A partnership approach involving local actors and blended financing proved essential to the project's success.**

Now around 3,000 farmer families are supplying sorghum to the SLBL brewery, and the number is still growing. The top benefits cited by farmers include **additional income** and **access to financial services** (loans), thereby allowing them to pay school fees for their children, improve their homes, and diversify their farming to include other crops and livestock. But in addition, farmers appreciate the training and workshops they receive, which help them to produce other crops and learn from their peers. Heineken and SLBL also benefit as the costs for using sorghum are substantially lower than importing malted barley, and without the long delivery lead times of imports.

The success of the local sourcing program in Sierra Leone has been replicated in 10 other countries in Africa. With 45 breweries all over the continent, the company sourced 48% of its agricultural raw materials locally in 2014.[27] Heineken is well on track to reach its goal to achieve 60% local sourcing of agricultural raw materials from farmers in Africa by 2020. More than 100,000 farmers' families are benefiting from this approach. Considering the full direct and indirect impacts of Heineken's presence in

Figure 13: A financing and financial training chain in parallel to the sorghum supply chain



[27] Heineken (2014) "Heineken Sustainability Report 2014".

terms of value-added (salaries, profits and savings, taxes paid, and employment), one job at Heineken supports 108 jobs in Africa and the Middle East – more than 1.6 million jobs in total.[28]

Recommendations

The case of local sourcing in Sierra Leone and other African countries demonstrates the win-win opportunities for multinationals and local economies and communities when new supply chains are created. But in order to do so successfully, policymakers and multinationals should consider the following essential factors:

Governments should ensure that **policies support multinationals in building new value chains,** bearing in mind that it can take a company several years before it reaches commercial viability. Sudden policy changes, instabilities, or the lack of a level playing field can jeopardize such projects.

New value chains need to ensure that **fit-for-purpose financing** along the chain is provided, on a case-by-case basis. As demonstrated in Sierra Leone, this may involve providing guarantees to support the access of SMEs to bank loans, thereby mitigating risks, as well as ensuring efficient payment to suppliers and predictable loan repayment. Other examples may include special funds created by the parties involved (the multinational, banks, local industry organizations and/or government authorities) to ensure SMEs receive tailored support.

Multinationals, banks, industry organizations, government authorities and other actors can play a key role in providing **financial training and capacity-building for SME suppliers,** which is vitally important to ensure reliable financing throughout the chain.

Responsible business conduct is important for the long-term investments of multinationals in developing countries. For instance, sorghum production for commercial use in Sierra Leone is designed to avoid jeopardizing local food supply.

Developing new value chains requires trust and local knowledge, and thus multinationals should seek to **partner with local stakeholders** (including government bodies and NGOs) and follow international good practice when establishing their chains.

Local SMEs and entrepreneurs should explore business opportunities created through multinationals' new supply chains. As demonstrated in the case of Sierra Leone, local entrepreneurs are making use of the additional sorghum for other agri-food products.

[28] Heineken (2015) "Creating a real impact on local economies and communities: Africa and Middle East", http://www.theheinekencompany.com/sustainability/case-studies/creating-a-real-impact-on-local-economies-and-communities

Chapter 10 – How the insurance market can help SMEs flourish and grow: Practices underway in the UK market

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Background

"L'Angleterre est une nation de boutiquiers." So said Napoleon I over 200 years ago. Whilst Napoleon was speaking in relation to Britain's preparedness for war, the description of the United Kingdom SME marketplace is so very true today.

The UK is one of the most dynamic and fiercely competitive marketplaces. It acts as a good example amongst global markets of how SMEs are sought after and courted. The UK case presents examples of current and emerging practice taking place.

From an insurance perspective, the marketplace is estimated to be worth £6.1bn of Gross Written Premium, the bulk of which is sourced from micro enterprises. The micro enterprise market accounts for 95.5% of enterprises in the UK (in terms of numbers of businesses) and 62.9% of the SME market Gross Written Premium in relation to insurance placements.[29]

The SME market comprises 4.8m businesses. The market split looks as follows:

- 7,000 corporate businesses
- 35,000 businesses with up to 250 employees
- 185,000 small businesses with up to 50 employees
- 1m micro traders
- 3.6m sole traders

When relating to the insurance market place, the UK SME insurance market is forecasted to reach £7.2bn by 2018.

The insurance industry itself has a massive interest in ensuring that it is creating accessible conditions to enable SMEs to flourish and grow. As insurance is a key component in providing resilience to businesses, the industry has a lot to offer.

Equally, government bears responsibility. David Cameron, Prime Minster, speaking at the Conservative Party conference in 2014, stated he wanted to "create a climate for Enterprise". George Osborne, Chancellor of the Exchequer, speaking at the same conference, stated "the future of Britain is to be a pro-business economy".

All businesses face risks and exposures and challenges, but not all will understand what those are. For SMEs which are 'time-poor', multi-tasking, and entrepreneurial by nature, then the industry is already well advanced in taking great strides to be increasingly accessible.

UK-wide industry support

Industry bodies represent the insurance industry in a number of ways.

The Internet has meant that SMEs are no longer confined to trading within their locale. Transacting business on a global basis is increasingly the norm for many SME businesses.

[29] Data Monitor UK SME Insurance: market Dynamics and Opportunities.

Understanding where liabilities lie and the ease of pursuing subrogation across geographical boundaries, thinking about supplier chains, and different obligations means that understanding cover that is being purchased is very important. With new and emerging risks developing, the traditional need to simply insure bricks, mortar and stock is being overtaken by professional and new liability exposures.

Professional advice to understand these risks and protection afforded is essential. BIBA (British Insurance Brokers Association) seeks to help consumers and business access suitable insurance protection. BIBA works with insurer partners, consumer bodies and Government departments to assist customers in accessing insurance, and this includes greater signposting to brokers. In 2014 BIBA's not for profit Find Broker service helped deal with more than 350,000 general insurance enquiries, passed onto BIBA brokers.[30]

In May 2015, the CII (Chartered Insurance Institute) launched an initiative "Insurance Made Simple" to provide easily accessible and straightforward information for customers wanting to learn more about insurance, even down to specific questions such as "How is my premium spent?". The aim of this initiative is to show that the insurance profession is increasingly making insurance as clear and simple as possible – encouraging greater consumer confidence. A website fronted by "Ciindy" represents the CII and helps the public navigate the world of insurance. Feedback from brokers to the CII has been very positive and whilst stage one of the launch is aimed at personal consumer insurance, the feedback already indicates that a similar approach for SMEs would be valuable. Askciindy.com provides more detail.

Initiatives such as this, coupled with BIBA booklet "Small business insurance for dummies", are all aimed at demystifying a complex legal contract.

The industry itself is always working closely to speak with unity and credibility when representing itself externally and to gather feedback and views of members – BIBA from brokers and ABI (Association of British Insurers) from insurers - to ensure relevance when representing our industry to Government, to the regulator, and EU institutions. Being active in all these discussion helps ensure legislation is proportionate and fair and not overburdening in enabling compliance and trade.

Individual Professional Broker Support

Brokers are the interface between clients and insurers. The SME world has flirted with online quote sites over the years, provided by insurers directly and by brokers, and following a similar approach to the personal lines aggregator model. But beyond "micro" transactions, where premium spend is £150/£250, there has failed to be the big move to trading directly online. The threat of disintermediation has simply not arrived and brokers remain more relevant than ever. Research carried out regularly shows that SME clients feel unsure about buying covers such as professional indemnity and liabilities, the SME client recognizing that adequate protection for their assets is in its own interest, as the business being protected translates back more often than not to the owner's pension and future security.

To help SMEs flourish and grow, brokers have an important role in providing access to comprehensive products and backing that with advice. It's here that there is an evolution in how to effectively do that. Thus the insurance industry is adapting to provide good trading platforms between brokers and insurers to ensure service given to SMEs aligns with everyday expectations of being quick, easy and

[30] BIBA Manifesto 2015: Insuring Britain's future.

accessible, but delivered via an insurance professional.

To help SMEs trade effectively and with confidence, and to fully understand both the breadth of their insurance cover along with the restrictions and obligations, brokers have a key role to explain cover and make it relevant to the clients' business activity. They also explain to the client fully in their language what that allows them to do from a trading perspective to enable their entrepreneurial spirit to flourish and grow, and for business owners to be clear on the potential, or risk exposure, they may face as they seek to find new markets and opportunities.

UK Legislative Change

The Insurance Act reforms and provision will come into effect across the UK as law from August 2016. With the UK's commercial insurance contracts being based on an Act that was in place more than 100 years ago, this change will do a significant amount to encourage SMEs to flourish and grow. Existing legislation, The Marine Insurance Act 1906, imposed a duty to disclose every material circumstance which would influence a prudent underwriter, and this potentially gives an underwriter the opportunity to decline claims where there may be no related material impact (for example a security condition that wasn't implemented impacting on a fire loss). The changes means that customers who make non deliberate or non-reckless, non-disclosure or misrepresentation will find the insurance industry taking a fair approach to the client and more confidence that the policy will perform as expected and as the "man in the street" may expect would be reasonable.

Change was needed as the existing law undermined market trust and confidence: the unbalanced nature of the law exacerbated disputes between insurers and business, reducing trust and confidence in insurance by UK economy; and also threatened the credibility of UK business law. The very fact that the law is so antiquated and inconsistent with current practice threatens the long established credibility of UK business law itself.[31]

Deliberate attempts at fraud are of course still unacceptable and insurers still retain the right to void the policy and retain the premium. Warranties will be mainly removed and the basis clause that commits the client in many ways that can feel unfair is being abolished.

In summary:
"The provision of the Insurance Act will modernise the law: balance more fairly the interests of insurance and buyers and provide a framework for an effective, competitive and trusted business insurance market"
Stephen Lewis, Law Commissioner

So from small initiatives to major legislative changes the many component parts of the industry, be that trade and professional bodies, brokers, and insurance companies, are all working collectively and independently to create fiercely competitive modern ways for the SME market to find a supportive approach to enabling them to trade. Other G20 countries can consider the examples above, in the context of their own culture and practices to determine what may work well within their own country.

[31] Chartered Insurance Institute

Section 4

Maximizing the potential of global value chains and identifying actions for different actors

Chapter 11 – Building an integrated approach to financing across global value chains

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Background

SMEs are typically responsible for 80% to 90% of job creation in an economy.[32] SMEs are the backbone of the world economy. In Europe, they employ over 65% of the non-financial workforce and generate 58% of value added.[33] In order for SMEs to grow, their access to fit for purpose finance is of critical importance, both for the SMEs and for achieving sustainable and balanced economic growth, ensuring that all members of the community are economically and financially included.[34]

In most of the world, SMEs rely essentially on bank financing, with only limited access to capital markets[35], limited use of alternative, more sophisticated, financing, and a growing use of shadow banking. Given the current constraints facing banks and SMEs' dependency on bank financing, access to finance is generally of greater concern to SMEs than to large companies. This is also in part due to the **disadvantageous asymmetry** between the cost of lending to SMEs (largely fixed) and the potential revenue (proportional to volume) when compared to larger companies. There are also asymmetries in the availability and quality of information relative to company size.

These disadvantageous asymmetries have amplified since the 2008 financial crisis[36], and are further exacerbated by material differences in SMEs' levels of financial education relative to larger corporates. SMEs are often unaware of (or do not fully understand) the products that would best suit their funding needs and minimize their funding costs, as larger corporates are able to do.

Improving SMEs' access to **fit-for-purpose finance** is all the more important given that the success of many SMEs depends on their ability to participate more fully in global value chains (GVCs). According to the OECD, world trade, investment, and production are increasingly organized around GVCs, which contribute to greater growth, productivity, and job creation.[37] Strong and more collaborative GVCs also make the economy more resilient.[38]

All players (private and public) need to appreciate that GVCs act as a platform that, if properly developed, can be instrumental in facilitating the financial inclusion of SMEs, reducing the information and education asymmetries, and leveraging on SMEs' flexibility and speed to take advantage of opportunities

**I am grateful to Matt Young, Joao Oliveira, Stephen Pegge, and Peyman Ostovar, for their invaluable support and inputs in writing this paper.*

[32] B20 Australia 2014, *B20 Financing Growth Task Force Policy Summary*, July 2014
[33] European Investment Bank, *Investment and Investment Finance in Europe – Investing in competitiveness*, 2015
[34] B20 Australia 2014, *B20 Financing Growth Task Force Policy Summary*, July 2014
[35] B20 Australia 2014, *B20 Financing Growth Task Force Policy Summary*, July 2014
[36] European Investment Bank, *Investment and Investment Finance in Europe – Investing in competitiveness*, 2015
[37] OECD, *Interconnected Economies: Benefiting from Global Value Chains – Synthesis Report*, 2013
[38] CBI, *Pulling Together – Strengthening the UK's Supply Chains*, October 2014

that emerge as GVCs change or new ones are created.

On the other hand, SMEs continue to face a number of barriers to participating fully in GVCs, such as the need to enhance their business, financial, legal, and digital skills, the importance of meeting quality standards, and the availability of finance.[39]

If an SME is unable to secure financing, it will not be able to participate effectively in GVCs. This not only means that the SME will lose out on the inherent benefits of doing so, both for itself and for the economy as a whole, but it also implies that the SME risks being 'left behind' when the chain evolves into new and different markets. Financing is therefore key.

Financing Global Value Chains

Companies that participate in a GVC are for the most-part separate firms and have to procure their funding independently. This can be obtained from sources 'internal' to the GVC, such as supplier credit, or from external sources, generally bank credit in the case of SMEs.

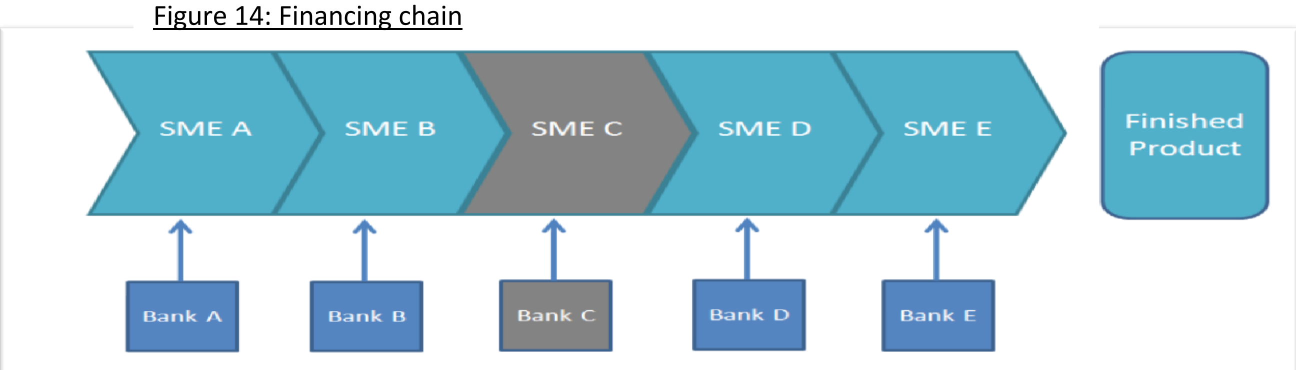
SMEs generally have limited self-financing capacity. This is made worse by what at times may be a significant payment-misalignment, occurring when an SME pays its bills on time but where a large corporate or public client delays payment.

This "**timely payment spread**" causes serious liquidity problems for SMEs around the world, as highlighted by Intrum Justitia's European Payments Index.[40] The liquidity gap fuels the need for SMEs' external financing, but also argues in favor of commitment by the public sector and from large corporates to improve their payment discipline.

In an ideal scenario, a GVC is most efficiently and sustainably served if the financing to its participants is consistently provided throughout the chain (Figure 14). It is not just a question of financing individual pieces of the chain in isolation, but rather to have an end-to-end "financing chain" supporting it. Breaches in the financing chain will not only negatively affect the specific SME, but also reduce the efficiency and efficacy of the GVC itself, with a resulting loss of value for all parties.

In today's world, however, the fragmented nature of the financing of GVCs creates inefficiencies, preventing companies from fully realizing the GVC's potential and thereby constraining wider benefits for jobs and economic growth.

Figure 14: Financing chain



[39] OECD, *Interconnected Economies: Benefiting from Global Value Chains – Synthesis Report*, 2013

[40] Intrum Justitia AB, *European Payment Index Report 2014*, 2014

From a banking services perspective, in addition to the material growth of capital requirements, the **proliferation of regulations from different directions** (all with good intentions but uncoordinated both locally and internationally) has the unintended consequence of piling up large costs on bank customers. Smaller clients (SMEs) increasingly face difficulty in sustaining such costs, which ultimately curbs the portability of financial services across jurisdictions. A case in point is KYC (Know Your Client) **conduct regulations,** which are of paramount importance, but whose insufficient coordination has led to costs for opening simple accounts in different markets to levels that are marginal for large players, but significant (and in cases unsustainable)[41] for smaller SME players.

A vicious circle therefore exists, where an SME cannot take advantage of opportunities in a GVC because it is unable to secure financing. In turn, not being part of GVCs weakens the long-term sustainability of the SME's business model and productivity, negatively affecting its creditworthiness, and so decreasing the financing opportunities to support its growth.

Moving from a vicious circle towards a virtuous circle of financing

In order to transform from a vicious circle towards a more virtuous one that supports SME access to finance, work is needed in two complementary directions:

- Offer SMEs **a platform** in which they can operate and grow by seizing opportunities in new markets, and where tools are offered to reduce their competitive disadvantage vis-à-vis larger corporates;
- Ensure that finance is **consistently accessible** for SMEs.

By their very nature, GVCs offer a platform for SMEs to reap the benefits of participating in international markets, but this in itself is not sufficient and needs to be complemented with actions that enhance the ability of SMEs to also access finance beyond their local market. Banks and financial services providers can sustain SMEs in accessing products tailored to their needs and finding the most appropriate funding solutions for the markets that they wish to target (either within or outside national borders).

SMEs require not just loans, but also more sophisticated financial services that "fit" their increasingly international needs, as well as financial education and support/advice to ensure better alignment between funding and a company's investment and growth opportunities.

At the international level, however, SMEs face difficulties in accessing foreign markets due to the wide variety of regulatory, administrative, and tax regimes affecting their businesses and their access to financing, which place a considerable burden on SMEs' limited resources and available skills. These constraints can act as disincentives to SME participation in GVCs. Governments and regulators should therefore ensure that regulatory frameworks are implemented consistently across borders, taking care to remove obstacles to the provision of the particular financial services upon which SMEs depend.

The financial industry also has a role to play. As well as providing finance, banks can support SMEs that are part of a GVC (indeed, all SMEs) in a variety of ways:

- Help build and expand GVCs, and help overcome breaks in the chain, by introducing and **connecting SMEs to each other** and to larger corporates beyond domestic borders.

[41] A case in point is offered by the KYC risk rating of clients in African countries, which are so high and the costs so exorbitant that effectively it is very difficult for SMEs to enter the GVCs of European or US firms.

- Provide enhanced **advice to SMEs,** either using their own resources or in partnership with consultants.

- Leverage on investment in **digital technologies** to support the development of SMEs. The goal should be to provide a **"one stop shop" online platform** (domestic and/or cross-border) to help SMEs access advisory support to meet international/regional standards and requirements, and to facilitate connectivity of SMEs with relevant networks; but also to support them in managing even basic, though very costly, administrative and bureaucratic burdens.

- The above, in turn, offers the opportunity of a formal or implicit **"credit visa"** for an SME which can ensure the meeting of **defined credit, conduct and compliance standards,** so facilitating its access to finance.

- **Currency risk management** by simplifying hedging products and related documentation.

- Provide SMEs with the **skills** they need, facilitating access to education and skilled employees.

A related challenge is how banks and other financial service providers can support SMEs with a certain degree of "**portability in the financial services**" on offer to them as such clients increase their operations across **new international markets** (e.g. offer guarantees or financing in markets not covered by the bank and needed by the SME). Such services have traditionally been offered by large multinational banks that can support SMEs across multiple countries in which these banks are present, but "too big to fail" and other regulations are curbing the global reach of banks.

Moreover, when SMEs are clients of banks focusing on domestic markets (or on a limited number of markets), such banks are in practice faced with two options:

- Either not support (and hence lose) the client, directing it to international players;

or

- The smaller banks grow into new large global players.

Either way, the unintended consequence of the current status and growing regulation (and relative cross-border differences) is an implied incentive for clients to be directed to large international players (or for domestic banks to grow into large international players), which goes in the very opposite direction of what "too big to fail" regulations are trying to achieve.

Recognizing the imperative to support SMEs in a climate where large banks are facing new constraints, an **integrated approach to financing the chain is needed.** This can be achieved in two complementary ways:

- Through a **"financing chain",** where any bank can support their domestic SME clients involved in a GVC, by connecting with other banks in order to ensure that the SMEs are supported across the chain, also in new markets that would otherwise be difficult for the SMEs to penetrate; and doing the same for the other banks' SME clients in different parts of the same GVC.

- Through the action of large corporates in a GVC, most frequently the "clients" of the SMEs, to ensure that cross-border support (ranging from simple sponsoring to trade credit) is available to SMEs.

Such an integrated approach to financing GVCs would provide increased stability to all the companies in the value chain, thus improving their creditworthiness and consequentially reducing their financing costs. Such an approach is most easily explained referring to international markets, but is by no means limited to them – it equally applies to different markets within domestic borders.

Recommendations

This paper's main recommendation is that financing to SMEs should be provided via an **integrated approach to GVCs,** as this will deliver win-win outcomes for both the financial service providers and their SME clients, and ultimately generate growth and stronger, more creditworthy, SMEs. This also embodies the G20 Turkish Presidency's priorities to deliver financial stability, economic growth, and financial inclusion.

Indeed, banks (and other financial services providers), by improving their support of their immediate clients in operating within GVCs, would be in a position to further adapt their offer to better suit their clients' needs and provide more fit for purpose financing, supporting their business proposal and improving their creditworthiness, and ultimately supporting financial stability, growth, and inclusion.

Additionally, such an integrated approach can be leveraged upon by the full chain to support efforts to reduce the "timely payment spread" (e.g. by supporting trade credits, or financing any timing gap in the chain), or encouraging international invoice discounting and factoring, with a material positive effect on the SMEs' financing needs, making the deployed working capital more efficient.

Such an integrated approach can be achieved easily for example by banks partnering with each other (and other players) internationally across GVCs in order to ensure that continuity in financing and support is provided to the SME.

In order to support such efforts by banks to ensure stability of financing across the chain, governments and regulators need to appreciate the benefits that such an integrated approach brings, and hence (if and where existing) remove unnecessary legal and regulatory obstacles, and ensure greater international coordination and consistency in the implementation of regulations and policies.

Chapter 12 – Global value chains, equity crowdfunding and financing SMEs: The example of New Zealand

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Background: The launch of equity crowdfunding in New Zealand

In New Zealand, equity crowdfunding via licensed platforms became legal with the enactment of the Financial Markets Conduct Act 2013 and the corresponding regulations that came into force in 2014. The market started in August 2014 with the launch of Snowball Effect, the country's first operational licensed platform. The market has developed rapidly since then. Snowball Effect is New Zealand's leading equity crowdfunding platform and has successfully raised over NZ$ 6 million (around 4 million Euro or USD 4.5 million) for 6 companies in a variety of industries from a leading drone innovation company to a company developing a drug to treat cystic fibrosis to a wine company. To date, all of the companies raising funds through Snowball Effect have successfully raised the amounts they were seeking.

The success of equity crowdfunding in New Zealand in the first year of operation should not come as a surprise given the rapid year on year growth of equity crowdfunding in more established markets such as the UK.

What is crowdfunding?

Crowdfunding is when many people (the crowd) contribute relatively small amounts of money to support a business or project.

Equity crowdfunding is one of the three main types of crowdfunding. Through equity crowdfunding a business raises funds from investors and those investors receive shares in that business. The other types of crowdfunding are rewards / donation crowdfunding and debt crowdfunding (also known as peer to peer lending).

So what makes equity crowdfunding different to other means of raising funds? The key differences from other investment processes are that the investment takes place online, and investment opportunities are accessible to "retail" investors without the need for an expensive regulated offer document. This means that early stage, high growth companies now have access to the largest investor pool they've ever had.

Equity crowdfunding is complementary to existing players in the early stage funding ecosystem. It does not seek to offer an alternative to traditional bank lending, but instead complements bank lending by widening the funding base and distributing risk. The most successful firms are those that manage to build a well-structured funding base tailored to their specific business development plans.

Advantages of crowdfunding

So why would a company opt to raise funds via equity crowdfunding rather than through an alternative method? There are three key benefits to equity crowdfunding.

Efficiency:
Private investment can take a long time to arrange. It may take a company 6 or 9 months, which is a lot of time away from running the business.

Companies often like equity crowdfunding because they set the terms of the offer, they set the offer period, and they know how much time and resource they need to commit to raising capital. A crowdfunding offer is generally only open for a short period of time, such as a month. This short period creates a sense of scarcity which encourages investors to get in quick, and this helps an offer to build positive momentum. One company that has used Snowball Effect raised NZ$ 1.5 million in just six days.

Large investor pool:
A crowd of new shareholders brings with it a host of benefits to the company beyond the capital itself. The crowd can be utilized to help a company to promote its products, or can be leveraged to source skillsets and capabilities that are missing in the company. The investor base can also provide a credible source of market feedback and ideas for a growing company.

Marketing:
A well marketed equity crowdfunding offer can generate high levels of public awareness about a company. This increase in exposure generally transfers through to increased revenue for the company too. An established craft beer company that raised funding via Snowball Effect almost doubled its sales during the period of the offer, and has seen record sales in the months since the offer closed. The marketing advantages of an equity crowdfunding offer can be just as valuable as the capital invested for some companies.

Equity crowdfunding also helps companies to reach new markets in a number of ways. Obviously, the new capital may be allocated to implementing an international expansion strategy. In New Zealand, which is geographically distant from many major markets, capital is often crucial to allow international expansion to occur. For example, a significant portion of the capital raised by the craft beer company allowed it to increase its international marketing and to have a full time staff member focus on the international development of the business.

A second way that companies that raise funds through equity crowdfunding can reach new markets comes from having several hundred new shareholders who are advocates for the brand. For instance, a cleantech company client has had several international growth opportunities open up thanks to introductions made by some of its new investors.

Challenges to consider

Equity crowdfunding isn't perfect for every company. Low-growth businesses, and businesses in their very early stages of development, are generally not suitable. Successful crowdfunding requires well-crafted offer materials which take time and effort to develop. During the funding period, a company needs to dedicate time to answer questions from potential investors. International experience indicates that the time required to carry out a successful campaign from start to finish is approximately 135 staff hours.

There are certainly barriers which limit the potential of crowdfunding. **A key barrier is legislation.** This is still a new concept worldwide, and many countries are considering whether to allow it, and if so, what form their legislation should take. Until legislation permits, equity crowdfunding usually can't be facilitated to retail investors within a country, and this is a major barrier.

New Zealand is one of the early adopters globally of laws to facilitate equity crowdfunding, however we are still restricted in the amount companies can raise – a cap exists of NZ$ 2 million per company per 12 month period.

Steps for the future

The responsible behavior of crowdfunding platforms is essential for the positive experience of both investors and companies. If this new market is to survive and flourish, investors need to make returns that are commensurate with the risks of the investments over the long term. The market will not survive if it is viewed as a home for "dumb" money. If platforms allow unsuitable companies to raise funds through them, the reputation of crowdfunding as an investment channel could be damaged. As the market is in its early days, it is important that platforms do what they can to ensure that both investors and companies have good experiences investing and raising funds through this rapidly evolving channel. The responsible behavior of market platforms will encourage policy makers to keep regulations relatively flexible, allowing companies and investors to make the most of this liberalization of the equity capital markets.

Cooperation among different public and private actors is needed to build secondary markets. The development of secondary markets where shares may be freely bought and sold will be important in the long-term. Developing secondary markets will require support from regulators and fundraising companies, and will need to be carefully designed and implemented by crowdfunding platforms.

Coordination and cooperation in the financial industry is key to building an early stage funding ecosystem for SMEs. The Snowball Effect team sees equity crowdfunding as complementary to banks and other existing players in the early stage funding ecosystem, and we believe it can thrive alongside debt funding alternatives, such as banks, and equity funding alternatives, such as angel investments. Moreover, working alongside banks and other institutional funders can strengthen the credibility of crowdfunding platforms.

In New Zealand, existing financial players are supporting equity crowdfunding, and we have already facilitated deals where angel groups have been participating in the same rounds on the same terms. We see a real opportunity for syndicated deals as 80% of angel investment deals in New Zealand are syndicated already, and crowdfunding is a new and wider channel to syndicate with.

Chapter 13 – The interface between cross-border investment and global value chains: The tax dimension

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Background

Cross-border trade and investment is the engine of growth in a global economy. Governments around the world recognize this and have been extending their network of bilateral investment agreements and bilateral trade agreements and have pushed for regional networks of free trade agreements, since they believe that these are effective in removing barriers to cross border activities. Countries are also extending their tax treaty networks and identifying potential tax barriers to cross-border trade and investment but at the same time cracking down on aggressive tax planning and tax evasion. It is very much a responsibility of government to set the "rules of the game" in the trade, tax and investment areas which business must then follow.

Increasingly governments are using taxation to attract investment, to increase their share of GVCs and to promote SMEs. This note examines the political and economic environment within which tax systems operate and then analyze changing patterns in world trade and investment. A final section examines the implications of these trends for tax systems.

The OECD's Tax World

The OECD has concluded that the appropriate tax response to the pressures of globalization is better cooperation between governments, rather than attempting a global harmonization of tax systems. This is the approach that the OECD has followed for many years in the direct tax area and with some success. The OECD Model Tax Convention forms the basis for the 3,600 bilateral tax treaties around the world, thereby minimizing frictions between national tax systems. It has also been at the forefront of promoting cooperation between tax authorities to counter both double taxation and double non-taxation of cross-border income.

The OECD has been successful in promoting its transfer pricing guidelines which are now used as the basis for national legislation in both OECD countries and many non-OECD countries. The OECD has also developed global guidelines on VAT and has been active in identifying best tax policy options in the design of tax systems, both in emerging and developed countries and providing the analytical framework and statistics which enable countries to make informed policy decisions, including in their approach to SMEs.

But the question remains will these forms of non-binding cooperation be sufficient to avoid tax being used to protect domestic markets, to discriminate in favor of, or against, non-residents or to give a competitive advantage to a country's enterprises? This is why the international tax community is increasingly focusing on ways in which tax systems may create intentional or unintentional tax barriers to cross-border trade and investment and the ways in which non-tax agreements treat taxes, both explicitly and implicitly, and how this treatment may conflict with the treatment under tax treaties.

Traditionally, cross-border tax issues have been dealt with in specifically designed tax treaties. These are generally bilateral agreements based upon the OECD and UN Model Tax Conventions. Today there are more than 3,600 treaties in existence, although a significant number of developing countries lack an extensive network of tax treaties and even a large country like the US has less than 70 tax treaties (the UK, France and China have over 100 tax treaties).

The current economic and political climate

The current political and economic climate is characterized by high levels of uncertainty. At the political level, we see tension between Russia and the West; China has adopted a more muscular approach to foreign policy; Brazil is grappling with a major corruption scandal that is affecting the ability of its government to move forward on much needed structural reforms; civil wars are proliferating in Africa; terrorism is spreading in the Middle East; and nationalism is rising within Europe.

At the same time, the exit from the 2007-2008 crisis is still very tentative. The Eurozone has not really dealt with some of the structural weakness in the financial sector and growth is expected not to exceed 1% in 2015. The situation in the United States is somewhat more optimistic with growth forecasts of 3% but with only a slow creation of new jobs. In Japan, Prime Minister Abe has launched all three "arrows of his bow" and yet prices remain stubbornly stable and the economic recovery has been tepid.

A major driver of global growth over the last 10 years has been emerging economies but the BRICS can no longer be relied on to pull the world economy out of recession:

- Brazil is facing a real risk of zero or even negative growth.

- It is unclear if China will achieve a soft landing and a growth rate of 6% is probably the best outcome that can be expected, particularly if it is unable to deal with the massive overhang of public debt.

- India is perhaps the brightest spot on the BRICS scene with an expectation that it will achieve between 7-8% growth in 2015, overtaking China.

- In the case of Russia, there is now a consensus amongst the international organizations that its economy will contract by 3-4%.

- In the case of South Africa, it continues to fail to address many of the structural problems that are holding back its economy and it is unlikely to achieve more than 2-3% growth this year. (Africa as a continent is expected to grow at between 4-7% with East Africa being at the higher end of this range).

The consensus which seems to be emerging from the IMF, OECD and the World Bank growth forecasts is that the best the world can hope for is to achieve an overall growth rate of between 3-4% in 2015. Wherever one looks, the political and economic outlook is uncertain and we must be careful not to add to this uncertainty in the tax area.

Changing patterns of world trade

Few now contest that cross-border trade and investment are engines for growth. In the three decades up to 2008, world trade expanded at twice the rate of world GDP's. But since the crisis, the rate of growth in trade and GDP has been aligned and there has been a significant slowdown both in cross-border trade and investment. This slowdown has many explanations:

- China shifting away from an export led economy.

- New technologies which reduce the need for a physical presence.

- Anti-globalization forces which have made it difficult for some countries to take forward the trade liberalization agenda. The increase in inequalities which is an outcome of the interface between globalization and new technologies, and which have been well documented by the French economist, Thomas Piketty, has added to this anti-globalization sentiment.

This slow-down in world trade and investment makes it even more important that the Transpacific and the Transatlantic trade and investment partnerships should be concluded as soon as possible. It also suggests that we need to look again at the tax area to see how we can minimize tax uncertainty.

Apart from the slow-down in the growth of trade, we have also seen changes in trade patterns. The most significant are:

- A shift away from trade in goods to trade in services. Today, 70% of the trade within the OECD area is now in the service sector and increasingly the BRICS are moving into this sector.

- Trade patterns are also significantly changing. In 2014, almost 50% of world trade is between the 34 OECD countries but recent forecasts by the OECD suggest that by 2060 this will fall by 25% and that trade between OECD countries and non-OECD countries, which is currently at 38%, will increase to 42%. South-South trade will come to dominate trade patterns and by 2060 India and China combined will account for 23% of world exports (today the figure is 14%). The pattern of trade continues to shift towards emerging economies and we will continue to see fast growth in trade in services.

Another important structural change in trade patterns is the increasing importance of GVCs. What we are seeing is an increased fragmentation of production across borders leading to an increased interrelationship between national economies. Some relevant figures are:

- Cross border activities within GVCs have doubled within the last 2 decades and have increased in China six fold.

- Between 30-60% of G20 countries' exports are now based on imported intermediary goods and services.

- 80% of these GVC activities are controlled by MNEs.

- 40% of this growth in GVCs is accounted for by cross-border services.

Few now contest that GVCs have increased the productivity of our economies. In a recent study, the World Bank found that developing economies which are highly integrated into GVCs grew on average by 2 percentage points more than countries which are not.

The conclusion of regional free trade agreements can be an important driver of growth. The OECD has recently estimated that concluding the Trans Pacific Partnership (TPP) and Transatlantic Trade and Investment Partnership (TTIP) could result in a boost to world growth of 0.6% and that a 1%

reduction in the costs associated with cross-border trade could lead to up to 40 billion dollars of extra output. Governments and businesses need to continue to push for a more open, transparent and predictable environment for cross-border trade and foreign direct investment. This in turn requires governments to make the linkages between the policies that they follow on trade, on tax and on investment and assess both the intended and unintended consequences of their actions.

Changing investment landscape

The global financial and economic crisis has emphasized the importance of solid regulatory frameworks for investment. Growing dissatisfaction with the existing international investment agreements (IIA) regime and its impact on contracting parties' regulatory powers to pursue public interests and to enhance sustainable development, has led to some countries reconsidering their approach to IIA.

The rise in disputes under IIA (the ISDS process) may partially account for this review. ISDS cases rose from 326 in 2008 to 608 cases at the end of 2014, involving both developed and developing countries as defendants. More than 40 cases have involved taxation. In addition, investment disputes became more complex, raising difficult legal questions about the borderline between permitted regulatory activities of the state and illegal interference into investor rights for which compensation has to be paid.

Accordingly, governments have entered into a phase of evaluating the benefits and costs of IIAs and reflecting on their future objectives and strategies as regards these treaties. Mounting criticism from civil society plays a role as well. As a result, several countries have embarked on a path of IIA reform by revising their BIT models with a view to concluding “new generation” IIAs and re-negotiating their existing BITs. This move is based, among others, on UNCTAD's Investment Policy Framework for Sustainable Development (IPFSD), which had been developed to provide guidance to the reform of investment policies at the national and international level and which is increasingly being used by developing and developed countries.

A few countries have announced a moratorium on future IIA negotiations and a few have chosen a more radical approach by starting to terminate existing IIAs. Some countries have also renounced their membership in ICSID. Others have opted for an intermediate approach, under which they continue negotiating BITs, but refrain from including ISDS in future agreements.

While bilateral treaty-making lost much of its dynamism, regional IIA making accelerated. This is partially a reaction to the failure in establishing multilateral investment rules, leaving regional approaches as a “second best solution”. Examples involving the EU are the Canada–EU Comprehensive Economic and Trade Agreement (CETA) and negotiations for the EU–United States TTIP. Outside the EU, negotiations are ongoing for the TPP, the Regional Comprehensive Economic Partnership Agreement (RCEP), and for a Pan African Investment Code. For IIA treaty-making, mega-regionals offer opportunities to consolidate today’s multifaceted and multi-layered treaty network. However, they can also create new inconsistencies resulting from overlaps with existing agreements and raise issues of how BITs interact with Tax Treaties.

What are some of the implications of these developments for tax policies?

The raised political awareness over international tax issues and the debate over the Base Erosion and Profit Shifting (BEPS) outcomes (which in some areas has highlighted the divergence of views between developed countries, the BRICS and developing countries) offers the international community a once in a lifetime chance to reconsider how international tax arrangements need to be updated and how to address some of the issues referred to above. Whilst there are many policy implications of the above trends, particularly the growth of GVCs, the following are of particular relevance to taxation:

- We must rethink the traditional distinctions between source and resident countries and between capital exporting and capital importing countries. China, for example, is now both a major capital exporter as well as a capital importer and Chinese MNEs are expanding rapidly abroad, which will have an impact on China's approach to international tax arrangements.

- We must review the old mercantilist view that in some way exports are "good" for a country and imports are "bad".

- We must also accept that it is going to become increasingly difficult to distinguish between goods and services, particularly in "bundled cross-border products". Yet corporate income taxes, custom duties and VAT continue to have distinct rules which apply to services and goods.

- We must adjust many of the existing international tax arrangements to the emerging reality that SMEs are using new technologies to enter foreign markets and that it is unrealistic to expect that these types of companies are going to be able to handle complex tax rules such as we find in the area of transfer pricing. There is also the related trend that in many countries the fastest growing businesses are in the unincorporated sector, with more and more companies forsaking the corporate form (in part because of tax reasons).

- We must also consider the implications for the current international tax arrangements of the way in which our economies are becoming increasingly digital, accepting that it is not just the Googles or Amazons that operate in the virtual world.

- And there needs to be a collective reassessment of the role of tax incentives building on the work commissioned by the G20. Governments need to recognize the tension between using incentives to attract FDI and the risk that badly targeted incentives may lead to base erosion and profit shifting. Incentives should be targeted to address real barriers to investment such as high start-up costs and made more transparent and accountable.

All of the above developments and trends mean that the whole issue of international tax arrangements becomes of increasing importance. As we remove non-tax barriers to trade, we need to avoid that tax become the last trade barrier. To do this, we need to achieve consensus on what the international tax rules of the game should be. We need to monitor that these rules are consistently implemented and we need to have in place effective mechanisms to resolve tax disputes when they arise between governments. This agenda has taken on a new importance with the OECD/G20 BEPS project. Few would contest that the current situation whereby some large multinational enterprises are able to exploit mismatches between countries' tax rules to reduce substantially their effective tax burden is unsustainable. It is important to recognize that there needs to be a real consensus on how to address this lack of coherence and also how to avoid that large corporations can use tax havens to avoid taxes in their home countries and that any rules coming out of BEPS do not create new tax barriers for SMEs.

The G20 has been very successful in providing the political impetus to take forward this work (as it did in 2009 to remove bank secrecy as a veil behind which tax evaders could hide). But the G20 now needs to put this work in the broader context of the developments referred to above and in particular, to look at how we can develop national tax systems to promote growth: sustainable and job creating growth and growth which is fairly shared between developed economies, emerging economies and developing economies and how these economies can be further integrated into GVCs.

Already, at the G20 Finance Ministers Meeting last September, a mandate was given to international organizations to go back and review the work that was done by the OECD in 2010 on promoting a pro-growth tax system. At the same time, the international organizations were also asked to look at the way in which tax incentives are used to compete for investment. These two agendas and the BEPS work need to be brought together by G20 leaders so that we have a better balance between tax rules which effectively counter non-compliance but at the same time promote growth and employment. This is particularly important for the developing countries which have massive needs in the area of infrastructure which must be met if they are to achieve sustainable growth.

As China takes over the G20 presidency from Turkey, so there is an opportunity to broaden out the G20 tax agenda beyond just looking at how the BEPS 15 actions points will be implemented. The focus of the tax agenda needs to broaden to encompass how countries can design tax systems which contribute to achieving sustainable growth, which integrate developing countries in GVCs, which support the development of SMEs, which contribute to addressing climate change and reducing growing inequalities, and which at the same time generate the revenues needed by developing countries to invest in the physical and social infrastructure required to achieve sustainable growth paths.

Such a G20 led program could include the following elements:

- **Re-examining tax structures** and, in particular, the balance between taxes on income and profit, on consumption, on land and buildings and on polluting activities, with the aim of promoting inclusive growth

- **Redesigning taxes on capital** so that they contribute to reducing inequalities in the distribution of wealth

- **Achieving a real global consensus on how to tax MNEs** and changing the dynamics of the relationship between multinational enterprises and tax authorities

- **Agreeing on a 'bright red line' between what is acceptable and unacceptable competition**

- **Designing guidelines on the use of tax incentives which would lead to better targeted incentives,** with less scope for base erosion and profit shifting and which could be endorsed by both business and government

- **Removing tax barriers to the integration of developing countries into GVCs, including SMEs**

- **Undertaking an in-depth review of how tax impacts on the digital economy** which goes beyond this perspective of BEPS

- **Reconsidering the way that trade, investment and tax agreements interact** so that they work coherently towards the promotion of trade and FDI

Some elements of this program could be achieved under the Chinese presidency; others may flow over into future presidencies.

Chapter 14 – The World SME Forum: For SME advancement globally

Tunc Uyanik

Member of the Executive Board

World SME Forum (WSF)

Why create a World SME Forum?

SMEs account for 60 per cent of the global informal and formal workforce and are important for social stability, equitable growth and poverty alleviation. They are also the backbone of the middle class. Beyond representing the lion's share of firms, SMEs act as engines of growth and have a profound impact on the economic potential of developing and transition economies. Indeed, because of their sheer numbers and the potential magnitude of their contribution to growth, a small productivity improvement in SMEs can have a substantial positive ripple effect on overall GDP growth.

SMEs are also of critical importance for poverty reduction, as they often employ poor and low-income workers, and are frequently found to be the only source of employment in poor regions. Nonetheless, there is widespread recognition that their potential has not been fully realized, in particular owing to:

- A dearth of official representation and advocacy both at country and international levels;
- Lack of targeted supporting facilities that are able to deliver the promise of vibrant technical skills and expertise that are essential to the well-functioning of SMEs generally; and
- Lack of effective mechanisms to link promising SMEs to potential markets and more broadly to GVCs.

As a result, their value addition to the economic pie is typically far short of potential.

These constraints, coupled with the size of SMEs, make them particularly vulnerable to downturns in the economy. Barriers to growth are further exacerbated by the lack of a collective voice and ability to influence policy due to lack of organization and market fragmentation. Furthermore, high information costs and lack of resources limit SME access to local, regional, and global markets.

Addressing these constraints calls for a systemic approach. Being cognizant of these challenges, SMEs have formed associations, and clamored to belong to chambers at national levels to give them voice in their dealings with policy makers. But in most cases, they continue to lack voice, resources and access to best practice information. This leads in many instances to advocating popular but proven ineffective measures such a subsidized finance for SMEs, instead of supporting measures to address underlying policy and institutional constraints to SMEs and providing them with facilitating means to access markets, as well as knowhow and "know-what".

To address these clear voids, there is a need for a globally focused new cross-cutting entity/forum, which can assume advocacy, advisory, and capacity building roles for SMEs at the national, regional, and global levels.

What is the World SME Forum?

Launched on 23 May 2015, the World SME Forum (WSF) will provide an inclusive and open global platform for partnerships and cooperation for the worldwide development of SMEs. Aiming to address the major bottlenecks mentioned above the WSF will structure its agenda and deliverables under the following three pillars:

- **Advocacy and Research.** Global advocacy for sustainable SME development to ensure that the economic interests of the global community of SMEs are more effectively represented in the deliberations of international governance bodies, such as G20, APEC, ASEAN, and other regional blocs, global standard setting entities, and the relevant agencies of the United Nations.

- **Advisory Services.** Scalable advisory and technical assistance services for policy and business solutions, including business and talent strategies/management. In addition, provision of technical expertise that identify and link policy makers with financing, through conventional and Islamic finance, support specialized assistance to SMEs through virtual means, and so on.

- **E-Market Platforms.** Scalable access to markets, expertise and information through establishment of networks, and knowledge creation/dissemination, including establishing an e-Market Information Services Platform to facilitate global connectivity with GVCs (e.g. a bulletin board of opportunities – "demand" – made available in different countries by various MNEs interested in increasing local content in their supply chain; and a list of certified of SMEs with the relevant quality / certification standards – "supply").

The WSF operates under three guiding principles:

- **Not-for-profit, global and independent.** Acting as a credible "honest broker", with an international profile both in terms of its client base and staff.

- **Demand-driven, supply enhancing, and pragmatic. The** WSF will be geared towards removing supply side barriers to SME growth while channeling SMEs towards seizing demand-driven opportunities that leverage low-cost information technology.

- **By private sector, for private sector.** The operations of the WSF will be funded by chambers/associations, private sector entities, and private foundations only, and through its own revenue generating activities. Government and IFI funding could also be accepted, but only to finance specific pre-defined projects.

Who coordinates and participates in the WSF?

The Union of Chambers and Commodity Exchanges of Turkey (TOBB) and the International Chamber of Commerce (ICC) are the Founding Partners of the WSF. The WSF will be legally domiciled in Turkey and its headquarters will be based in Istanbul, with future bases of its operations to be gradually expanded across the globe. Potential technical partnerships have already been discussed at the highest levels with relevant IFIs, and concrete interest to join the initiative has been expressed by several SME associations and other relevant organizations.

The WSF will deliver its services through its highly specialized global core technical staff as well through its national and international partners.

The WSF aims to operate in partnership with multilaterals, think tanks, standard setters, policy makers, and the business community at large. It will have membership from key associations/ chambers that have an interest in SMEs around the globe. The founding partners have already started outreach efforts encouraging representative bodies in the national and global communities such as SME and trade associations and national chambers to become members of the WSF. To this end, the WSF has already established close working relationships with bilateral and multilateral organizations such as the World Bank Group and the OECD.

Section 5

Priorities for the G20

Chapter 15 – Priorities to the G20 on business access to global value chains and financing SMEs

Bernhard Welschke
Secretary General
BIAC

Rifat Hisarcıklıoğlu
Chair
B20 Turkey

Background

On 4 June 2015, representatives from SME associations, governments, financial institutions, large corporates, and international organisations gathered for a BIAC-B20 Turkey special event at the OECD Headquarters in Paris to share perspectives and identify G20 priorities for enhancing *Business Access to Global Value Chains and Financing SMEs* (Annex 1). Discussions also provided inputs for the development of voluntary high level principles for SME financing, due to be submitted by the OECD to G20 Finance Ministers and Central Bank Governors in September 2015.

Held halfway through Turkey's G20 and B20 Presidencies, the event represented a unique and timely occasion to offer feedback on emerging recommendations and proposed actions ahead of the G20 Leaders' Summit later this year. The BIAC-B20 Turkey event was in many ways ground-breaking:

- By focusing on SMEs and by bringing together a diverse group of participants, not all directly involved in G20-B20 work, the event underlined the importance of the B20 Turkey theme of **inclusivity.** It offered a comprehensive understanding of the different interests and needs of the various stakeholders participating in or supporting global value chains.

- By taking a holistic approach across the full length of global value chains, the event embodied the B20 Turkey theme of **connectivity.** It examined intended and unintended consequences of policy and regulatory measures, and also identified recurring themes relevant to the G20 agenda. Participants were therefore able to "connect the dots" and identify coordinated policy approaches to support the three objectives of financial stability, economic growth, and return on investment.

- Including the participation of Chinese business representatives, the event worked to ensure **continuity** with China's forthcoming G20 and B20 Presidencies in 2016.

In contribution to the G20 Leaders Summit in November 2015, this final chapter synthesises the priorities identified by participants in the BIAC-B20 event.

Recurring themes and priorities across the B20 Task Forces

The B20 Turkey's six Task Forces (Anti-corruption, Employment, Financing Growth, Infrastructure and Investment, SMEs and Entrepreneurship, and Trade) have each been preparing their recommendations to G20 Leaders (Annex 2).

Currently, B20 Task Forces have developed approximately 20 recommendations with 70 specific actions. Combining those emerging recommendations and actions with the proposals expressed in this publication and special event held on 4 June, there are a number of **recurring themes** (i.e. the 'common denominators' across various recommended actions) that can be summarized as follows:

Enable the growth of SMEs

SMEs provide the main source of employment and value creation in our economies. Ensuring the right enabling conditions for SMEs to grow, invest, and create jobs is therefore essential. This calls for (among others) minimizing red tape, simplifying administrative processes, and working with tax administrations to ensure that best practice tax measures are used to promote entrepreneurship and investment.

More broadly, it is essential that SMEs can operate in a global level playing field. Proposals in this direction include: creating a G20 entrepreneurs' start-up visa to help SMEs conduct business internationally; advisory support (e.g. the newly established World SME Forum); and financing chains that ensure seamless financing to SMEs along GVCs.

Maximize the effectiveness of GVCs

Beyond simply supply chains, GVCs represent a broader concept in today's digital age. They present a platform along which SMEs can step-up their access to finance, markets, and human talent.[42] GVCs also represent opportunities for all stakeholders to take actions that increase effectiveness, efficiency and reliability along the chain. With respect to SME financing, for example, measures may include financial tools (e.g. credit insurance and start-up funds) and legislative actions to avoid the disruptive effects of late payments.

Strengthen coordination and consistency for a global level playing field

Coordination and consistency in policies and regulations, both domestically and internationally, are essential in ensuring a level playing field for SMEs to operate in world markets. Different and sometimes diverging rules – both inside and between countries – act as obstacles to SMEs and other actors in GVCs. For example, the proliferation of uncoordinated financial regulations by different jurisdictions, such as diverse "know your client" investment rules, affects SME access to finance, markets and talent. Also, actions to tackle Base Erosion and Profit Shifting (BEPS) may impact the participation of SMEs in foreign markets and GVCs.

Thus implementation is as important as the rules themselves. A principles-based process for regulatory cooperation is needed in order to encourage transparency and consistency, foster comprehensive and evidence-based impact assessments, and thus mitigate unintended consequences and redundancies.

Enhance access to finance

SMEs tend to encounter more difficulties in accessing fit-for-purpose financing compared to larger corporates. Poorly coordinated regulatory approaches appear to amplify this situation, prompting many countries to introduce policies that in effect compensate for the weak lending environment.[43] Coordinated actions along GVCs are needed to ensure seamless financing for SMEs, thereby providing win-win outcomes for SMEs, financial service providers, and all other actors in the chain. Policies and regulations should seek to enable SME access to finance, such as through strong information infrastructures for credit risk assessment and by enabling a diversification of finance instruments for SMEs, including high-quality securitization.

Improve information sharing

There is a pressing need to enable the exchange of data and information among all parties and along GVCs. Digital platforms for sharing information can help SMEs, financial service

[42] In the BIAC-B20 special event on 4 June 2015, participants discussed a model for cooperation and information exchange along GVCs in order to support SMEs, similar to the sorts of alliances present in the airline industry.

[43] BIAC (2014) "The case for a more coordinated approach to financial regulation: A BIAC discussion paper".

providers, large corporates to connect in new ways and with unprecedented efficiency. Governments can support such initiatives by removing administrative and regulatory obstacles that may otherwise hinder their development.

All actors can and should take actions

Finally, rather than only focusing on the measures to be taken by governments and public entities, SMEs can be best supported if all relevant stakeholders are able to undertake their own distinct voluntary approaches and initiatives, in a coordinated manner (Annex 2). Success hinges on G20 policy approaches that enable, and do not hinder, private sector-led approaches. Thus there is a growing willingness to move a more interactive process of shared actions, consultation, and support.

Recommendations for G20 Leaders on Business Access to GVCs and Financing SMEs

Having identified a number of the cross-cutting themes, we distill **three overarching recommendations** to G20 Leaders aimed at enhancing the financing of SMEs to participate in GVCs. Common to each of these recommendations is the need for governments in the current economy to expand their focus from gatekeepers of stability towards enablers of growth and investment.

1. Focus on coordination, consultation, and impact assessment

In support of the G20 Turkish Presidency's 3 'I's (Investment, Implementation and Inclusion), the G20 Leaders' Summit Communiqué should recognize the broader economic impacts and cumulative effects of G20 policy and regulatory approaches – both domestically and across borders – within the **nexus of financial stability, economic growth, and return on investment** (Chapter 1). This is essential for building a competitive environment for companies of all sizes, and particularly SMEs, to conduct business across a global level playing field.

Impact assessment and consistent implementation play an essential role in mitigating any unintended consequences of policies and regulations. Thus, an **international principles-based implementation process for financial regulation** should be introduced, possibly based on a model Memorandum of Understanding for regulatory cooperation, that also provides opportunities for cross-border consultation and mutual recognition.[44]

2. Raise SME access to finance and skills through an integrated approach

G20 Leaders should provide a predictable and enabling policy environment that allows and supports different actors to undertake voluntary approaches that **ensure seamless financing to SMEs in GVCs –** through an integrated approach along GVCs that combines diverse forms of fit-for-purpose finance. Such approaches should focus on raising the quality of products, and may include, among others, greater use of credit insurance, partnerships among financial service providers, high-quality securitization, guarantees, and equity crowdfunding. Along these lines, a key step would entail making strong progress on the Capital Markets Union in Europe, with particular attention to developing private placement markets (Chapters 2 and 8).

We encourage the OECD to expand and strengthen its analysis and guidance in this field, building on the *OECD Scoreboard on Financing SMEs and Entrepreneurs* and forthcoming voluntary high-level principles on SME financing (Chapter 3).

Recognizing that SMEs need to possess the human talent to make the most of alternative

[44] This approach is advocated by the Global Financial Markets Association (GFMA), among others.

sources of financing (often obtained through digital platforms), G20 Leaders should **support measures for investing in skills – both financial and digital.** More broadly, all stakeholders should recognize the importance of a risk-taking culture for entrepreneurship, in which failures are accepted in line with sound bankruptcy laws.

3. Maximize the sharing of information through digital platforms

Leveraging the use of digital technologies, G20 Leaders should encourage the sharing of timely information between different actors (including SMEs, large corporates, and financial service providers). Such information exchange will enhance the flows of financing, skills, and investment throughout GVCs.

In this respect, the G20 Leaders' Summit Communiqué should recognize the great potential of the recently-established **World SME Forum** which will provide technical advice and support to SMEs. In addition, G20 Leaders should help pave the way for the creation of a central **global online platform** for data and information exchange. Existing platforms should be reviewed to raise awareness and strengthen coordination, in particular among private sector-led voluntary initiatives for financing and skills.

Next steps

On the road to the G20 Leaders' Summit in November 2015 in Antalya, we trust that this publication – and in particular the conclusions of the BIAC-B20 Turkey special event held on 4 June 2015 – will **encourage the G20, and all actors concerned in markets, to undertake respective actions** that will support businesses of all sizes to participate in GVCs inside and across borders.

We encourage G20 Sherpas to use this publication as a key point of reference in preparing the G20 Leaders' Summit Communiqué. Similarly, we encourage the OECD to make use of the issues raised in this publication when preparing its G20-mandated reports and instruments – notably the forthcoming voluntary high-level principles on SME financing.

Finally, looking beyond 2015, we encourage the Chinese G20 and B20 Presidencies in 2016 to ensure continued attention to issues affecting business participation in GVCs, and SME financing in particular. The importance of **continuity between G20 Presidencies** cannot be understated in order to ensure policy consistency for long-term financial stability, economic growth, and return on investment.

Annexes

Annex 1 – Agenda of BIAC-B20 Turkey special event "Business Access to Global Value Chains and Financing SMEs", 4 June 2015

AGENDA	
	WELCOMING REMARKS
09:15 – 09:35	**Phil O'Reilly, BIAC Chairman and CEO of BusinessNZ** **Erol Kiresepi, B20 Turkey Executive Committee Member, Vice President of TISK, and CEO and Chairman of SantaFarma Pharmaceuticals**
09:35 – 09:45	**Gianluca Riccio, Event Moderator** *Overview and format for the day*
	SESSION 1 **Current economic challenges and the need for growth:** ***The importance of global value chains and financing SMEs***
09:45 – 10:30	*Format & Objective*: Two keynote presentations will introduce current economic challenges and raise the importance of increasing business participation in global value chains, with a focus on financing SMEs. **Jason Furman, Chairman of the Council of Economic Advisers, President Obama's Chief Economist, and a Member of the Cabinet, United States** *Global economic outlook* **Stefan Kapferer, OECD Deputy Secretary-General** *Learnings from "Financing SMEs and Entrepreneurs: An OECD Scoreboard 2015"*
	SESSION 2 **Defining the issues: Global value chains and SMEs' financial needs**
10:30 – 11:10 *20 minutes of kick-off remarks by speakers* *20 minutes of interactive discussion among all participants*	*Format & Objective*: The objective of this session is to define what is meant by 'global value chains' and 'SMEs' financial needs'. Speakers followed by interactive roundtable discussion will share understanding about the types of global value chains that exist, ranging from supply chains through to value chains inside the finance sector. **Moderator: Kent Andrews, Chair of BIAC Finance Task Force** **Dirk Pilat, Deputy Director, OECD Directorate for Science, Technology and Innovation** *What types of global value chains exist? Learnings from OECD work on trade in value-added and global value chains* **Christin Pfeiffer, Secretary-General, International Network for Small and Medium Enterprises (INSME)** *What sorts of financing do SMEs need to participate effectively in global value chains?*

Coffee Break 11:10 to 11:30	
SESSION 3 **Challenges and barriers to the financing of SMEs in global value chains, and lessons learned**	
11:30 – 13:00 *45 minutes of kick-off panel remarks* *45 minutes of interactive discussion among all participants*	Format & Objective: The objective of this session is to bring together the perspectives and experiences of different actors (e.g. governments, financial institutions, large corporates, and SMEs) on barriers to the financing of businesses in global value chains. Concrete examples will help to highlight factors for success, but also impediments and unresolved issues. Kick-off panel remarks will be followed by interactive roundtable discussion. **Moderator: Korkmaz Ilkorur, Deputy Chair, B20 Financing Growth Task Force** **Matthew Gamser, CEO of SME Finance Forum** *Factors holding back SME financing* **Raghunath Mahapatra, Vice President and Head of Strategy, Welspun Energy** *Cross-border financing constraints facing the growth of businesses and their supply chains* **Fabio Gallia, CEO of Banca Nazionale del Lavoro** *Current trends and challenges experienced in financing SMEs* **Olav Jones, Deputy Director General, Insurance Europe** *Addressing the cross-border insurance needs of companies*
LUNCH SESSION 13:00 – 14:30	
SESSION 4 **Maximizing the potential of global value chains and identifying actions for different actors**	
14:30 – 16:00 *45 minutes of kick-off panel remarks* *45 minutes of interactive discussion among all participants*	Format & Objective: Having covered opportunities and constraints in Session 3, the objective of this session is to identify areas where actions are needed by businesses, financial institutions, governments and regulators to achieve more effective participation of companies in global value chains. Kick-off panel remarks will be followed by interactive roundtable discussion. **Moderator: Gianluca Riccio, Vice-Chair, BIAC Finance Task Force and Member of B20 Financing Growth Task Force** **William Perraudin, Director, Risk Control Ltd.** *Maximizing the cross-border potential of SMEs: How European securitization can assist SME financing* **Christian Laverdure, Director General, Service for Business, Government of Canada** *What governments can do to support businesses in global value chains* **Laurene Lottmann, Head of Product Development, Coface** *Helping SMEs with tailored insurance protection*

	Charles R. Johnston, Managing Director, Global Government Affairs, Citigroup Inc. *The coordination of financial regulatory approaches*
Coffee Break from 16:00 to 16:30	
SESSION 5 **Priorities for the G20**	
16:30 - 17:30	*Format & Objective*: This concluding session consolidates the outcomes of the previous sessions and identifies key priorities for the G20 to enhance SME participation in global value chains through appropriate financial services. The session brings together a panel of high-level representatives from public and private sectors. Discussions shall be synthesized in a forthcoming publication that will be tabled to the G20 ahead of the G20 Leaders' Summit in November 2015. **Moderator: B20 Turkey Executive Committee Member, Vice President of TISK, and CEO and Chairman of SantaFarma Pharmaceuticals** **Cavit Dağdaş, Undersecretary of Treasury, Republic of Turkey, Prime Ministry** **Robert Milliner, B20 2014 Sherpa** **Tunç Uyanık, Board Member, World SME Forum** **Umit Leblebici, Chief Executive Officer, Türk Ekonomi Bankasý (TEB)** **Yan Jufen, Director General, China Council for the Promotion of International Trade (France)**
CLOSING SESSION	
17:30 - 18:00	**Erol Kiresepi, B20 Turkey Executive Committee Member, Vice President of TISK, and CEO and Chairman of SantaFarma Pharmaceuticals** **Bernhard Welschke, BIAC Secretary-General** **Angel Gurría, OECD Secretary-General**
RECEPTION	
18:00 – 19:30	

END

Annex 2 – Methodology used in reviewing B20 Task Forces' recommendations and actions

The BIAC-B20 Turkey special event on "*Business Access to Global Value Chains and Financing SMEs"*, held on 4 June 2015 at the OECD Headquarters in Paris, brought together representatives from all B20 Task Forces. This is because GVC and SME issues are inherent to all aspects of our economies and societies. Cross-cutting and integrated approaches are therefore needed to enhance the participation of SMEs in GVCs.

The special event on 4 June attracted representatives from governments, international organizations, SME associations, business federations, large corporations, and financial institutions, among others. Bringing this diverse group around the same table was considered vital because approaches to support the participation of SMEs in GVCs depend not only on the G20 (i.e. governments), but also on the actions of many other public and private entities operating throughout the chain.

Participants at the special event were therefore presented with a room document by the Moderator, Mr. Gianluca Riccio, that 'mapped' the emerging B20 Task Forces' recommendations and actions. However, beyond simply listing the Task Forces and their respective recommendations, the document prompted readers to examine the commonalities, gaps, and interdependencies across all Task Forces' recommendations, in order to determine which actions could be most effective in addressing all of the Task Forces' objectives. This holistic overview helped participants to connect the dots and develop a synthesis. Additionally, this approach presented participants with an opportunity to review SME participation in GVCs, and to consider which actor(s) can endeavor to implement the various actions.

The matrix in Figure 15 provides an adapted version of the room document used on 4 June. The importance of this matrix is not so much the "what" (i.e. recommendations and actions), but rather the "how" (i.e. the methodology and its implementation). Therefore, without naming the specific B20 recommendations or actions, the main purpose of Figure 15 is to encourage similar exercises in future at both B20 and G20 levels, and to encourage the readers of this publication to:

- Consider what may be the **recurring themes** (common denominators) across B20 Task Forces' recommendations and actions that relate to SME participation in GVCs. This is essential for ensuring coordinated and integrated approaches that avoid unintended consequences of certain actions.

- Consider what **roles** are expected of different public and/or private entities in order to implement the actions associated with the B20 Task Forces' recommendations. Coordinated efforts by different actors in markets is vital.

Figure 15: Reviewing the B20 Task Forces' recommendations and actions

This figure shows B20 Task Force recommendations and related actions on the left-hand side of the table. Titles have been anonymized due to the confidentiality of the information at the time of publication. The right-hand side of the table attempts to take the B20 recommendations one step further by asking *who* can actually implement (tick) and/or support (S) these recommended actions. The far-right column highlights recurring themes by examining how each B20 recommendation might relate to GVCs and financing SMEs.

		Recommendations		Implementation expected by?						How can players act within GVCs?							GVC themes -- which apply ?									
		Recommendation / Good practice	Actions	SMEs	Large Corporates	Banks	Insurance	Dev Banks	Govt / Regulators	SMEs	Large Corporates	Banks	Insurance	Dev Banks	Govt / Regulators	Notes	Access to Talent	Share Information	Access to Markets	GVC Effectiveness	Access to Finance	Banking / FM Regulation	Legislation	Access to Innovation / Ecosystems	Infrastructure (incl. Digital)	Coordination / Consistency
Employment	1	Recommendation 1	Action 1	√	√	√	√		√	√	√	√	√		s		√	√								√
			Action 2						√						√		√									√
			Action 3	√	√				√	√	√				s		√	√								√
			Action 4						√	√	√	√	√		s		√	√								√
			Action 5						√	√	√	√	√		s		√	√		√				√		√
			Action 6		√	√	√		√	√	√	√	√		s		√			√						√
	2	Recommendation n	Action 1						√	√	√	√	√		s		√									
			Action 2						√						√		√			√						√
			Action 3						√	√	√	√	√		s		√	√								
			Action 4						√						√		√						√			√
			Action 5						√						√		√	√					√			√
			Action 6						√						√		√		√				√			√
			Action 7	√	√	√	√	√	√	√	√	√	√	√	s		√	√					√			
Financing Growth	1	Recommendation 1	Action 1						√	√	√	√	√		s			√	√	√	√		√			√
			Action 2						√	√	√	√	√		s			√	√	√	√	√	√			√
	2	Recommendation n	Action 1						√	√	√	√	√		s			√	√	√	√					√
			Action 2						√						√			√		√	√	√			√	√
			Action 3						√						√						√	√				√
			Action 4						√						√						√	√	√			√
			Action 5						√	√	√	√	√		s			√		√	√	√			√	
			Action 6						√	√	√	√	√		s						√	√				√
			Action 7						√	√	√	√	√		s			√		√	√	√			√	√
Infrastructure & Investment	1	Recommendation 1	Action 1	√	√	√	√			√	√	√	√					√	√		√				√	√
			Action 2	√	√	√	√			√	√	√	√					√	√		√				√	
			Action 3	√	√	√	√			√	√	√	√					√			√	√			√	
			Action 4	√	√	√	√			√	√	√	√					√			√	√			√	√
	2	Recommendation n	Action 1					√	√					√	√										√	√
			Action 2						√		√	√	√		s						√			√	√	√
			Action 3						√		√	√	√		s					√	√			√	√	√
SMEs & Entrepreneurship	1	Recommendation 1	Action 1	√	√	√	√	√	√	√	√	√	√	s	s		√	√	√	√			√		√	√
			Acttion 2						√	√	√	√	√	s	s			√	√	√	√		√			√
	2	Recommendation n	Action 1		√	√	√	√	√		√	√	√	s	s			√	√	√	√				√	√
			Action 2						√	√	√	√	√		√				√	√	√					√
Anti-Corruption	1	Recommendation 1	Action 1						√	√	√	√	√		s				√		√			√	√	√
			Action 2						√	√	√	√	√		s			√	√							
			Action 3						√	√	√	√	√		s			√	√							√
	2	Recommendation n	Action 1	√	√	√	√			√	√	√	√		s				√							√
Trade	1	Recommendation 1	Action 1						√						√				√				√			
			Action 2						√						√				√				√			√
			Action 3	√	√	√	√		√	√	√	√	√	s	s				√	√			√			√
			Action 4	√	√	√	√		√	√	√	√	√	s	s				√				√			√
	2	Recommendation n	Action 1						√						√				√				√			
			Action 2						√						√				√	√			√			√
			Action 3						√						√				√				√			√

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