

## **THE POLICY RECOMMENDATIONS OF THE 19<sup>TH</sup> MEETING OF THE COMCEC TRADE WORKING GROUP**

The COMCEC Trade Working Group successfully held its 19th Meeting on October 4th, 2022, in a virtual-only format, with the theme of “Increasing the Internationalization of SMEs in OIC Member Countries”. During the Meeting, Trade Working Group made deliberations on the policy recommendations related to improving the internationalization of SMEs. In the light of the main findings of the report and the intense deliberations during 19th Meeting, the Working Group has come up with the following policy recommendations:

**Policy Recommendation 1:** Promoting formalization of SMEs and eliminating informality through, among others, reducing the time and cost of registration and reducing administrative burdens.

**Rationale:** Throughout the world, especially in developing countries, informal activity by small and medium size enterprises (SMEs) is a significant problem. Given that SMEs are a driver of national economic growth, formalizing informal SMEs is critical to increasing productivity, creating better jobs, and supporting inclusive growth. The OECD has published several documents and guidelines enriched with best practices, such as Best Practice Principles for Regulatory Enforcement and Inspections (OECD, 2014), OECD Regulatory Enforcement and Inspections Toolkit (OECD, 2018), and Formalization of Micro Enterprises in ASEAN: Policy Insight (OECD, 2020). The general recommendation is not to take overly stringent measures to discourage SMEs. Specifically, enforcement mechanisms are recommended, complemented by other reforms such as facilitating formalization. Since the state is the largest procurer of goods and services, governments should use public procurement to either penalize or incentivize local SMEs to support and otherwise promote them. Reducing the time and cost of registration and reducing administrative burdens would encourage formalization. Quick and easy registration would reduce the cost of formalization. Simplifying business registration and making it cheaper or free would be attractive to informal SMEs. Reducing the burden on formal businesses, access to finance, business development services, and public procurement would be the components of incentive-based mechanisms.

**Policy Recommendation 2:** Adopting a uniform SME definition and clearly identifying the objectives of SME-related laws and regulations.

**Rationale:** Before taking the steps to improve the SME internationalization, it is important to adopt a uniform SME definition for clarity and comparability. This definition may vary from country to country; however, it is useful if an international standard (when possible) is adopted for comparison purposes. Any kind of political intervention needs a legal basis to be legitimate. The type of laws and regulations may change according to the constitutional structure and needs of each country, but the main premise is the same when it comes to the internationalization of SMEs: It is to comprehensively promote policies for SMEs by establishing basic principles, fundamental policies and other basic issues related to policies for SMEs, and clarify the responsibilities of the state and local public institutions, so as to contribute to the healthy development of the national economy, its integration into the global economy and the improvement of people's quality of life.

**Policy Recommendation 3:** Making SME internationalization a part of national policy documents by developing an SME strategy, setting out the strategy in a binding multi-year

document and positioning SME internationalization policies in the context of broader policy frameworks.

**Rationale:** As discussed in the Report, internationalization of business, especially SMEs, has far-reaching implications for development, such as higher-value economic growth, better employment opportunities, less poverty, and greater prosperity. Consequently, it is a good candidate to become part of the central government's policy agenda. SME strategy, sometimes referred to as a policy framework, should encompass the various facets of SME development, including but not limited to creating a business-friendly environment, promoting entrepreneurship, providing financial support, building a culture of innovation, e-commerce, and internationalizing SMEs. Setting out the strategy in a binding multi-year document can provide clarity to all relevant stakeholders on the intended course and includes concrete targets and appropriate policy instruments in a variety of SME policy areas. Positioning SME internationalization policies in the context of broader policy frameworks including industrial, innovation or regional policies, is necessary. All such frameworks should reflect the priorities of the national development agenda, the preference for the internationalization approach across the economy, or the institutional division of responsibilities between the central and other levels of government.

**Policy Recommendation 4:** Supporting the institutional framework by necessary financial means and government guarantees to facilitate SMEs' access to finance as they move into international markets.

**Rationale:** Access to finance is always a major problem for SMEs, whether they operate domestically or internationally. Entering the international market is a big step for a small business. It takes time for SMEs to build trusted relationships in other countries. It is more difficult for SMEs to receive payments for export within a short period of time. Financial institutions in the country may consider SMEs' business risky and prefer not to lend to SMEs. In this regard, trade finance support and guarantees provided by the government are the most important tools for internationalization. In order to facilitate SMEs' access to finance as they move into international markets, government institutions such as Exim Bank or SME Bank are natural candidates for providing trade finance to SMEs. If these institutions are not available in the country, the central bank would delegate this task to a private institution. Publicity campaigns by public institutions or local banks would inform SMEs about access to trade finance. Banks are reluctant to lend to SMEs because of the cost of loan handling and the risk of default. These barriers can be overcome by providing a guarantee. In doing so, the government should use expert personnel with experience and knowledge of credit transactions. Not all guarantee applications are suitable, and the agency must conduct a credit check. It also needs to develop efficient systems so that loans at banks that could be guaranteed can be processed proficiently. The rate of the guarantee can differ widely from program to program, from close to 50 percent to over 90 percent. A high guarantee rate creates moral hazard by reducing the lender's due diligence and risk. It also allows SMEs to continue to rely on the guarantee and unprofitable businesses to continue to survive and become zombie firms. Applications for guarantees should be considered on their merits and not subject to nepotism for politically connected individuals or companies. Guarantees issued on the basis of political preferences increase the default rate and the size of public subsidies. This can also result in potential borrowers who are worth more being priced out of the market (ADB, 2015).

**Policy Recommendation 5:** Categorizing SMEs in terms of their capacity and potential for internationalization and involve them in export assistance programs based on the results of the sorting system.

**Rationale:** In many countries, there are numerous institutions responsible for the growth, capacity building, and export of SMEs. Considering that each institution must review applications for its program, a tremendous amount of manpower is required. To make better use of resources and reduce costs, the main institutions responsible for SMEs should sort them and make the results available to other stakeholders. The newly established funding programs would require that SMEs receive a benchmark rating as an eligibility criterion based on the nature of the program. In addition, the primary institution conducting the scoring would direct SMEs to different programs based on their needs. Mandatory systems would discourage SMEs from applying or working formally. Therefore, the system should be voluntary. SMEs would participate in the system if there was an incentive to apply for funding programs, e.g., through a priori set criteria. To get the most out of the rating system, share the results with other stakeholders. Each time they design a new program, they will ask applicants for a grading result. Once they have collected the applications, they will use the sorting results for shortlisting.

**Policy Recommendation 6:** Supporting managerial and human resources of the SMEs in line with the requirements of successful internationalization.

**Rationale:** The influx of well-educated and experienced workers to SMEs is contingent on the development of robust training organizations and national training networks (ADB, 2015). Graduates enter the labor market seeking employment in both small and large companies. These new workers need training geared toward participation in global markets (e.g., language courses), especially if the companies that employ them are SMEs. In addition, the high degree to which skills become outdated makes it difficult for older workers to find jobs, while demographic aging requires better employability and working conditions for older workers. Automation and digitization are expected to further diminish demand for blue-collar and recurring tasks and increase demand for social and problem-solving skills to ensure complementarity between machines and workers (OECD, 2018). Therefore, improved lifelong learning is essential. Yet, there exists a lack of awareness. Furthermore, it is well known that on-the-job training is particularly costly for SMEs. There is a smaller workforce and fewer resources. Retention rates are meager, and the risk of stealing by other companies is abundant. To bring leadership and human resources to exporting SMEs, the governments must develop and support all levels of education from elementary school to highly qualified higher education and vocational training. To ensure that students receive a high-quality education, the government should implement a system of institutional certification to guarantee that a proper training program is provided through high quality teaching. The training system must provide skills for key sectors and try to anticipate the skills needed for new and emerging sectors. Many SMEs produce for large companies and some directly export. Therefore, they need competent workers to fill their positions. Adaptable training opportunities should be contemplated by SMEs themselves as well as by public and private training providers. For example, training can be offered on a part-time basis during slow times of the week or month. Language or communication courses can be offered to improve relations with foreign partners. The traditional way to provide training is to send workers to training programs. However, another option is to bring instructors into the company, so that time can be saved, and training can focus on the specific tasks of the individual company. SMEs are often uninformed about state funded training programs, such as schooling support, vouchers, or partial cost grants.

Public agencies should provide the necessary outreach to ensure that SMEs know about these programs.

**Policy Recommendation 7:** Providing guiding mechanisms for SMEs to improve their products according to the market- and product-specific required standards and certifications.

**Rationale:** SMEs need to understand the standards required for their products in target countries. To prove the standards of the products, certifications are required for many goods. It is costly and time-consuming for SMEs to meet target country requirements for standards and certifications. The government would support MSMEs by providing the necessary information through a well-designed online portal. There are many examples that could be used. When SMEs are ready to export, they are faced with standardization and certification requirements. It is very difficult for them to understand the procedures. They would benefit greatly from semi-formalized government support. There are international institutions that provide consulting services for SMEs' standardization and certification requirements for export. Governments need to refer their SMEs to these institutions for advice. The COMCEC is a large community of governments that have expertise in exporting certain goods. Therefore, the community would help each other in standardization and certification to increase exports of SMEs in the region.

**Policy Recommendation 8:** Supporting SME branding by creating a national brand and including the SMEs' products in the national brand.

**Rationale:** Branding is defining a unique name and image for a product or service in the minds of consumers and binding a customer to a supplier. Wendelin, (2004) explains that brand reputation has a psychological impact on purchase. Differentiation from competitors is one of the most important benefits of branding. Penetrating international markets is a difficult process that helps products and services become known worldwide, leading to faster adoption. It is more difficult for SMEs to create their own brands. Instead, the governments can create a national brand and group SMEs under the national brand. SMEs should be grouped under the national brand based on a list of criteria. Governments should promote the national brand around the world.

**Policy Recommendation 9:** Conducting impact analysis of implemented programs regularly and share transparently with public.

**Rationale:** Evaluating the impact of funding programs is very important to better allocate resources. They help the government design better programs each year, and SMEs receive better services from the government when programs are improved based on the results of the impact assessment. Regular evaluation is necessary to further improve the programs. Continuous evaluation of programs allows the government to identify program weaknesses. If a program does not meet its goals over a period, policymakers should redesign it. Impact assessment allows policymakers to make decisions about programs. However, for accountability reasons, they must also be published regularly to the public.

#### **Instruments to Realize the Policy Advice:**

**COMCEC Project Funding:** Under the COMCEC Project Funding, the COMCEC Coordination Office calls for projects each year. With the COMCEC Project Funding, the Member Countries

participating in the Working Groups can submit projects to be financed by the COMCEC. For the above-mentioned policy areas, the Member Countries can utilize the COMCEC Project Funding and the COMCEC Coordination Office can support financing the successful projects in this regard. These projects may include training programs, study visits, workshops, organizing seminars, peer-to-peer experience sharing, needs assessments and producing promotinal materials/documents.