SME COMPETITIVENESS OUTLOOK 2019

Executive Summary

Big money for small business

Financing the Sustainable Development Goals

International Trade Centre

TRADE IMPACT FOR GOOD

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Foreword

The United Nations Sustainable Development Goals (SDGs) remain an important ingredient in achieving the world we all want by 2030.

A key component of this is financing the SDGs – but for many of us, the world of global finance has been challenging to understand and difficult to navigate. Part of this stems from its sheer size: asset managers manage tens of trillions of dollars globally, and hundreds of billions of dollars are traded on stock exchanges daily. But another hindrance has been the sometimes impenetrable language used by its experts and the distance between the world of global finance and the daily life of most individuals and businesses.

The work of the International Trade Centre (ITC) often intersects with the world of finance – or rather the world of 'lack of finance'. It is not unusual for the small and medium-sized enterprises (SMEs) that we work with to have challenges accepting a large order, because they are unable to borrow a few thousand dollars to invest in scaling up production. We frequently work with start-ups that have excellent business ideas, yet are unable to find the funding required to turn these ideas into reality. For every such business that cannot secure the financing it needs, an opportunity is lost to make a contribution to the SDGs.

This is the case because SMEs have tremendous potential to make an impact on the SDGs through the employment they generate, the business practices they choose to adopt, the sectors in which they operate and their impact on innovation and diversification in the economy. Our analysis suggests that SMEs can make a positive impact on 60% of the individual SDG targets.

The United Nations Finance for Development agenda has the ambition to strengthen synergies between private and public finance, for the benefit of the SDGs. Finance for SMEs is therefore a key element of Finance for Development, which aims to 'leave no one behind'.

This report makes the case that drawing more financing into SMEs in developing countries would yield disproportionate dividends in terms of SDG progress, while delivering healthy returns for investors.

A prospective investor's most basic expectation is a reasonable return. While some SDG-related investments may deliver only social returns, there are incredible opportunities for private-sector development projects to deliver social as well as financial returns. The developing world is full of SMEs with commercially viable business ideas. One estimate puts this market for SME financing at $5.2 trillion.

Yet, investors typically consider SMEs to be risky, and even more so in the developing world. They perceive the macro environment as precarious, and investment processes as non-transparent and unpredictable.

What's more, the weakness of relevant financial intermediaries in most developing countries means international investors lack the business intelligence needed to identify promising opportunities and correctly assess risks.

In this report, we aim to disentangle what it would take to bring the world of global finance a little closer to the world of SMEs. And we describe what governments and multilateral agencies can do to close the information gap that separates foreign investors from local small and medium-sized businesses.

Local financial intermediaries – what the report calls 'investment facilitators' – are critical connectors between global finance and developing country SMEs. The stronger those facilitators are, the easier it is for foreign investors to assess the risks and opportunities of investing in local SMEs. This will not come as a surprise to finance specialists in the development community, who have long lamented the weakness of financial systems in the developing world.

Investing in strengthening investment facilitators like accelerators, investment promotion agencies or local financial institutions would have major multiplier effects.

According to our calculations, generating an additional $1 trillion annually of private investment for SMEs will make major inroads towards achieving the SDGs. This may sound astronomical but would correspond to closing one-fifth of the existing SME finance gap in the developing world. It is also an order of magnitude that is realistic for the global finance community.

At ITC, we have always worked with and through local partners to reach out to SMEs. Our partners, or multipliers as we call them, include trade promotion agencies, chambers of commerce and sector associations. As export-ready businesses are typically also investment-ready, we increasingly work with local accelerators and investment promotion agencies. By strengthening these partners and their networks with the knowledge of local SMEs, we contribute to making trade and investment happen.

Working through local investment facilitators is effective and contributes to national ownership. It represents the best mechanism for scaling up investment, which is necessary to transform the slogan '*Big Money for Small Business*' into reality, and make a tangible contribution to achieving the Sustainable Development Goals.

Arancha González
Executive Director

Executive Summary

Big Money for Small Business: Financing the Sustainable Development Goals

$1 trillion per year would have major impacts on achieving Sustainable Development Goals while generating profits for investors.

Increasing annual investments in small and medium-sized enterprises (SMEs) in developing countries by $1 trillion would yield disproportionate dividends in terms of progress towards the Sustainable Development Goals (SDGs), while also delivering healthy returns for investors. Yet, less than 1% of the tens of trillions of dollars that global asset managers have under management is currently invested in developing country SMEs. *Big Money for Small Business* explains how best to scale up private sector investment in developing country SMEs for sustainable development impact.

SMEs contribute to the SDGs through the employment opportunities they generate, the business practices they choose to adopt, the sectors in which they operate and the impact they have on the broader economy.

Their relevance is underscored in the United Nation's (UN) 2030 Agenda for Sustainable Development, which calls on the international community to 'encourage the formalization and growth of micro-, small- and medium-sized enterprises, including through access to financial services.'

According to the *SME Competitiveness Outlook 2019*, lack of scalable SME investment projects and knowledge about enterprise capacities, as well as challenges in matching SMEs and investors, are holding investors back from channelling more funding into otherwise profitable investment opportunities in developing countries.

The key questions addressed in this report include:

- How important is SME finance to achieving the 2030 Agenda for Sustainable Development?
- Why is finance for SMEs in developing countries considered a risky investment, and what can be done to reduce risk and risk perceptions?
- Who are the international investors financing start-ups and SMEs, and what are their approaches?
- What can policymakers do to bridge the gap between the supply of finance from international investors and the demand for finance from developing country SMEs?

1. Investing in small businesses for sustainable development

ITC analysis shows that investments in SMEs can contribute to 60% of the 169 SDG targets.

Small businesses in developing countries contribute to the SDGs through four main channels: employees; business practices; sectors; and national competitiveness. ITC analysis shows that through these channels, investments in SMEs can contribute to 60% of the 169 SDG targets. SDG 8 and 9 stand out among the multiple goals that can benefit from strengthened SMEs.

Link between competitive SMEs and achieving the SDGs

- **Employee impacts.** SMEs employ about 60%-70% of the workforce in many countries. Investment that increases their competitiveness can foster decent job creation and have a positive influence on wages, with significant effects for reducing poverty and inequality.
- **Business practice impacts.** How managers choose to run their firms affects environmental and social aspects of surrounding communities. Human resource policies can improve gender equality, for example, while energy-efficient production methods can reduce the environmental footprint.
- **Sectoral impacts.** Small businesses in the sanitation, water, health, education, manufacturing, agriculture and energy sectors deliver goods and services that can be crucial to providing the basic needs at the heart of the SDGs.
- **National economy impacts.** Value-creating SMEs stimulate backward and forward linkages that can foster competition, innovation, diversification, international trade and growth. Investments in human and physical capital improve productivity and hasten structural transformation.

How investing in competitive SMEs can help achieve the Sustainable Development Goals

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