DONOR COMMITTEE FOR ENTERPRISE DEVELOPMENT

TECHNICAL REPORT

Creating Better Business Environments for Micro and Small Enterprises

BUSINESS ENVIRONMENT WORKING GROUP

The Donor Committee for Enterprise Development

Simon White

November 2018

Links updated August 2021

Creating Better Business Environments for Micro and Small Enterprises
Business Environment Working Group
Donor Committee for Enterprise Development: www.enterprise-development.org

Citation: White, S. (2018) 'Creating better business environments for micro and small enterprises', *Technical Report*, Donor Committee for Enterprise Development, Cambridge, UK

The author is grateful for the support of a project Task Team, which was made up of members from the Business Environment Working Group and who provided advice, documentation and contacts: Stefanie Springorum (German Technical Cooperation), Enabling Environment for Sustainable Enterprises Team (ILO), Andreja Marusic (World Bank Group), Siobhan Kelly (UN Food and Agriculture Organisation), Fulvia Farinelli (United National Conference for Trade and Development), Kåre Johard (Swedish International Development Agency).

Photos: ALCP, 2016
Icons made by Freepik

Executive summary

A poor business environment can disproportionately affect micro and small enterprises (MSEs). Does this require reforms that specifically target MSEs, or are these effects simply a result of the size and limited resources of these enterprises?

This report presents the findings of a review of the theory and practice behind differentiated approaches to business environment reform. The study reviews literature, programme documents and other resource material on MSE-oriented business environment reforms and presents the results of a survey of donor and development agencies on their views and experiences in MSE-oriented business environment reform.

The rationale for MSE-oriented reforms

There are many arguments used to justify business environment reforms that target MSEs. Not all of these explain the reasons why MSEs face problems in the business environment or adequately describe how reforms will address these problems. While MSEs provide a useful lens for viewing the business environment and identifying concerns, it is important to better understand the range of interconnected issues that make up the system and create the problems MSEs face.

Donor and development agencies are divided on the desirability of business environment reforms that focus on the concerns of MSEs. Some agencies specifically target their programmes to benefit MSEs, others are more concerned with economic growth and transformation and only focus on MSEs if an assessment of the business environment and the country context warrants this.

Overall, there is a concern that reforms focused on the MSE sector can distract reformers from focusing on economic growth and transformation. However, it is also recognised that the growth of MSEs is often constrained by poor business environments.

MSE reform objectives

There are a number of possible reasons or objectives for supporting MSE-oriented business environment reform:

- **Economic growth and transformation:** to maximise the opportunities for economic growth and transformation through an assessment and identification of the factors that inhibit the growth of MSEs;
- **Formalisation:** to contribute to the formalisation of firms by creating the conditions in which informal firms find that formalisation offers more benefits than cost, along with the use of better enforcement mechanisms;
- **Entrepreneurship:** to design and implement national entrepreneurship policies and programmes, which include support for entrepreneurship education, finance, innovation, and culture, and are mostly focused on entrepreneurial start-ups.
- **Job quality:** to improve labour and labour-related legal and regulatory regimes to address the job quality challenges faced by a high number of MSE workers;
- **Women's economic empowerment:** to address the legal and regulatory barriers affecting a disproportionately high number of women-owned and managed enterprises found in the MSE sector;

- **Support disadvantaged regions and industries:** to support business environment reforms in areas where poor people are more prevalent and MSEs more common (e.g., rural economies), and to support reforms that target industry sectors in which poor women and men operate businesses (e.g., agriculture); and
- **Public-private dialogue:** to improve public-private dialogue that improves the representation and participation of MSEs.

Reform challenges

There are many challenges to supporting business environment reforms that target the MSE sector. Some of these concern broad reform measures that affect all sizes of enterprise, others concern reforms that specifically target MSEs. Agencies are challenged to:

- **Avoid inhibiting growth and transformation:** rather than focussing exclusively on MSEs, donors can support business environment reforms that contribute to enhancing the dynamics of the broader private sector as the engine of economic growth.
- **Provide the right incentives to encourage formalisation:** the motivations for formalisation are not well understood and the right incentives for the transition to the formal sector are often lacking. Thus, it is important for donors to understand the growth motivations and aspirations of informal firms and respond to these with the relevant incentives.
- **Understand the drivers and dynamics of informality:** it can be risky to overemphasise support to formalise informal firms and often better to understand the economic drivers and dynamics of informality. Design reforms that are tailored to address these issues based on clear evidence.
- **Take care not to support overly simplistic, isolated reforms:** reforms should not be treated in isolation. Understand how reforms in one part of the system affect the whole system.
- **Recognise the limitations in government capacity:** reforms are often hindered by the limited capacity of developing-country government ministries, departments and agencies. Donor and development agencies should ensure their programmes and ambitions are customised to these constraints.
- **Work with limited data:** the lack of data inhibits an evidence-based approach to policy making and reform. More investment into relevant and accurate data is required, in the design phase and whilst monitoring reform effects.
- **Respond to political economic drivers:** the power imbalances between MSEs and larger enterprises and government authorities can make it difficult to establish the political will for reforms that benefit the MSE sector.
- **Find ways to integrate MSEs into the supply chain:** while business environment reforms can be used to integrate MSEs into national and global supply chains (e.g., value chain interventions, public procurement, local content), these often need to be complemented by other supply-side interventions.
- **Measure the progress of reform programmes and adapt accordingly:** it can be very difficult to quantitatively assess the constraints and priorities for MSEs and measure the impact of reforms.
- **Coordinate reforms efforts:** there is a need for coherent policy and effective information sharing and programme alignment between ministries, departments and agencies, and collaboration and dialogue with the private sector.

Creating preferences and exemptions

This report specifically examines the arguments concerning the use of policy preference and exemptions that benefit MSEs. These are largely based on the business environment problems MSEs face that reduce their competitiveness and inhibit their growth.

Because MSEs typically have specific reform needs that go beyond general business environment issues, a more differentiated approach to reforms based on enterprise size class is often proposed. While the 'one size fits all' theory that underpins the need for a level playing field is generally agreed on, the need for a case-by-case differentiation can be worth considering. However, a market or systems-based approach argues against this. This approach seeks to benefit all enterprises regardless of their size.

There is a strong argument for mainstreaming MSE concerns in business environment reforms and ensuring reforms are designed to benefit all firms regardless of their size, while ensuring MSE perspectives are fully captured in business environment assessments and programme monitoring.

There may be a case where reforms targeting MSEs are warranted in a more direct and specified manner. In such cases, reform programmes should establish clear criteria to identify which kinds of enterprise require attention and why. Donor and development agencies, and their partners, should develop a better understanding of how business environment reforms affect MSE growth and competitiveness. More awareness and evidence on MSE growth factors is needed to guide policy and legislation reforms.

Using an MSE lens to assess the business environment, adopting a Think Small First approach to policy, legal and regulatory reform, will focus on how to improve the business environment for the majority of businesses and not just a selected few. Thus, the use of exemptions or other forms of preference should only be applied, if justified, to a minority of firms (e.g., large firms, foreign investors).

Best practices

Drawing from the literature reviewed and the donor survey, the following practices are recommended for business environment reforms that benefit the MSE sector:

- **Give priority to levelling the playing field:** ensure firms are not disadvantaged in the business environment based on their size or the sex of their owner (and recognise that while a law, regulation or procedure may appear neutral, it can have very different effects on firms of different sizes);
- **Simplify, reduce costs and improve transparency:** simplify the legal and regulatory regime, reduce the costs of compliance and improve the transparency of regulatory and administrative decisions for all firms;
- **Invest in an objective assessment of the business environment:** place more effort on proper diagnostics, improving the quality of data to guide policy making, including an assessment of how the business environment affects MSEs;
- **Identify the causes and not just the symptoms:** carefully analyse national circumstances and contexts and identify the root causes to poor MSE performance;
- **Think small, aim for growth:** understand how government policies, laws and regulations affect the MSE sector and its potential for growth;
- **Avoid single, isolated reform measures:** understand how change in one part of the system may affect other parts;
- **Go beyond business environment reform:** recognise how the business environment relates to other factors affecting MSE competitiveness and growth;
- **Ensure integrated solutions:** use technical and financial cooperation to create suitable framework conditions and public-private dialogue, while improving legislation and regulation, administrative provisions and bureaucratic procedures;
- **Improve representation and voice:** promote dialogue between the private and the public sector and ensure the MSE sector is able to participate in these processes;
- **Improve policy coordination and coherence:** ensure the specific needs and opportunities of the MSE sector are addressed by government, whether through specialised MSE development agencies or inter-ministerial mechanisms;
- **Apply a gender lens to reform:** ensure the sex of a business owner is not a determinant of success;
- **Monitor and evaluate to stay on track:** apply regular reviews and establish robust feedback mechanisms; and
- **Invest in further research:** fill the gaps in the knowledge on MSE development and the contribution of business environment reforms to improving MSE competitiveness and growth.

Table of contents

List of acronyms

BEWG	Business Environment Working Group (DCED)
BMZ	German Federal Ministry for Economic Cooperation and Development
DCED	Donor Committee for Enterprise Development
DFID	United Kingdom Department for International Development
EC	European Commission
EU	European Union
FAO	Food and Agriculture Organization
GDP	Gross Domestic Product
GIZ	German Technical Cooperation
IFC	International Finance Corporation
ILC	International Labour Conference
ILO	International Labour Organization
JICA	Japan International Cooperation Agency
MSE	Micro and small enterprise
MSME	Micro, small and medium-sized enterprise
OECD	Organisation for Economic Cooperation and Development
PSD	Private sector development
RIA	Regulatory impact assessment
SBA	Small Business Act (EU)
SECO	Swiss State Secretariat for Economic Affairs
SIDA	Sweden International Development Agency
SME	Small and medium-sized enterprise
UNIDO	United National Industrial Development Organization
VAT	Value added tax
WBES	World Bank Enterprise Survey

1 Introduction

Because poor business environments typically create a disproportionately negative effect on micro and small enterprises (MSEs) and hinder their development, many donor and development agencies suggest that reforms should specifically focus on these enterprises. In addition, numerous in number, MSEs typically provide a substantial collective contribution to the national accounts. By improving the business environment for MSEs, the growth opportunities for these firms should increase. However, while this logic makes intuitive sense, the role of business environment reform and its impact on MSE behaviour, economic growth and poverty reduction is more complex.

This report examines the impact business environment reform has on MSEs in developing economies and considers the roles donor and development agencies can play to support this. It reviews the published literature on this topic and surveys the approaches taken by donor and development agencies to support MSE development through business environment reform.

1.1 Background

The Donor Committee for Enterprise Development (DCED) is a membership organisation made up of donors and development agencies and private foundations that share the vision of making private sector development more effective.[1] The Business Environment Working Group (BEWG) of the DCED is a thematic group of members focusing on how donor and development agencies can support reform of the business environment in developing economies.[2]

In 2008, DCED published guidelines on business environment reform, entitled *Supporting Business Environment Reforms*, which defines the business environment as a:

> complex set of policy, legal, institutional, and regulatory conditions that govern business activities. It is a sub-set of the investment climate and includes the administration and enforcement mechanisms established to implement government policy, as well as the institutional arrangements that influence the way key actors operate (e.g., government agencies, regulatory authorities and business membership organisations, civil society organisations, trade unions, etc.).

Governments reform their business environment with the support of donor and development agencies. They do this because of the significant influence the business environment has on the development of the private sector and, as a result, on economic growth and the generation of livelihoods and jobs.

Business environment reforms endeavour to change the behaviour of private enterprises to increase levels of investment and innovation and the creation of more and better jobs. This is done by:

- Reducing business costs: by reducing business costs firms are able to increase profits so that these may be further invested to increase market share so that output and employment is increased;
- Reducing risks and uncertainty: the risks of doing business are reduced by improving the quality and stability of government policies, laws and regulations in order to reduce the cost of capital and increase the number of attractive investments in the market; and
- Increasing competitive pressures: firms become more competitive by making market entry easier and by stimulating the efficiency and innovating incentives of the market.

[1] See https://www.enterprise-development.org/intro-to-the-dced
[2] See: https://www.enterprise-development.org/organisational-structure/working-groups/overview-of-the-business-environment-working-group

The Donor Guidance recognises a number of 'functional areas' of business environment reform that donor and development agencies have typically focused on. Most donor-supported reforms are concentrated on one or more of the following:

1. Simplifying business registration and licensing procedures;
2. Improving tax policies and administration;
3. Improving labour laws and administration;
4. Improving the overall quality of regulatory governance;
5. Improving land titles, registers and administration;
6. Simplifying and speeding up access to commercial courts and to alternative dispute resolution mechanisms;
7. Broadening public-private dialogue processes with a particular focus on including informal operators, especially women;
8. Improving access to market information; and
9. Enabling better access to finance.

In addition, the Donor Guidance describes how business environment reform can occur within specific industry sectors and sub-sectors, as well as at regional, national and sub-national levels.[3] Sector-specific business environment reform seeks 'to address policy, legal and regulatory requirements that unnecessarily raise the cost of doing business, increase risks or reduce competition within specific sector or industry categories'. This allows for 'a deeper analysis within those sectors that are most strategic for national development or pro-poor economic growth' (DCED 2008).[4] Similarly, the DCED has recognised that the impact of business environment reform is influenced by gender and that reforms need to specifically accommodate the experience of women-owned and managed enterprises.[5]

1.2 Business environment reform for micro and small enterprises

It has long been recognised that a poor business environment can disproportionately affect MSEs and their development. However, it is unclear whether this requires reforms that are specifically attuned to the needs, constraints and dynamics of MSEs or whether these effects are simply a reality MSEs face due to their size and limited resources. For example, should different legal and regulatory frameworks be created for small enterprises, or do parallel business environments create incentives for staying small? An additional challenge is that, in many countries, MSEs are informal. Thus, business environment reform could be considered as an important contribution for the reduction of informality among MSEs.

The DCED commissioned this study to examine these issues and to consider the theory and practice behind these differentiated approaches. The objectives of the study were to:

1. Review the literature on business environment reform and its impact on MSEs in developing economies;
2. Review donor and development agency business environment reform support programmes and identify the extent to which enterprise size and formality feature and the tools and processes used; and
3. Prepare a typology of reforms as they relate to enterprises of different size classes and degrees of formality.

The study began with a review of literature, programme documents and other resource material on MSE-oriented business environment reforms. Following this, a survey of 13 DCED member agencies was

[3] On regional and sub-national business environment reform, see the DCED Technical Report (White 2016) and the Annex to the Donor Guidance (DCED 2016b).
[4] On sector-focused business environment reform, see the DCED Technical Report (White 2015) and the Annex to the Donor Guidance (DCED 2016a).
[5] On gender and business environment reform, see the DCED Technical Report (DCED 2016c) and the Annex to the Donor Guidance (DCED 2016d).

undertaken to assess their views and experiences in MSE-oriented business environment reform. Annex 1 contains the terms of reference for this study. Annex 2 presents a summary of the survey results.

Throughout this study, special attention was given to the influence of the business environment on supporting early-stage business growth and the effects of labour laws and regulations for MSEs. Some consideration was also given to reforms that promote the development of 'high-growth MSEs'. Moreover, while not a primary focus, this study also sought to consider the role of business environment reform and the formalisation of informal firms (i.e., unlicensed and unregistered firms).

1.3 Defining micro and small enterprises

This report uses the term 'micro and small enterprises', or MSEs, to refer to private enterprises at the smaller end of the size spectrum. However, it is appreciated that the definitions of firm size vary by country and international organisation, based on a range of criteria, such as number of employees or value of sales or assets.[6] The most commonly used size thresholds define small enterprises as firms with fewer than ten or 50 employees and medium-sized enterprises as having fewer than 100 or 250 employees (ILO 2017).

Many countries define their enterprise sector size classes according to criteria that are relevant to their national economic and social contexts. Indeed, in 1998, the International Labour Conference (ILC), in its Recommendation Number 189 on job creation in SMEs, encouraged all states to define SMEs using appropriate criteria 'taking account of national social and economic conditions', in consultation with representative organisations of employers and workers (ILC 1998, para 1). The World Bank (2014b; 164) also recognises the importance on national conditions, arguing that while an appropriate definition of SMEs may be based on firm size, it is also contingent on country conditions: 'one size classification does not fit all'.

This report is focused on MSEs, which generally refers to those on the lowest end of the size spectrum. However, when referring to specific research, policy or programme documents, a variety of terms are used. In addition to the term MSE, the terms small and medium-sized enterprises, or SMEs, and micro, small and medium-sized enterprises, or MSMEs, are also used.

Unless otherwise stated, this report considers micro-enterprises as firms with fewer than five employees, small enterprises as firms with between five and 19 employees, medium-sized enterprises as firms with between 20 and 99 employees, and large enterprises as firms with 100 or more employees. This is in line with the definition introduced by the World Bank in its World Bank Enterprise Surveys (WBES).

[6] For example, the International Finance Corporation defines SMEs as having from 10 to 300 employees and assets between US$100,000 and US$15 million or sales in the same US Dollar range. While the World Bank has no single definition, it targets enterprises with five to 99 employees for its enterprise surveys. The OECD defines SMEs as ten to 250 employees and no more than €10 million sales. The EU defines SMEs as ten to 250 employees, with €10 to 50 million in turnover or €10 to 43 million in assets.

2 The special case of micro and small enterprises

One of the major arguments framing the discussion of MSE-oriented business environment reform is that MSEs represent a special kind of enterprise with a unique contribution to national economic and social development. Thus, based on these traits, MSEs demand particular attention by reformers. There are two important features to this argument.

First, MSEs deserve special attention because of the size of the sector and its overall contribution to national development.

Second, MSEs are more vulnerable to a poor business environment than larger enterprises. It is generally recognised that smaller firms pay a proportionally higher cost for doing business than do large firms and the external threats created by poor business environment place MSEs in a more vulnerable position.

These issues are discussed below. This is followed by a discussion on the merits of development support that specifically target MSEs.

2.1 Size and contribution of MSEs

The most common argument cited for the special role MSEs play in the national economy revolve around the size of the MSE sector and its contribution to job creation and, to some extent, value addition. There are a number of donor and development agencies that justify their support to SMEs on this basis. For example, the Japan International Cooperation Agency (JICA 2013;14) looks to SME support activities as a contribution to its vision of 'inclusive and dynamic development'. It considers SME promotion important because it contributes to the diversification and sophistication of industries and the enhancement of international competitiveness. It is also important from an inclusive development perspective because it creates employment opportunities while reducing poverty and contributing to socioeconomic stabilisation.

In most countries, MSMEs account for the highest number of firms and this number increases as the size of the firm decreases. However, while the numbers of MSEs are generally substantial, they are individually small by nature in terms of turnover, employment and value addition, discussion revolves around the cumulative contribution of these firms.

Birch (1981) presents one of the first seminal studies on SMEs and job creation. This study found that SMEs were the major job creator in the United States of America. Subsequent studies have highlighted the important contribution of SMEs to employment levels and growth in developing, emerging and developed economies (see Ayyagari, et al., 2011; Aga, et al., 2015; Criscuolo, et. al., 2014).

Ayyagari, et. al., (2003) find a significant variation in the size and economic activity of the SME sector across income groups. Countries with a higher level of Gross Domestic Product (GDP) per capita have larger SME sectors in terms of their contribution to total employment and GDP. However, the overall contribution of small firms, both formal and informal, remains about the same across national income groups. As income increases, the share of the informal sector decreases and that of the formal SME sector increases. More recently, the ILO (2017) in its *World Employment and Social Outlook; Sustainable Enterprises and Jobs* report, describes how the contribution of formal micro-enterprises to growth and employment is important. It presents an analysis of 14 economies across Africa and Asia that shows how formal micro-enterprises contribute a significant share of employment: in six of the 14 economies, micro-enterprises account for between 13.8 and 48.7 per cent of permanent employment (ILO 2017).

The ILO (2018b) in its *World Employment and Social Outlook; Trends* report, presents evidence to show how the share of total employment in SMEs has been growing over the last few years, from 31.2 per cent in 2003 to 34.8 per cent in 2016, with important differences across countries at various stages of development. Indeed, the number of total full-time employees in SMEs has also risen: over the period 2003 to 2016 the number nearly doubled, from 79 million to 156 million.

While there is significant evidence on the contribution MSEs make to job creation, there is some contestation regarding their role in job destruction. The World Bank (2014b; 6) presents evidence to show how smaller and younger firms are subject to more job destruction: 'studies that use panel data, allowing for firms to exit over time, bring into question any special role in job creation for smaller firms'. However, Criscuolo, et al. (2014b) present evidence from Organisation for Economic Cooperation and Development (OECD) countries, which shows how young SMEs play a central role in creating jobs, whereas old SMEs tend to destroy jobs: young firms are net job creators, while downsizing by old firms accounts for most job losses. These results, claim the authors, highlight large cross-country differences in the growth potential of young firms and the critical role played by national policies in enabling successful firms to create jobs. Calvino, et al. (2016) present cross-country evidence that shows how start-ups in volatile and high-growth sector are significantly more exposed to national policies and framework conditions than start-ups in other sectors.

Current literature suggests that economic growth and transformation in developing economies is unlikely to be driven by MSEs. Instead, medium and large firms drive these processes, particularly those that are export-oriented and integrated into global supply chains (Bloom, et al., 2014).[7] Many developing economies are challenged by crowded microenterprise markets and a handful of large enterprises, often multinational, which drive globally connected import and export markets. Between these, there are very few growth-oriented or integrated SMEs. This is what is often referred to as the 'missing middle'.

There are numerous debates theorising the origins and functions of the missing middle. Using data from formal and informal manufacturing firms in India, Indonesia and Mexico, Hsieh and Olken (2014) argue the missing middle does not exist: while mid-sized enterprises are missing in these economies, so too are large enterprises.[8] However, Tybout (2014) suggests the missing middle is still a relevant concept, arguing there are a variety of features of the business environment that create the missing middle and these effects cannot be rigidly linked to enterprise employment levels. This point highlights the vulnerability of MSE in poor business environments.

2.2 MSE vulnerability

The second major argument concerning the importance of MSEs in the national economy and why they deserve particular attention concerns their vulnerability. Many studies highlight the churn of MSEs in the national economy, referring to the high rate of MSE creation and destruction. MSE destruction is often cited as a result of a poor business environment.

Beck, et al., (2005; 171) provide evidence that SMEs face 'greater financial, legal and corruption constraints compared to large firms, and that the impact of constraints on firm growth is inversely related to firm size'. Moreover, small firms 'stand to benefit the most from improvements in financial development and reduction in corruption'.

In his review of the literature, Vandenberg (2005) suggests that the size-specific disadvantages in the business environment may arise from two sources.

First, is a created disadvantage in which business environments inherently disadvantage smaller firms due to the intended or unintended actions of policymakers, lawmakers and lobby groups. For example, larger firms

[7] These firms tend to be more productive and able to provide higher paying, formal and sustainable jobs. Additionally, these firms are also better able to capture and create backward linkages to the rest of the economy when interacting with foreign direct investment.

[8] For example, in Ghana, Teal (2016) considered these arguments when assessing manufacturing data dating back to 1962 and does not find a missing middle as defined by either Hsieh and Olken (2014) or Tybout (2014). Instead, he finds the enterprise size distribution in Ghana is close to what would be expected without policy distortions, unlike in India, Indonesia and Mexico. Sandefur (2010) studies microenterprises in Ghana, which accounted for the bulk of gross and net job creation from 1987 to 2003, and says, 'big firms don't represent successful micro-entrepreneurs that have risen through the ranks of smaller firms. Rather, big firms are born big'.

may benefit from tax incentives or subsidies simply because they are larger. On this basis, reforms are needed to create a level playing field, which is currently biased in favour of large enterprises.

The second is a natural disadvantage in which smaller firms are disadvantaged due to their size and smaller resources. For example, larger firms are able to absorb the higher cost of regulation and reporting because they have greater internal resources to apply to these functions. Thus, size-specific reforms are needed to ensure the business environment does not impose a disproportionate burden on these firms.

When faced with excessively complex bureaucracies, SMEs are more likely to make illegal payments in order to secure an advantage as they often lack the time and resources necessary to be informed about complex regulations and requirements, to cover up mistakes or avoid overly bureaucratic procedures (OECD 2016).

United National Industrial Development Organisation and United Nations Office of Drugs and Crime (2012) finds that SMEs are more susceptible to bureaucratic corruption than larger companies. This is due to a number of factors, including: (1) their structure (e.g., greater degree of informality and fewer accountability mechanisms); (2) a vision and perspective that focus on the short term implications of entering into corrupt transactions (i.e., SMEs may be less concerned about reputation and other long-term negative impacts of corruption); (3) limited financial resources; and (4) their inability to wield influence over officials and institutions as they lack bargaining power to oppose requests for illegal payments from public officials. Apart from the tangible monetary costs involved, 'acts of corruption also impose other costs on small businesses, since they may influence the decisions of SME managers to set up, expand, close down or reinvest in their business; look for customers abroad; hire, dismiss and train their workforce; improve product quality; invest in research and development; or change location'. This report identifies the following problems SMEs typically face in the justice system in developing countries: (1) lack of access to adequate legal information; (2) prohibitive costs of using the justice system and long delays, (3) lack of adequate legal aid systems providing reliable and affordable legal representation or unsuitable eligibility criteria, and (4) abuse of authority and powers in the justice system.

The World Bank (2014a) assessment of WBES data suggests that the constraints on firms are influenced, not only by enterprise size, but also on the interaction of size with country conditions. It argues that understanding the constraints and needs of small firms requires an understanding of systemic challenges, such as reliable electric power supply, an honest and transparent public sector, moderate taxes, political stability, fair rules of the game, an educated workforce, and a developed, competitive and stable financial system.

Informal enterprises are one of the most vulnerable types of enterprises in the MSE sector. The informal economy comprises around 80.9 per cent the workforce worldwide (ILO 2018a). However, employment in the informal economy is often characterised as unsafe, precarious, unprotected, poorly paid, and under represented at a massive scale. While informality can be found in enterprises of all sizes, this brief is concerned with MSEs, which represent the bulk of informal employers in developing and transition economies.

The nature of informality makes it difficult to measure and monitor. The ILO (2018a) presents a statistical profile of informal employment around the world.[9] The 61.2 per cent of global employment that is informal is comprised of 51.9 per cent in the informal sector, 6.7 per cent in the formal sector and 2.5 per cent in households. Agriculture has the highest level of informal employment (93.6 per cent) around the world, while the industry (57.2 per cent) and service (47.2 per cent) sectors are relatively less exposed to informality.

Globally, informal employment is a greater source of employment for men than for women (63.0 per cent compared to 58.1 per cent). However, there are important regional variations. For example, in Africa, 89.7

[9] This distinguishes between 'informal sector employment, which includes women and men who are employed by informal enterprises, and 'informal employment', which covers workers who are informally employed by formal and informal enterprises. Informal employment can be in the informal sector, in the formal sector or in the household sector.

percent of employed women are in informal employment in contrast to 82.7 per cent of men. Even though globally there are fewer women than men in informal employment, women in the informal economy are more often found in the most vulnerable situations than their male counterparts (e.g., as domestic workers, home-based workers or contributing family workers). Moreover, the lower the participation rate of women in the labour market, the lower the share of informal employment in total women's employment.

SMEs are also found to employ more women in their full-time permanent workforce compared to larger firms, at least in most of the world's regions (ILO 2017). SMEs often provide the entry point for women into formal sector employment. This suggests that a strong SME presence contributes to improving labour market outcomes for women. Indeed, new analysis shows that emerging and developing countries experiencing an increasing share of formal employment in SMEs are more successful in reducing the working poverty gender gap (ILO 2018b).

2.3 Targeting MSE assistance

Drawing from the arguments presented above, many donor and development agencies focus on MSMEs within their broader private sector development programmes. For example, the German government identifies MSMEs in both the formal and informal sectors in developing countries as its main target group for German-supported private sector development (PSD) (BMZ 2013). However, there is some variation in how targeted-MSE assistance is applied.

On the one hand, there are agencies that propose direct and specific support to MSEs. The United National Industrial Development Organisation and United Nations Office of Drugs and Crime (2012; 68) recommends that practitioners do not consider the private sector as a 'homogenous mass', but develops 'distinct and tailored programmes for SMEs, as a one-size-fits-all approach has proved not to have any effect on that particular group'.

On the other hand, while German-supported PSD identifies MSMEs as a primary target group, its support strategy 'is geared to helping partner countries put in place an enabling political, legal and administrative environment for private investment and to establish competitive and sustainable economic structures'. German development cooperation pursues a systemic approach in PSD, linking interventions at the level of individual institutions (i.e., meso level) and those at company level (i.e., micro level) with structure-building interventions at policy level (i.e., macro level) and activities to build closer links between the different actors (BMZ 2013; 16).

Consistent with this approach, Hallberg (2000) argues that the justification for MSE interventions lay 'in market and institutional failures that bias the size distribution of firms, rather than any inherent economic benefits provided by small firms'. Thus, there is a need to look beyond the symptoms of MSE vulnerability in the business environment and to understand the underlying causes more clearly and objectively.

JICA's (2013) guidelines for SME promotion centre on two development themes: trade and investment promotion, and SME promotion. It pursues three 'development strategic goals' for trade and investment promotion: (1) improvement of the business environment, (2) improvement of systems for trade promotion, and (3) improvement of systems for investment promotion. Under SME promotion, two development strategic goals are pursued: (1) development of policies and institutions for SME promotion and (2) enhancement of competitiveness of businesses. A key focus in JICA's business environment work is the improvement of policies and systems for SME promotion, which is an effort to resolve the external macro and meso issues SMEs face, and in which government is the main actor. Enterprise competitiveness, on the other hand, deals with the internal micro issues faced directly by enterprises. This includes public and private BDS providers, financial institutions, and business membership organisations.

The World Bank's (2014b) Independent Evaluation Group evaluation of targeted-SME assistance finds that 'many targeted projects are weakly justified, are weakly focused on SMEs, and/or have limited potential for additionality' (p. xiii). It describes how targeted SME support has been justified by one of two kinds of reasoning: first, because SMEs make special contributions to developing economies to growth, employment, productivity, and investment they merit special support; second, because SMEs face special challenges that do not apply to larger firms, addressing these challenges will level the playing field and address this imbalance. However, its review of the literature reports ‘inconclusive evidence on the first claim, but a wealth of support for the second’ (p.1).

The arguments for levelling the playing field relies on evidence that targeted approaches contribute to the special MSE challenges, where targeted growth eliminates systemic constraints. Here, the objective ‘is not to benefit SMEs as an end in itself, but to create economies that can employ more people and create more opportunity’ (World Bank (2014b; 163).

3 Themes and instruments

This chapter examines the key themes for MSE-oriented business environment reform. Nine 'functional areas' of business environment reform are described in the Donor Guidance (DCED 2008). Within the context of MSE development, the following broad themes emerge for donor and development agencies across which many of the above functional areas apply:

1. Formalisation of informal MSEs: reforms that are introduced to support the formalisation of informal firms;
2. Legal and regulatory exclusions: reforms that exclude MSEs from the demands of full legal and regulatory compliance, especially within the application of tax and labour laws;
3. Access to finance: while this corresponds to a single functional area identified in the Donor Guidance, reforms in this field also span other areas; and
4. Women-owned and managed enterprises: this topic is important because of the high number of women-owned and managed enterprises found in the MSE sector in many countries.

These themes are discussed in more detail below.

3.1 Formalisation of informal MSEs

Many donor and development agencies define informal enterprises as unincorporated or unregistered enterprises. However, the ILO and the International Labour Conference (2015) defines the 'informal economy' more broadly as 'all economic activities by workers and economic units that are – in law or in practice – not covered or insufficiently covered by formal arrangements'. This goes beyond registration and relates to compliance with taxes, social security, labour laws, among others. Thus, the formalisation of informal MSEs is a major focus for business environment reform and donor and development agency support programmes.

The DCED (2011) annex to the Donor Guidance, 'How business environment reform can promote formalisation', provides guidance on how to successfully promote formalisation through business environment reform and on implementing complementary reforms that address the causes of informality.

Figure 1: Formalisation of informal MSEs: summary of reform interventions

Employment, labour and labour-related policies, laws and regulations
Business registration and licensing
Taxation policy and administration
Land ownership and titling
Judicial reform
Financial services
Intellectual property rights
Public procurement and supply-side responses
Voice and representation

There appear to be significant benefits to firms that transition from informality to formality. For example, in Vietnam, Boly (2015) finds that becoming formal leads to increased profits, value addition and revenue. The performance of firms that switch from informal to formal is higher than those that remain informal, but lower than those that were formal from the start. The benefits of formalization were found to materialise in the short term and persist over time. These benefits run through access to improved equipment, larger customer base, advertising, and business association membership, but not access to credit. Similar results are reported in Sri Lanka (de Mel, et al., 2012) and Indonesia (McCulloch, et.al., 2010).

The DCED (2011) suggests there are two broad policy responses to informality. The first focuses on improving the conditions in which informal enterprises operate and employ workers. The second focuses on encouraging informal enterprises to formalise (i.e., so that unregistered and unlicensed firms become registered and licensed). Because 'informal economic activity can promote innovation and can act as a buffer to economic shocks that developing economies regularly face' it is argued that policy and legal reforms can be used to "enhance the positive effects of informality while making it safer, protecting the vulnerable, and encouraging equity'.[10] This is because, a 'dynamic, competitive, and growing economy will display movement between the formal and informal economies'. On the other hand, policy and legal reforms can also be used to help informal actors transition to become formal and to participate more in the mainstream, formal economy, including the global economy. Formalisation endeavours to encourage MSE owners and managers to invest more into their enterprise and its workers so that the enterprise becomes more sustainable and competitive, contributing to achieving full and productive employment and decent work for all.

The causes of informality vary. The ILC (2002) acknowledges that informality has multiple causes, including governance and structural issues. Thus, policy reforms that promote formalisation need to be designed based on a clear diagnosis of prevailing forces that shape informal economy. This is likely to include an assessment of the following general causes (ILO 2016a; 7).

- Poor general business environment: Many developing countries have business environments that are difficult and costly to comply with. Instead of being short, simple and cheap, regulations are numerous, lengthy and expensive. These conditions contribute to increasing the cost of doing business in the formal economy, which can reduce productivity and competitiveness.
- Few incentives to formalise and poor government services: Many informal firms associate formalisation with high regulatory and tax burdens. Informal enterprises fear that by registering or obtaining the licenses and permits they officially require, they will become more visible to government and subject to increasing costs. Formalisation in developing countries does not necessary lead to more public goods or improved government services. Enterprises operating in poor areas are typically subject to regular power outages, the lack of rubbish removal, and ailing infrastructure, whether they are registered or not.
- Exclusion and marginalisation: Certain groups, such as women and indigenous peoples, are disproportionately represented in the informal economy, as a result of social conditions that exclude or marginalise these groups making it more difficult for them to engage in formal markets.
- Poverty and unemployment: High levels of poverty and unemployment force men and women into starting an enterprise as the last, and only, resort. These people are in business to survive and rarely do they consider the legal or regulatory consequences of their actions. Indeed, while they may be running an informal enterprise for many years, many of these people will immediately stop running a business if a decent work opportunity became available.
- Informality due to conflict and other forms of social disruption: Informality can be caused by external shocks and social disruptions that create instability and force people to operate outside of the formal legal system. This includes the experience of armed conflict, famines, and natural disasters where the rule of law is weakened, and informal behaviour increased.
- Reducing costs and maximizing benefits: Many informal MSEs trade off the costs of formalisation with the benefits. Many countries with large informal economies make it difficult to formalise and offer few benefits.
- Poor enforcement mechanisms: Informality can stem from an environment in which law and regulations are not enforced or, where they are enforced, are not enforced based on clear rules and procedures. Local government officials, tax inspectors and other kinds of officials in these situations

[10] It is interesting to note that some writers, such as Neuwirth (2011) highlight the positive contribution the informal economy makes to our society.

have a high degree of discretion and can choose to interpret laws and regulations as they see fit. This does not build confidence in the legal system and encourages enterprises to respond strategically as and when these situations arise.

The ILO (2014) illustrates how the various causes of informality can be used to develop a policy response.[11] In Figure 1, below, four common causes to informality found in Latin America and the Caribbean are presented, accompanied by possible policy reforms.

Figure 2: Causes of informality and strategies for MSE formalisation

Low productivity and high costs of formalisation
Promoting productivity in MSEs - MSE development policies (access to markets, finance, technology) - Association building, cluster development, local economic development
Complex procedures, inadequate regulation for the size and characteristics of MSEs
Revision/adaptation of regulations, procedures and norms - Simplification of administrative procedures - Differential regulations
Informality as an attractive option: flexibility and independence
Incentives to formalise - Access to social security - Access to public procurement - Access to financial and business services
Limited inspection, state and social control
Enhancing the capacity to enforce compliance - Inspection with technical assistance - Unique identification numbers - Effective sanction systems - Institutional coordination

SOURCE: International Labour Organization (2014)

Business environment reforms can be used to directly promote the formalisation of informal firms. However, this requires an integrated response that is based on a thorough diagnosis of the causes of informality. BMZ (2013; 16) describes the German government's twofold focus on formalisation: overcoming the obstacles to growth for formal and informal firms (2) raising the degree of formalisation of the economy as a whole by reducing the costs of moving from the informal to the formal sector. Similarly, the ILC (2015) says reforms should cover a broad spectrum to policy concerns, including the promotion of strategies for sustainable development, poverty eradication and inclusive growth, as well as the generation of decent, formal jobs, among others.[12]

[11] Also see ILO (2017) *Enterprise formalisation*, SME Unit, Enterprise Department, ILO, Geneva
[12] Other reforms identified by the ILC include an appropriate legislative and regulatory framework, a conducive business and investment environment, respect for and promotion and realisation of the fundamental principles and rights at work, the organisation and representation of employers and workers to promote social dialogue, the promotion of equality and the elimination of all forms of discrimination and violence, including gender-based violence, at the workplace, the promotion of entrepreneurship, micro, small and medium-sized enterprises, and other forms of business models and economic units (e.g., cooperatives and other social and solidarity enterprises), as well as access to education, lifelong learning and skills development, financial and business services, markets, infrastructure and technology, and the promotion of sector policies, the establishment of social protection floors, the promotion of local

Overall, the evidence on the formalisation of informal firms suggests that reforms targeting single issues within individual firms are not effective. Instead, it is necessary to take a broader, systemic perspective that integrates a wider range of factors that combine to produce high levels of informality in the economy. Similarly, reform programmes should identify and target those firms that are most likely to benefit from formalisation (e.g., those that are motivated to grow).

Some of the most relevant policy reform domains are described below.

Employment, labour and labour-related policies, laws and regulations

Informal employment, where employees are engaged without contract, or social protection, or in unsafe or low-paid conditions, is a common feature of the informal economy. Conversely, many MSE employers fear the costs associated with complying with the full requirements of national labour laws. The ILC (2015, para 14) says it is important to ensure national employment policies are formulated with the central goal of 'full, decent, productive and freely chosen employment' and incorporated into national development and growth strategies. This should include the need for 'immediate measures to address the unsafe and unhealthy working conditions that often characterize work in the informal economy' and 'promote and extend occupational safety and health protection to employers and workers in the informal economy' (para 17). Moreover, it recommends the progressively extension of social security provisions, maternity protection, decent working conditions, and a minimum wage to the informal economy, in 'law and practice' (para 18). The DCED (2011) says the 'challenge of balancing enterprise growth and workers' protection calls for an active role of the state, particularly in implementing a legal framework for the labour market, basic social protection (e.g., health and safety, minimum income), and skills development'.

Chen (2007) argues that labour market deregulation is associated with the rise of informal employment and creates a situation in which workers are caught between two contradictory trends: rapid 'flexibilisation' of the employment relationship to make it easy for employers to contract and expand their workforce as needed, and slow liberalisation of labour mobility to make it difficult for labour to move easily and quickly to new opportunities. The challenge is to find the balance between increasing the level of protection for formal workers, while encouraging informal MSEs to adopt more formal employment practices. This implies a re-regulation of the labour market rather than a complete removal of employer requirements.

In some cases, special exemptions for MSEs within the labour and labour-related legal regime have been used in some countries. This issue is discussed further below.

Business registration and licensing

Because informal enterprises are typically unregistered and unlicensed, reforms that make registration and licensing easier and cheaper can affect the process of formalisation. Thus, many donor and development agencies have supported these reforms, which includes support for the creation of one-stop-shops and electronic business registration systems.

The ILO (2014a) argues that registration and licensing reforms should be an 'important cornerstone of any agenda' to formalise MSEs. The most common strategies for doing this include reducing or consolidating the number of steps required to register, simplifying administrative processes for licensing, reducing or eliminating minimum capital requirements, administrative deadlines and positive administrative silence, and digitising the process and using on-line facilities. Indeed, the ILC (2015, para 25a) says that Members should undertake business entry reforms 'by reducing registration costs and the length of the procedure'. Initiatives in this field have also included the creation of one-stop-shops and establishing simplified legal formats for micro businesses.

---

development strategies, effective occupational safety and health policies, efficient and effective labour inspection, income security, access to justice, and mechanism for international cooperation.

As important as these reforms are, it should be recognised they may not be enough. A number of reviews and evaluations in recent years have found that improving business licensing and registration does not, on its own, appear to work as a strategy for formalisation, at least in terms of the number of businesses registered and licensed (for example, see Bruhn 2011, 2013; Fajnzylber and Montes-Rojas 2011; and Monteiro and Assunção 2012). The International Finance Corporation (IFC 2013; 46) suggest that other efforts are needed to bolster the intended outcomes of business registration and licensing reform: 'business entry reforms work best when complemented with other investment climate reforms'. This includes reforms that increase the market opportunities for registered and licensed firms.

Taxation policy and administration

Inappropriate taxation systems have been found to encourage informality. Many MSEs fail to comply with the tax system because it is too complex, expensive and opaque. Moreover, MSEs may simply not be aware of their tax obligations or are fearful of the tax system. A desire to avoid tax is often at the heart of the decision to not register or obtain the necessary licences. Tax compliance can be eased by introducing more transparent and simplified tax reporting requirements, improving tax inspections, reducing the number of payments, offering different payment options, and differentiating tax schemes for microenterprises and farmers.

Several countries have created special tax regimes for MSEs to promote formalisation, support small enterprise development and allow greater administrative efficiency in tax collection. These schemes typically provide lower tax rates, presumptive taxation methods, and the integration of different taxes into one single tax payment. Zinnes (2009) describes how the implementation of a simple non-discretionary tax that can be collected cheaply and with high compliance can lead to better working conditions for the poor. Increasing the threshold for payment of value addition tax (VAT) has also greatly reduced the bureaucratic burden for MSEs and start-up businesses and contributes to greater activity in the formal business sector (ILO 2015).

The evidence finds that reforms to streamline and improve tax administration do indeed contribute to the formalisation of informal firms (see Rand and Torm 2012; Boly 2015; Fajnzylber, et.al. 2009; Kenyon and Kapaz 2005; and McKenzie and Sakho 2010). The IFC (2013) claims that a streamlined tax system can increase the number of firms in the formal economy, facilitate investment, widen the tax base, and rationalise a company's tax compliance cost.

Land ownership and titling

The lack of access to land title is a key challenge facing informal firms and there have been many studies that present the relationship between improved property rights, economic growth and poverty reduction.[13] This issue is particularly acute when the lack of access women have to formal property rights is considered (World Bank 2014). To this end, policy reforms that promote formalisation have often included land titling and administration reform. These reforms focus on redressing incomplete cadastres, onerous or costly land registration procedures, and addressing intrusive government ownership of land. In some cases, land ownership and titling reforms have been introduced to increase the capacity of poor women and men to raise capital through land-based collateral. However, the impact of these initiatives has not proved to be sufficient, again reflecting the multifaceted nature of informality and its causes.[14] Formal land title is only one factor affecting access to credit.

[13] The concept of 'property rights' is broad and includes "the rights individuals appropriate over their own labour and the goods and services they possess" (North 1990). Authors such as De Soto (2000) have long argued that household property rights and formal land titles have a significant impact on capital formation and poverty. Acemoglu, *et.al.,* (2001) have shown the importance of property rights and good institutions, while Acemoglu and Johnson (2005) find that good 'property rights institutions' have a "first-order effect on long-run economic growth, investment, and financial development".

[14] Bromley (2009) critiques these claims and provides a secondary analysis of the literature to argue that the focus on formalisation is misplaced: poor people are not poor because they don't own the land, but because of a broader set of "flawed economic policies". He argues there is very little empirical evidence linking the formalisation of land titles to

Palmade and Anayiotos (2005) recommend that governments relax tenant laws, zoning restrictions, and building codes to provide a relatively quick and easy way to increase the availability of formal land. In addition, land property taxes should be increased to discourage speculators from holding vacant land and to provide local governments with the financial means and incentive to develop more land for commercial and residential use.

Judicial reform

Zinnes (2009) describes how the lack of access informal firms have to the formal commercial court system restrict their transactions to the immediate locale and with those parties with whom they have personal or social ties. While these arrangements allow the parties to make use of informal dispute resolution processes and traditional means of justice, they can also lock out informal firms from formal dispute resolution mechanisms and the commercial courts. Thus, policy reforms in this field typically focus on improving access to formal dispute resolution channels, strengthening and improving the quality of customary and traditional governance methods, improving linkages between formal and informal systems of justice, and improving access to justice in bureaucratic administration (DCED 2011). In addition, the Commission on Legal Empowerment of the Poor (2008) recommends the improvement of registration systems, without user fees, and the strengthening of legal aid systems with expanded legal service specialists.

Financial services

Access to finance is an essential prerequisite to enterprise growth and the lack of access often keeps firms trapped in informal and overcrowded markets. Thus, the formalisation of informal firms often requires attention to this problem.

Kanji (2015) recommends that policy incentives be introduced to encourage financial institutions to develop profitable initiatives that promote the formalisation of their informal clients. This includes the use of formal bank accounts to ensure informal enterprises and their workers are a part of the formal banking system.

The ILC (2015, para 25d) recommends improving ‘access to inclusive financial services, such as credit and equity, payment and insurance services, savings, and guarantee schemes, tailored to the size and needs of these economic units’. Similarly, the ILO (2015) recommends that attention be given to increasing finance options for MSEs. This includes establishing loan guarantee funds, increasing the availability and suitability of financial products for MSEs through commercial banks, disseminating information about financial services to MSEs, promoting innovative ways in which MSEs can use a positive credit history as collateral to access loans at better rates and seek more competitive terms, and increasing access to low-cost business management training. Although informal finance mechanisms and microfinance institutions have received support to help informal enterprises gain access to finance, the process of formalisation involves reforms that increase the access of poor women and men to the full range of financial services.

Beyond informality, the broader problems experienced by MSEs in accessing financial services is discussed further below.

Intellectual property rights

The World Intellectual Property Organization (2005) highlights the importance of intellectual property rights as well as ‘traditional knowledge’ for indigenous people. Improved rights can ensure this knowledge and genetic resources are not misappropriated or misused.[15] On a broader scale, poor intellectual property policy can lead to informal provision of substandard products. Informal enterprises sometimes use trademarks and

---

poverty reduction and that land tenure reform should not be elevated above other policy reform priorities. This view is supported by Payne, *et.al.,* (2009) and Cousins *et.al.,* (2005).

[15] One example illustrating the use of intellectual property rights relates to traditional medicines in the People’s Republic of China, in respect of which several thousand patents have been granted in past years (World Intellectual Property Organization 2005).

other property illegally and campaigns are needed to replace illegal products with legally protected products. These initiatives should aim to provide economic opportunities for operators based on consumer benefits and protection under legal operation.

Public procurement and supply-side responses

A key motivation for informal firms to consider formalisation is the perceived opportunity for getting access to larger, formal markets. Thus, donor and development agencies have supported reforms that seek to increase the access firms have to new markets and increasing the competitiveness of firms in these markets. This includes value chain interventions. Informal firms are encouraged to become formal and more competitive in order to access these markets. The ILC (2015) says states should promote access to public procurement, providing training and advice on participating in public tenders, and reserving quotas for informal firms. Similarly, support should be given to informal firms in terms of entrepreneurship and business management training (for example, see ILO 2016c).

Voice and representation

Finally, donors and development agencies have supported reforms that endeavour to improve the organisation and representation of informal MSEs and to give them a better voice in policy and advocacy. For example, Mihaylova and Poff (2018; 31) describe how improved public-private dialogue in Senegal in which informal firms are included ensures these firms 'have a voice in the reforms that affect them most'.

3.2 Preferential treatment and exclusions

Governments of both developing and developed countries have introduced policy initiatives that provide preferential treatment for firms based on their size or provided exclusions from specific onerous or costly legal and regulatory responsibilities. In developing economies, some donor and development agencies have supported reforms that reflect this approach.

The discussion below begins by looking at some of the more common approaches to providing preferential treatment to MSEs. Following this, the use of exclusions, specifically in terms of exemptions from certain elements of tax and labour administration, are discussed.

Figure 3 *Preferential treatment and exclusions: summary of reform interventions*

Preferential treatment
Micro, small and medium-sized enterprise policies, laws and agencies
Small Business Act for Europe and the 'think small first' principle
Procurement preferences
Legal and regulatory exclusions
Tax exclusions
Labour exclusions

3.2.1 Preferential treatment

There are many instances where MSEs are provided with preferential treatment in the business environment. Typically, this ranges from ensuring the needs of MSEs are clearly understood and defined, before initiating reforms or new policy measures, to instances where clear preferences or advantages are assigned to MSEs on the basis of their size.

Micro, small and medium-sized enterprise policies, laws and agencies

Many countries have established national MSME policies, strategies and programmes that outline how the government will work with other public and private stakeholders to promote entrepreneurship and MSME development, often with the support of donor and development agencies. In some cases, specific legislation and public agencies have been developed. This includes the development of specialised MSME development agencies (for example, see Association of Chartered Certified Accountants 2016 and ILO 2016b).

Several donor and development agencies support these policy initiatives in developing economies. For example, in Armenia in 2011, the government, with support from the Centre for International Private Enterprise introduced a new SME law, which includes provisions that streamline tax reporting requirements by implementing e-reporting and help to ensure that SMEs benefit from state support programs. A national SME Development Council, chaired by the prime minister, was also established (Mihaylova 2018). In Egypt in 2017, the prime minister issued a decree (Prime Minister's Decree No. 947/2017) to establish an Agency for Micro, Small and Medium Enterprise Development, which aims to 'draw up a national programme for the development and upgrading of enterprises; securing the necessary favourable environment for their encouragement; motivating citizens to enter the labour market via these enterprises; spreading and fostering the culture of entrepreneurship, research, creativity and innovation; and coordinating the efforts of all the entities concerned in this field'. This decree was aligned to an MSMEs and Entrepreneurship National Strategy (2017-2022), which the Canadian Government and ILO supported.

Around the world, SME development agencies exhibit a range of institutional structures. In some cases, an agency may simply be a unit within a government ministry, where staff are public officials reporting to the minister. In other cases, an agency may be more independent from government. The agency may be an autonomous body, run by a council or board, receiving funds from government as well as from the private sector and other sponsors. In this case, agency staff are not government officials and while the agency may still report to government, it has a more independent and apolitical status. The governing board or council would be predominantly comprised of people from the private sector. From a business environment reform perspective, national agencies provide an opportunity to collect and analyse data on the MSME sector and its contribution to the national economy and employment. This includes research into specific areas associated with MSME development, such best practices, value chain assessments, financial and business development services assessments, and emerging market opportunities; and the provision of advice on policy, legal and regulatory reform to national government. In some cases, agencies can provide a secretariat or support function for public-private dialogue.

UNCTAD's (2012) *Entrepreneurship Policy Framework and Implementation Guidance* aims to support developing country policymakers in the design of initiatives and institutions to promote entrepreneurship. It identifies policy objectives and options in the form of recommended actions, and proposes checklists, case studies and good practices. It also offers a user guide and methods for policy monitoring and evaluation, suggesting a set of indicators to measure progress. While this document does not focus exclusively on MSEs, it describes entrepreneurship as 'one of the most important drivers of job creation and economic growth and is crucial for the development of a vibrant formal small- and medium-sized business sector' (p. 5).

One of the pillars of the UNCTAD framework refers to 'optimizing the regulatory environment'. This generally refers to reforms that affect the whole private sector, with a strong emphasis on entrepreneurs and start-ups. UNCTAD does not call for interventions that create alternative or preferential treatment but does suggest it may be necessary to differentiate between enterprises based on their size class. However, it also says enforcement must apply to all:

> Entrepreneurship development benefits from rules and regulations that are simple and transparent. Rules may differentiate between micro, small and large firms but enforcement should be ensured across the board to avoid unfair competition, while safeguarding the interests of informal 'necessity entrepreneurs' (those who run their own informal business as their only means to earn a living) and helping them to upgrade their business (UNTAD 2012; 6).

Indeed, the UNCTAD policy framework recognises that small-scale entrepreneurs often suffer most from a heavy regulatory burden and its derivative—corruption (UNTAD 2012; 16).

Small Business Act for Europe and the 'think small first' principle

The Small Business Act (SBA) is a regional framework for the EU policy on SMEs. It aims to improve the approach to entrepreneurship across Europe, simplify the regulatory and policy environment for SMEs, and remove the remaining barriers to their development.[16] It has four main priorities: (1) promoting entrepreneurship, (2) reducing the regulatory burden on SMEs, (3) improving SME access to finance, and (4) improving SME access to markets and internationalisation.

The European Commission (EC) conducts a regular SME Performance Review to monitor and assess progress in implementing the SBA.[17] This includes consultations with the European Parliament and EU Member States' governments, as well as the network of SME Envoys. The Commission operates two mechanisms to test the impact of EU legislation and programmes on SMEs, which are managed by the Enterprise Europe Network. The first are SME panels, which consult SMEs on forthcoming EU legislation and policies. The second are SME feedback mechanisms, through which Enterprise Europe Network partners collect the views and feedback from SMEs on a broad range of EU policy initiatives, actions, legislation or programmes related to the internal market.

The 'Think Small First' Principle takes SMEs' interests into account at a very early stage of policy making. This helps the EU develop SMEs-friendly legislation. To support and feed the above key enabling factors, the SBA have established ten principles:

1. Education and training for entrepreneurship;
2. Efficient bankruptcy procedures and second chance for entrepreneurs;
3. Institutional and regulatory framework for SME policy making;
4. Operational environment for business creation;
5. Support services for SMEs and public procurement;
6. Access to finance for SMEs;
7. Supporting SMEs to benefit from Euro-Mediterranean networks and partnerships;
8. Enterprise skills and innovation;
9. SMEs in a green economy; and
10. Internationalisation of SMEs.

The SME Test analyses the possible effects of EU legislative proposals on SMEs. By assessing the costs and benefits of policy options, it helps implement the Think Small Principle and improve the business environment through:

- A preliminary assessment of the businesses likely to be affected;
- Consultation with SMEs and their representative organisations;
- Measurement of the impact on SMEs (i.e., a cost-benefit analysis); and
- Applying mitigating measures, if appropriate, to reduce the negative impacts on SMEs.

[16] For more information go to: https://ec.europa.eu/growth/smes_en
[17] For more information on the EU SME Performance Reviews go to: https://ec.europa.eu/growth/smes/sme-strategy/performance-review_en

A 'systematic and proportionate application of the SME Test' can be found in the European Commission (2015) Better Regulation Toolbox, which contains a range of tools association with impact assessment.[18]

To illustrate the use of the SBA, the SME Test was introduced in the Croatia in 2016 as a mandatory part of the evaluation process of new proposed legislation changes. This is a step towards the expected full implementation of the SME Test in the Croatian legislation. The Regulatory Impact Assessment (RIA) on SMEs includes the decision-making process of the regulation based on evidence and relevant data. This RIA serves as guidelines for the selection of the most appropriate regulation. Further work is envisaged to ensure the application of the comprehensive SME Test and assessment of the effects of legislation changes on SMEs. The government expects that the legislative introduction of the SME Test will bring significant economic effects, stimulating the production and employment growth in the SME sector (European Union 2017; 39).

The SBA Review was launched in 2011 to track the implementation of the SBA. Among other things, this review integrates the SBA with the Europe 2020 Strategy. The review found that the implementation of the SBA and its Think Small First principle is 'patchy or even non-existent' in some Member States as well as within the EU legislative and decision-making processes. It is also interesting to note that the Think Small First slogan was often interpreted as Think *SMEs* First, while 92 per cent of businesses are microenterprises that operate on a highly diverse range of markets. Indeed, the Think Small First principle was initially designed with micro-enterprises in mind. Microenterprises find it harder 'to apply EU policies and legislative measures and consequently deserve more attention and a simplified approach that is tailored to their needs' (European Commission 2011).

The EU *2017 SBA Fact Sheet and Scoreboard* indicates that a total of 35 policy measures have been adopted or implemented in the period (2016-Q1 to 2017). Indeed, over 250 policy measures have been adopted or implemented under the Think Small First principle since 2011. Most of the measures minimise the burdens for businesses, apply the Think Small First principle to administration and apply regulatory exemptions for SMEs. Recent examples of policy developments include Austria's facilitation for Loss Adjustment for SMEs that perform accounting on a cash basis and Cyprus' introduction of a SME Test mechanism. Furthermore, nearly 350 policy measures were adopted or implemented since 2011 at the EU-level under the 'responsive administration' principle. In particular, the simplification of licensing procedures, reducing the cost and time to register a business, and reducing overall administrative and tax burdens. One-stop shops are in place in most EU Member States.

Close to 165 policy measures have been adopted or implemented under the state aid and public procurement principle since 2011. A majority of EU Member States have put in place protective measures for SMEs in case of late payments and have adopted proportionate requirements in public procurement tenders to enable micro-enterprises to also be eligible. In addition, almost all EU Member States have an effective e-procurement portal where all public tenders are announced and can be applied for.

The EC (2013) promotes the use of 'smart regulation' that 'responds to the needs of SMEs in four broader areas:

1 Applying the micro-enterprise exemption: Before the EC-proposed initiatives or revisions of existing EU legislation, comprehensive preparatory work takes place. It publishes roadmaps to inform stakeholders about possible Commission initiatives, available evidence and planned preparatory and consultative work. These roadmaps contain information on the initial problem definition, objectives, options and preliminary assessment of impacts and the envisaged timetable. Through the impact assessment process, the Commission aims to avoid unnecessary regulatory burden. It analyses whether micro-enterprises can be exempted from the coverage of the initiative without undermining the objective of the potential proposal. However, impact assessments shown that it is not always possible to exempt micro-enterprises. For instance, they cannot be excluded when there is clear evidence that excluding them

[18] For more information on the SME Test, see Tool No. 19 in the European Commission (2015) Better Regulation Toolbox (pp. 128-134): https://ec.europa.eu/info/sites/default/files/better-regulation-toolbox-2015_0.pdf#page=128

would mean that the regulation would not be able to achieve its goals (e.g., to protect workers or consumers).

2 **Introducing lighter regulatory regimes for SMEs:** When exemptions are not possible, efforts are made to tailor regulatory proposals to suit SMEs, such as through the introduction of a lighter set of requirements. In addition, some EU legislation leaves it up to each Member State to decide whether it wants to introduce lighter regimes for SMEs (e.g., in the areas of information and consultation of workers, food hygiene, waste and annual accounts).

3 **Introducing the SME scoreboard:** The EC issues an annual scoreboard covering regulatory initiatives expected to have a significant impact on SMEs. This scoreboard allows all interested parties, including the network of national SME Envoys, to identify where and how progress on SME relevant legislation is being made at the EU level. It allows the progress of the legislative cycle from Commission proposal through to implementation in Member States to be tracked. It identifies the main issues involved and indicates the positions taken on them throughout the legislative cycle, flagging if regulatory burden has been added or reduced at the various stages from Commission adoption to implementation.

4 **Ensuring regulatory fitness:** The SBA has established strong governance mechanisms based on the close cooperation with Member States and SME stakeholders. The implementation of the SBA is now supported by a network of SME Envoys with high-level representatives from Member States.

Procurement preferences

Many governments around the world have introduced incentives for small businesses to more successfully participate in public procurement.[19] The World Bank produces the *Benchmarking Public Procurement* report, which presents a cross-country analysis in 180 economies on how regulatory environments affect how private sector does business with the government. In the most recent report of 2017, less than half (43%) of the 180 economies measured have set up policy or legal provisions to promote the access of SMEs to government contracts.[20] However, this figure largely focusses on SME assistance measures.

The World Bank (2017; 32) encourages governments to establish a policy framework that promotes SME participation in 'private sector participation' within broader public-private partnership models. This framework would take into account policy initiatives that promote a greater SME share of the public procurement market and may include initiatives that promote and facilitate SME participation in public procurement systems, such as:

- Public-private dialogue and assessment of needs;
- A policy framework that mandates and promotes greater access of SMEs to public contracts (including set-asides and other forms of preferential policies, and measures to foster innovation by SMEs);
- Inclusion in the legal and procedural framework of provisions that promote and facilitate SME participation, including easing administrative burdens of participation (e.g., procurement planning requirements that include preparation and publication of annual procurement plans; division of procurement into lots; allowing procuring entities to forego the imposition of bid securities and, where appropriate, applying the bid-securing-declaration technique; ensuring application of qualification requirements proportional to the nature of the contract and streamlining of documentation of eligibility; enablement of bidding by joint ventures and consortia);
- Establishment of financing facilities to assist SMEs bid for and implement procurement contracts;
- Capacity building programs for public officials and SMEs that facilitate implementation of pro-SME procurement policies; and

[19] For more information on how business environment reforms and public procurement systems can support SME development see DCED (2017a).

[20] See World Bank Group (2016b)

- Appointment of focal points and inter-ministerial commissions focused on promoting SME access to public procurement.

Many OECD countries have adopted tools to reduce corruption while reinforcing competition and efficiency in procurement procedures. These measures do not specifically create preferences for SMEs but improve the performance of smaller firms by reducing costs or building firm capacity. In Spain, for example, a self-declaration system facilitates participation of SMEs in public procurement. Italy runs a train the trainers programme to empower SMEs in the area of public procurement and Ireland has consultation and review mechanisms in place to tailor the procedures to SME needs (OECD 2016).

In 2017, the multi-donor-funded E4D/SOGA project support SME procurement in the extractive industries and identified nine key areas where local suppliers need to improve their performance. These key areas were classified as internal challenges because potential suppliers can address them, given the right support measures. Furthermore, the major players in the extractive industries agreed that where suppliers can successfully satisfy these challenges, they will be on the right track to qualify as competitive bidders for supply contracts. In Uganda, the project supported 30 local companies in upgrading their health, safety and environmental standards to enable them to bid successfully. A public-private partnership approach to supplier development for micro and small enterprises has proved very successful, especially in countries with 'uncertain framework conditions' (E4D/SOGA Employment and Skills for Eastern Africa (2018).

3.2.2 Legal and regulatory exclusions

In some cases, policy preferences for MSEs are created through the use of exclusions in which firms, on the basis of their size, are excluded from meeting some or all of the obligations of the legal and regulatory framework. Exclusions are most commonly applied in the tax and labour administration. However, sized-based exemptions can lead to 'growth traps' that inhibit firms from growing beyond the threshold, unfair competition with firms that don't benefit from exemptions, and negative externalities (e.g., environment) or social consequences (e.g., labour legislation) (see Reinecke and White 2004; Vandenberg 2006).[21]

Sized-based exemptions are most commonly applied in two policy domains: tax and labour administration.

Tax exclusions

In most countries, the rates of taxation are determined by the volume of revenue or profit. Indeed, this is the hallmark of a progressive taxation system applied in many countries. However, the exemptions referred to here, refer to the administration of tax and the degree to which MSEs are included in the tax system in order to encourage their registration and enrolment in the tax system. Drawing from WBES data, the World Bank (2014; 183) describes how tax rates are a top five constraint in all groups of SMEs, except those in lower-middle-income countries. In low-income countries, tax rates rank third.

As indicated in 3.1, above, taxation can be a key factor in why smaller firms prefer to operate informally and taxation reforms, including the time-bound exclusion of firms from the requirement to pay tax has been used to encourage the formalisation of informal firms.

It is important to distinguish between MSEs exclusion from the tax system and their exemption from paying taxes. The former refers to a situation in which firms are hidden from or unknown to the taxation system. The latter refers to a situation in which firms are registered with the tax authority but, by virtue of their size, not required to pay tax.

The IFC (2013) argues that a streamlined tax system can increase the number of firms in the formal economy, facilitate investment, widen the tax base and rationalise a company's tax compliance cost. In

[21] Reinecke and White (2004) identified 'growth traps' in their seven-country research on SME policies and employment.

addition to finding that an inefficient tax administration (e.g., multiple taxes, cumbersome procedures and high compliance costs) imposes significant constraints on businesses, in particular for SMEs, it highlights the importance of undertaking reforms to adjust different tax rates for companies, or to modernise and rationalise the tax system and administration, including the adoption of electronic tax payment portals.

In Senegal in 2012 the Parliament passed legislation to reform the Senegal Tax Code, which resulted in a more streamlined tax code for SMEs with tax rates that are more proportional to their profit margins. Mihaylova and Poff (2018; 30) argue that a more uniform and proportional tax code for the SME sector ‘will help formalise Senegal’s informal sector, which in turn will expand the government’s tax base and promote accountability and transparency’.

White and Fortune (2015; 20) review the published literature on tax-related business environment reforms and describe how such reforms influence firm behaviour. This includes taxes on individuals (i.e., salaries, earnings), business, VAT, imports and exports, as well as taxes applied to specific business activities or sectors. Reforms aiming to specifically improve the tax regimes for MSMEs, including informal enterprises were introduced to make tax administration more transparent and efficient.[22] These reforms encompass efforts to broaden the tax net to include firms that were previously excluded. Beyond this, tax reform may include the adjustment of tax rates and the use of incentive instruments. These tax reforms were found to influence firm behaviour in ways that lead to investment, which includes the decision of business owners to formalise their firm by registering with the tax office. Thus, reforms to streamline and improve tax administration have been found to make firms more likely to register for tax as a result of the reform efforts.

Labour exclusions

In some cases, countries exempt MSEs and their workers from the full range of requirements of the national labour law. This is because the high regulatory costs associated with full compliance has led to a situation in which MSE employers avoid registering their workers with the labour authority. Thus, the logic is that exemptions encourage registration, without the burden of full compliance.

In their seven-country review of the impact of policies on small enterprise employment, Reinecke and White (2004) describe how general exemptions of MSEs from labour laws and regulations leave many workers unprotected and have a negative impact on job quality. They show how these measures can create a ‘growth trap’ in which MSE employers are influenced by the exemptions to keep their firm below the exemption threshold. Evidence for this was found in Pakistan, where many enterprises that had reached the threshold of nine employees were reluctant to grow, preferring instead to start an additional enterprise that also falls under the threshold. Thus, it was cheaper to have two enterprises employing nine workers each and avoiding the labour legislation than to have one enterprise of 18 workers that is required to comply to labour laws.

There is a general concern among some actors in this field that labour and labour-related laws and regulations create an unnecessary cost that burdens private employers, especially MSEs. For example, in the past, the World Bank Doing Business assessments largely treated labour regulation in negative terms. Berg and Cazes (2008) critique the former ‘employing workers’ index, which was a part of the Doing Business assessment, before it was removed in 2009. The authors argue for a more nuanced, qualitative approach to measuring the impact of labour policies and laws on private enterprises. They suggest there is a general lack of research in this field and identify a number of conceptual problems in the use of indicators that apply a simplistic ‘regulations are costs’ perspective, which negates many of the beneficial externalities associated with labour laws and which are, in effect, the *raison d’être* of labour law.

Godfrey, et.al., (2006) report on research from South Africa on the role of MSE exemptions in labour law and bargaining councils. Overall, this research finds that because coverage of employees reduced with firm size, there was very little case to be made for exempting MSEs. Instead, it was more important to ensure MSEs

[22] For example, see Carter (2013), Fajnzylber and Montes-Rojas (2011) and Joshi, et.al., (2014).

were better represented and engaged in formal bargaining structures, which are otherwise easily dominated by large employers. In situations where 'blanket exemptions of particular categories of business, particularly new and small businesses' were introduced, then firms would need to first register and to be carefully monitored over time.

Fenwick, et al., (2007) examine the role of labour market reforms focused on the MSE sector. Specifically, whether MSEs should be exempted from the full demands of the national labour legal framework because of their size. While labour and labour-related laws can be an important means of improving and ensuring job quality, MSE owners and entrepreneurs often perceive these as imposing unsustainable regulatory burdens and costs. However, the authors find little evidence to suggest that excluding MSEs from labour laws, or failing to apply them in practice, has major positive effects in terms of MSE growth and economic development or is likely to induce MSEs to become and remain fully formalised. Their study suggests that states should not simply exclude MSEs from the application of labour laws. While there is little evidence to suggest such exemptions have positive effects on MSEs, there is substantial evidence to show that these measures have significant adverse effects for MSE workers. States must find the best ways of regulating, to move toward achievement of their policy goals, rather than simply removing regulation. Indeed, 'markets are embedded in regulatory systems'. States are encouraged to 'develop innovative, responsive regulatory approaches' to how they regulate labour in the MSE sector (p. 100). Thus, firms and the markets they operate in should not be dealt with separately. Importantly, the authors argue that the design and implementation of labour law for MSEs should be specifically targeted at them. Thus, rather than consulting with large employers only when designing their labour regimes, governments should specifically consider the experiences of MSE employers and the potential impact labour and labour-related reforms will have on these employers and their workers.

3.3 Access to finance

The problems MSEs face in accessing the finance and financial services (e.g., savings facilities, insurance) they require to compete effectively and expand are well documented. Thus, MSEs often attract particular attention in this policy domain.

White, et al., (2017) reviews the evidence on the impact financial services have on SME growth and development and find that while improving access to finance generally enhances SME growth, the way this is achieved is more complex than simply focusing on the high cost of finance and the rigid eligibility requirements of commercial finance providers. Other factors affecting this dynamic are: poor business environments, inadequate infrastructure, corruption, and inexperienced business owners with poor management skills also inhibit growth. While there is evidence to show how stronger linkages between enterprises and financial institutions can improve access to financial services and induce growth, 'it is important not to isolate access to finance as a single constraint to growth, but to consider it as part of a more holistic approach'.

Schleifer and Nakagaki (2018) describe how, as entrepreneurs grow from micro to small and medium-sized enterprises, their financing needs are no longer met by microcredit, and they seek larger, commercial bank loans. Indeed, in order to expand production, rent new facilities, employ workers, and enter export contracts, small firms are often required to move from the informal to the formal economy. They highlight the problems women, in particular, face in terms of dealing with regulatory and governance hurdles as well as social barriers and discrimination. These issues extend beyond the direct issues of access to finance.

Drawing from the WBES data from 70,000 enterprise across 107 countries, Aterido, et al. (2007) measure the effects of access to finance, business regulations, corruption, and infrastructure bottlenecks in explaining patterns of job creation at the firm level. MSEs were found to have less access to formal finance, pay more in bribes than larger firms, and face greater interruptions in infrastructure services, while larger firms spend significantly more time dealing with officials and red tape. The authors argue that these results suggest that significant reforms to the business environment, including the finance sector, are needed to spur micro firms to grow. Martinez Peria and Singh (2014) also use WBES data from 63 countries in the period 2002-2013 to examine the effects of credit bureaus and find the likelihood that a firm has access to finance increases with the use of bureaus, while interest rates drop, maturity lengthens, and the share of working capital financed by banks increases.

Beck and Cull (2016) use WBES data to gauge access to financial services and the importance of financing constraints for African enterprises. They found that smaller firms were around 30 per cent less likely to have a formal loan than large firms, while medium-sized firms were 13 to 14 per cent less likely. In addition, firms organised as partnerships and sole proprietorships, the simplest organizational forms, are less likely to have a formal loan. In Egypt, Loewe, et al. (2013) identifies the factors determining the upgrading of SMEs. They find the scarcity of medium-sized enterprises in Egypt is due to the challenges firms face in remaining medium-sized or large. The business environment, notably problems in what they call 'state-business interactions', such as licensing, taxation, inspections, and competition control was found to constrain SME survival and growth.[23]

While the problems of MSEs accessing finance are generally understood, less clear is the impact of MSE-targeted development programmes that attempt to deal with these problems. McKenzie (2009) reviews a range of impact evaluations in finance and PSD to identify lessons learned and knowledge gaps. He finds that while evaluations have led reform efforts in areas such as microfinance, microenterprises, insurance, and regulatory reform, there are, in fact, only a handful of rigorous studies. More evaluations are needed on a wider range of policies in a number of different institutional settings, to learn what works, where and why.

Poor access to finance is a problem that many women-owned and managed MSEs struggle with. The World Bank (2014a) finds that female-owned firms and agricultural firms face particular challenges in gaining access to finance. Women-owned firms tend to be smaller than firms owned by men and grow at a slower rate partly because women have less access to finance. Fafchamps, et al. (2013) finds women micro entrepreneurs are less likely than men to realise business profits from increased cash grants, because they tend to be more susceptible to other demands on funds, including household demands. However, they benefit as much as male business owners when capital is increased. De Mel, et al. (2009) finds that in households where women are empowered with more decision-making power and more cooperative husbands, they invest a larger share of the grant into working capital and have positive returns from investments of the larger grant.[24] The DCED (2017a) presents evidence that suggests policies that create special lines of credit for women can increase their access to finance.

3.4 Women-owned and managed enterprises

As described in Chapter 2, the high proportion of women-owned and managed enterprises in the MSE sector, compared to the large enterprise sector, brings reforms in this field to the attention of donor and development agencies.

[23] These problems are mainly due to deficits in law enforcement, rather than in the cost of time and money required to comply. The authors suggest the main problems for upgrading SMEs in Egypt are: human capital deficits, the lack of motivation and readiness to take risks, poor market research, the inability to deal with persistent deficits in the rule of law, and inadequate access to finance.

[24] In Uganda, Fiala (2015) supports this finding: male-owned businesses are more likely to achieve enterprise growth from loans and training, combined, than female-owned businesses, which showed no significant firm-level impact. 'Family pressure on women appears to have significantly negative effects on business investment decisions' (p. 2). However, on the other hand, de Mel et al., (2009) find very limited evidence that women invest the grants in the schooling of their children and no evidence that they spend more of the grant on health or household durable goods. De Mel, et al., (2008) likewise found significant effects on SMEs owned by men of a capital grant, but not on those owned by women in Sri Lanka. Monthly profits increase by around nine per cent of the grant amount in enterprises owned by males, but do not increase at all in enterprises owned by females. This study shows that women fail to invest any portion of the smaller grant, while they invest as much or more of the larger grant than men do, but still realize no return.

Klapper and Parker (2011) finds that many studies dealing with gender differences in business suggest that women's educational backgrounds and their desire to combine entrepreneurship and family work are often offered as explanations as to why women entrepreneurs are overwhelmingly concentrated in highly competitive, small-scale, labour intensive businesses. However, this might also be driven by women's barriers to access to finance. Indeed, they suggest there are few studies that have analysed the gender implications of the business regulatory environment.

Using IFC data, Stupnytska, et al., (2014) claim there are roughly seven million formal women-owned SMEs in developing countries, of which as many as 70 per cent are unserved or under-served by financial institutions. Looking beyond formal SMEs, women's credit needs are substantial among MSMEs in the informal sector: for a number of countries the credit gap as a percentage of GDP for all MSMEs (formal and informal) is exceptionally high – as high as 12 per cent of GDP for Vietnam and ten per cent for China. In India, the credit gap for total women-owned MSMEs is over 30 times larger than for formal women-owned SMEs.

The World Bank's Women, Business and the Law programme measures legal restrictions on women's employment and entrepreneurship by identifying gender-based legal differences. This initiative started in 2009 in order to inform policy discussions and promote research on the linkages between the law and women's economic opportunities. Its goal is to encourage reform of these legal restrictions.

One of the key action areas in Global Affairs Canada's (2017) *Feminist International Assistance Policy* is 'Growth that works for everyone'. This recognises that women's economic empowerment is a prerequisite for achieving inclusive economic growth. Under this action area, Canada promotes competitive, innovative and environmentally sustainable markets for enterprises, particularly those that women lead, and improved employment and entrepreneurship opportunities for individuals, particularly women.

The policy specifically recognises the challenges facing SMEs that are owned by women. It argues for greater access to and control over assets such as land, housing and capital, including financial services, as well as labour rights and social protection from precarious work situations. It further promotes the integration of women-owned businesses enterprises into supply chains.

As with other themes of MSE-oriented business environment reform, a focus on women-owned MSEs is useful from a diagnostic point of view, but not always a relevant entry point for direct reform through preferences or exemptions. The problems women face in the business environment are significant and debilitating, yet the solutions from a reform perspective, are most likely found in an integrated response that deals with the systemic causes to women's exclusion and the factors that inhibit competitiveness and growth. In its annex to the Donor Guidance, the DCED (2016; 7) says 'all gender-sensitive business environment reforms require addressing more than simply the direct business environment factors that impact women's employment and their enterprise'. It is equally important to address the 'socio-cultural binding constraints on women' that impact on a women's ability to engage in employment and entrepreneurship.

4 Success factors and lessons learned

This chapter synthesises the findings of the literature reviewed in the previous chapters and draws from the finding of the survey of donor and development agencies. Annex 2 provides a general summary of the survey findings.

4.1 Defining a rationale for MSE-oriented reforms: describing symptoms and causes

There are many arguments used to justify business environment reforms that target MSEs. However, not all of these explain the reasons why MSEs face problems in the business environment or adequately describe how reforms will address these problems. While MSEs provide a useful lens for viewing the business environment and identifying concerns, it is often necessary to better understand the range of interconnected issues that make up the system and create the problems MSEs face.

The donor survey found that agencies are divided on the desirability of business environment reforms that focus on the concerns of MSEs. On the one hand, some agencies have no specific rationale for supporting MSEs. These agencies approach each economy differently and conduct assessments to identify the key drivers, challenges and stakeholders that deserve attention and determine the priorities for business environment reform. For example, one agency’s support for inclusive and sustainable industrial development is undertaken through technical cooperation projects under various themes, such as creating shared prosperity, advancing economic competitiveness and safeguarding the environment.

While the common justifications for supporting business environment reform are employment creation and income generation, this does not necessarily imply a focus on the MSE sector. By improving the conditions in the sectors where most poor people work, business environment reforms reduce barriers for all firms and create opportunities for more firms to compete on fair terms. This approach highlights the transformational role MSEs can play in economic growth but does not lead to the direct conclusion that reforms should focus on the MSE sector alone. Business environment reform typically focuses on enterprises of all sizes, with reform programmes being complemented by other PSD interventions that specifically support MSEs. Thus, while business environment reform can be seen as a means to improving economic demand through growth, business development interventions help MSEs compete more effectively in growing markets.

On the other hand, many agencies report they are broadly aware that MSEs represent the vast majority of firms and generate significant employment across developing economies. Indeed, as one agency suggests, ‘economic development often begins with MSEs, especially in developing countries’. Many agencies argue that MSEs are usually the majority of enterprises and a large source of work, whether formal or informal. Moreover, because of the high proportion business failure and high levels of informality MSEs are more sensitive and vulnerable to poor business environments. Thus, reforms that focus on the issues faced by MSEs will have more immediate and direct effects on the economy.

In his cross-country analysis of the impact of business environment reform on SMEs, Rocha (2012; 345) concludes that ‘it seems reasonable to support SMEs’ on the basis of their contribution to employment, value addition and productivity. While there are many inter-related factors that appear to vary across countries, overall, a large SME sector is more likely a sign on a competitive and enabling business environment than a poor one.

However, the World Bank (2014b; 169) argues that targeted support for SMEs needs to be ‘firmly rooted in a clear, evidence-based understanding of what distinguishes an SME and how the proposed support will sustainably remove the problems that constrain the ability of SMEs to contribute to employment, growth, and economic opportunity in developing economies’. Its review of the literature finds little evidence on the actual efficacy of the most common forms of targeted SME support, either for direct beneficiaries or, more broadly, for markets and economies. Thus, it recommends greater clarity when justifying and designing programme interventions that target smaller firms, clearly defining the objectives of interventions and presenting analytic justification for targeted-SME support. This should be based on country-specific diagnosis and a 'strategic framework that identifies the sequence and mix of systemic and targeted interventions that will address systemic challenges to SMEs, building markets and access to services' (p. 170).

It is also important to recognise that enterprise size may not be the only relevant criterion by which to select a firm for targeted support. For MSEs to be a 'meaningful category of enterprises, it should be a group of firms that is specifically differentiated from others by the way that it experiences particular policy, institutional, or market failures or the way it benefits the economy or the poor' (World Bank 2014b; 163).

In East Africa, developing entrepreneurs or strengthening enterprises is considered to be one of the most effective ways to stimulate economic growth, transformation and jobs in local communities. Some private sector partnerships were found to focus on enterprise development and labour demand stimulation interlinked with skills development to improve the employability of local workers (E4D/SOGA Employment and Skills for Eastern Africa (2018).

4.2 MSE reform objectives

The DCED (2008) Donor Guidance describes how development agencies design programmes to support reforms in developing countries that improve the business environment by reducing the legal, institutional and regulatory constraints for doing business. They support governments and other development partners their efforts to make the business environment more conducive to the growth and competitiveness of the private sector. This is done by reducing business costs and risks and increasing competitive pressures through new entry. Through these reforms, businesses are able to change their behaviours in ways that lead to increased levels of investment and innovation, and the creation of more and better jobs.

From the perspective of MSE development, business environment reform appears to have the following range of objectives:

- MSE growth: Many donor and development agencies are eager to support reforms that maximise the opportunities for economic growth and transform. This involves an assessment of the conditions for growth and specifically the identification of the factors that inhibit the growth of MSEs; some of which may be related to the business environment.
- Formalisation: Business environment reforms can contribute to the formalisation of informal firms. Many agencies highlight the importance of encouraging the formalisation of informal, or unregistered and unlicensed, MSEs. In part, this involves creating the conditions in which informal firms find that formalisation offers more benefits than cost, along with better enforcement mechanisms.
- Entrepreneurship: These reforms include the design and implementation of national entrepreneurship policies and programmes. This typically includes support for entrepreneurship education, finance, innovation, and culture and are mostly focused on entrepreneurial start-ups.
- Job quality: Reforms to labour and labour-related legal and regulatory regimes are relevant for many agencies because of the high number of people employed in the MSE sector and because of the job quality challenges MSE employment presents. There may be many MSE employers who don't comply with labour laws and regulations and agencies often look for reforms that encourage the formalisation of labour, while recognising the impact this may have in business costs.
- Women's economic empowerment: many women-owned and managed enterprises are micro and small. Thus, agencies focus on identifying the legal and regulatory barriers to women growing their businesses. As one agency put it: 'research shows that empowering women-led MSMEs to trade is good for the economy, good for society and good for women'.
- Responding to the problems of poor regions: MSE-oriented business environment reforms may focus on those areas where poor people are more prevalent and MSEs more common. While many

poor women and men live in urban settings, there are also poor rural economies that are some distance from commercial and administrative centres. Thus, reforms in these regions may be specifically focused on MSE concerns and opportunities.

- Supporting industry development: Supporting reforms that target industry sectors in which poor women and men operate businesses is the focus of a number of agencies. A common priority in this regard is the promotion of MSEs in the agriculture sector and the development of micro and small agri-businesses within agricultural value chains.
- Public-private dialogue: Support for public-private dialogue that ensures the participation of MSEs. Agencies argue that by promoting inclusive dialogue mechanisms, the private sector is supported in voicing its interests and in contributing to reform processes.

4.3 Reform challenges

The donor survey identified a number of challenges when supporting MSE-oriented reforms.

- Inhibiting growth and transformation: Focussing too exclusively on MSEs may not contribute to enhancing overall dynamics of the private sector as the engine of economic growth. Many agencies highlight the limitations such reforms may have on economic transformation. On the one hand, MSE-oriented reforms may have little impact on the binding constraints to growth experienced across the whole economy. On the other hand, many MSEs require more than just an improved business environment if they are to become more competitive and grow. Many agencies emphasised the systemic and interrelated nature of business environment reform, where, for example, enabling reforms in one sector may have unintended trade-offs for poor people in another sector or in general. Thus, programmes should adopt a systemic approach, looking at the whole ecosystem: working on the macro level with the government on framework conditions and industrial policy advice; on the meso level with business service providers to improve access to finance, trainings, education, services through value chain development, cluster support, innovation etc.; and on the micro level working through support to entrepreneurship, start-up, finance etc. However, it is recognised that this is not always easy with the programming cycles and budgets to tackle all necessary issues simultaneously.
- Lack of incentives to formalise: While many MSEs in developing and emerging markets try to stay 'under the radar' in the informal sector, due to taxation and corruption issues, the incentives to transition to the formal sector are often lacking. For example, in some countries MSEs still have to pay taxes once registered in the formal sector even if they produce no profit that year.
- How to identify the drivers and dynamics of informality: When encouraging firm formalisation, it can be risky to overemphasise support to formalise informal firms. This can stifle entrepreneurship and, if associated with costs or burdensome bureaucracy, make it difficult for entrepreneurs to stay competitive. It is often better to understand the drivers and dynamics of informality, and to design reforms and incentive mechanisms that are tailored to address the informal economy. One agency highlighted the need to find new solutions when dealing with the problem of informality.
- Overly simplistic, isolated reforms: Some agencies described the dangers of an 'overly simplistic' approach to labour reforms that seek to exempt MSEs. These reforms should not be treated in isolation; it is important to integrate impact on enterprise performance with other factors. Agencies should support effectively-designed regulation that assures protection of fundamental human rights, together with maintenance of an appropriate floor of minimum conditions. Respect for basic rights and minimum conditions demands some degree of regulatory burden, but this can be reduced through careful administration reforms.
- Limited government capacity: The work of donor and development agencies to support national governments in their reform of the business environment is often hindered by the limited capacity of developing-country government ministries, departments and agencies. Thus, while reforms attempt to create the right business environment with programming at the legal, regulatory and

policy level, it is also important to build the capacity of government to become more transparent and accountable, and to promote public-private consultative mechanisms with key business representative organisations to advocate for fair and equal laws and treatment.

- Lack of data: The lack of data in many developing countries inhibits an evidence-based approach in policy making. Moreover, there are very limited insights into the impact of government incentives on MSEs. Statistics and information on MSE priorities are often lacking. Macro-level indicators tend to be dominated by larger firms and relevant statistical data on the MSE sector and the economy is limited. In addition, informal businesses' situation is by nature hard to understand from statistics that are based on formal data only.
- Political economy: There are many power imbalances between MSEs and larger enterprises and with government authorities. Large enterprises are well resourced and better organised than the MSE sector. They also have greater political clout to influence favourable policy reforms It can be difficult to establish a political will for reforms that benefit the MSE sector.
- Integrating MSE into the supply chain: Because access to markets drive enterprise growth, it is important to support the integration of MSE into national and global supply chains. This often involves identifying the right sector to support reforms in, through for example, guidelines for value chain selection and selecting the right firms with most potential. Strengthening linkages between MSEs and larger enterprises, including foreign firms, may address such challenges, while local content policies can also be a useful way to encourage MSEs integration into supply chains.
- Measuring progress of reform programmes: It can be very difficult to quantitatively assess the constraints and priorities for MSEs and measure the impact of reforms. In addition to the generic business environment indices and reform monitoring, specific MSE surveys may be needed. This requires awareness of MSE problem and efforts to ensure the broader participation of MSEs, for example, when collecting private sector inputs. It also requires complementary interventions to actually improve capacity of MSEs to organise, make their voices heard, etc.
- Coordination challenges: There are coordination challenges in supporting MSE development and business environment reforms. For example, MSE development in the agriculture sector spans a wide range of government portfolios and sub-national levels of government, while also involves a complex array of large firms and MSEs. Thus, there is a need for coherent policy and effective information sharing and programme alignment between the ministries, departments and agencies. Similarly, because the number of MSEs can be so high, these enterprises tend to be not as well organised.

4.4 Creating preferences and exclusions

There are many arguments used to support the preferential treatment of MSEs in the business environment. These are largely based on the problems MSEs face that reduce their competitiveness and inhibit their growth. However, care should be taken when introducing preferential treatment for MSEs as this can lead to a systemic bias in the business environment in which smaller firms are favoured over larger firms. This can increase market distortions and lead to growth traps in which enterprise managers choose not to grow in order to avoid the legal and regulatory consequence of growing beyond the threshold.

The argument for preferential treatment

Because MSEs typically have specific reform needs that go beyond general business environment issues, many surveyed donor agencies suggested a more differentiated approach to the enterprise size criterion should be developed, while recognising the economy-wide impact of anticipated reforms. However, there is a risk of creating perverse incentives when creating a threshold of eligibility based on firm size. Introducing preferential treatment for one group over another may create a subsidised effect, encouraging firms to stay small to retain the subsidy.

While some claim that the 'one size fits all' theory that underpins the need for a level playing field is generally agreed on, the need for a case-by-case differentiation is worth considering. Furthermore, there may be a difference between 'de jure' and 'de facto' levelling, where a regulation may appear neutral, but has very different effects on firms of different sizes. With appropriate diagnostics, this should be identified and dealt with. Many agencies highlight the importance of understanding the national circumstances. This places higher demands on business environment assessment and governance issues and leads to the need for building the capacities of governments to introduce and manage reforms.

The argument against preferential treatment

There are two arguments against preferential treatment. This first concerns the importance of systems (i.e., market and government systems) and their influence on enterprise behaviour. The second concerns the unintended consequences of preferential reforms where markets are further distorted, and parallel business environments created based on enterprise size.

A market or systems-based approach has also been described as the 'tide that lifts all boats', arguing that reforms that improve the whole economy, and all enterprises regardless of their size, will flow on and lead to improvements for MSEs. Klein and Hadjmichael (2003) describe how establishing an equal playing field for all types of enterprises is often 'one of the most politically difficult parts of reform'. They argue that 'neither large nor small or medium-size firms should be favoured. What should be favoured are competition and the rule of law'. This view is supported by the World Bank (2014b; 170), which recommends reforms deal with the systemic problems of smaller firms within market and state systems. SME programmes should improve their relevance and additionality, including the role of intermediaries, rather than focusing on individual firm categories.

Survey respondents described how supporting reforms that focus specifically on smaller enterprises can dissuade firms from growing if they lose the rights to simplified processes or lower tax burdens. Thus, it may be more harmful to implement legislative reforms that benefit one size of business over another. Agencies should avoid reforms that make it attractive for an enterprise to remain small because of the specific benefits that only apply to MSEs.

The middle line: focus over preferences

Navigating between the 'for' and 'against' arguments, there appears to be an approach to reform that recognises and responds to the unique experiences of MSEs in the business environment, with reform measures that integrate the many factors that influence the competitiveness and growth of MSEs. Indeed, there is a strong argument for mainstreaming MSE concerns in business environment reforms. This means ensuring reforms are designed to benefit all firms regardless of their size, while also ensuring that MSE perspectives are fully captured in business environment assessments and programme monitoring.

Many agencies acknowledge that there may be a case where reforms targeting MSEs are warranted in a more direct and specified manner. They described the need to strike a balance between supporting MSEs while not putting larger enterprises at a disadvantage. This 'can be delicate', says one survey respondent. While it is important to promote a level playing field for all actors, it can also be risky supporting businesses that are only viable with specific exemptions or subsidises. Thus, reform programmes should establish clear criteria on which businesses to support to reduce this risk. For example, addressing the lack of access MSEs have to finance through the creation of a collateral registry may improve the credit-worthiness of MSEs. While this does not demand a size-differentiated approach, it is based on an analysis of the growth problems experienced in the MSE sector. This approach levels the playing field for all but has a greater benefit for MSEs; indeed, large enterprises may not have any need of a registry.

Donor and development agencies, and their partners, should develop a better understanding of how business environment reforms affect MSE growth. More awareness and evidence on MSE growth factors is needed to guide policy and legislation reforms.

Using an MSE lens to assess the business environment, and adopting a Think Small First approach to policy, legal and regulatory reform, donor and development agencies and their partners will focus on how to improve the business environment for the majority of businesses and not just a selected few. Thus, the use of exemptions or other forms of preference should only be applied, if justified, to a minority of firms (e.g., large firms, foreign investors).

4.5 Best practices

Drawing from the literature reviewed and the donor survey, the following practices are recommended for business environment reforms that benefit the MSE sector:

Give priority to levelling the playing field

In the first instance, business environment reform should focus on ensuring firms are not disadvantaged in the business environment based on their size or the sex of their owner. Business environment reforms should focus on unleashing potential, reducing bureaucracy and contributing to a more level playing field alongside larger firms for MSEs. Do not try to pick winners among enterprise size classes. A level-playing field should be equal for all players.

Simplify, reduce costs and improve transparency

At its most fundamental level, business environment reforms that benefit the MSE sector will be those that simplify the legal and regulatory regime, reduce the costs of compliance and improve the transparency of regulatory and administrative decisions for all firms. These reforms will improve the rule of law, reduce corruption and encourage a more accountable system of governance, which will improve the conditions for MSEs.

Invest in an objective assessment of the business environment

Donor and development agencies should place more effort on proper diagnostics. Greater attention should be given to improving the quality of data to guide policy making. This includes an assessment of how the business environment affects enterprises in different size classes, including MSEs.

Identify the causes and not just the symptoms

When assessing the business environment, donor and development agencies should work with their partners to carefully analyse national circumstances and contexts and to identify the root causes to poor MSE performance.

Think small, aim for growth

There appears to be general merit in and support for the EU Think Small First principle. This does not necessarily imply the need for preferential policy treatment for MSEs, but rather encourages reformers to understand how government policies, laws and regulations affect the MSE sector and its potential for growth. To think small first should not distract reformers from focusing on growth. Rather, this approach should allow the business environment to nurture MSEs growth and competitiveness.

Avoid single, isolated reform measures

The evidence is clear that reforms targeting a single, isolated element of the business environment do little to create the conditions for improved MSE growth and competitiveness. Avoid single, isolated reform measures that do not look at the whole system and understand how change in one part of the system may affect other parts.

Go beyond business environment reform

While the DCED 'functional areas' matter, policies and strategies and a functioning institutional support infrastructure are equally important. Enterprise-level constraints require adequate support as well. Much of the cost factors in the profit margin calculations are not only related to business environment, but also to intra-firm efficiency of processes, technology used, quality of product, etc.

Ensure integrated solutions

Provide an integrated approach to MSE development through technical and financial cooperation that includes creating suitable framework conditions and public-private dialogue, improving legislation, administrative provisions and bureaucratic procedures (e.g., registration and licensing), to reduce costs and risks for MSEs. In some cases, agencies have been focused on the challenges of the 'missing middle' or on the identification of high-growth 'gazelles'.

Improve representation and voice

Promote dialogue between the private and the public sector and ensure the MSE sector is able to participate in these processes. Donor and development agencies can support the development of skills and resources for MSE advocacy and strengthen their ability to effectively participate in public-private dialogue. Mihaylova and Poff (2018; 32) regular, ongoing public-private dialogue is an important tool to ensure the most vulnerable entrepreneurs, MSMEs and informal sector operators, 'have a voice and are able to participate in the policymaking process'.

Improve policy coordination and coherence

Good policy coordination and coherence is central to MSE development. In some cases, this may require a specialised MSE development agency (ILO 2016b). Such agencies can improve the coordination of government services, monitor the MSME sector and support programmes, and facilitate partnerships with other public- and private sector parties. In other cases, inter-ministerial mechanisms can be created to ensure the specific needs and opportunities of the MSE sector are addressed by government.

Apply a gender lens to reform

There are many underlying factors that affect the ways in which MSE operate in the business environment. One critical factor is the sex of the enterprise owner and manager. It is important to identify and address the cultural, social or legislative barriers that women-owned and managed enterprises face. The particular needs of women-led MSEs should be specifically addressed given their importance to inclusive economic growth and poverty reduction.

Monitor and evaluate to stay on track

Ensure there are regular reviews and robust feedback mechanisms in place so that reforms are achieving their intended outcome and are actually benefitting businesses. The World Bank (2014b) recommends an M&E framework that captures the effect of project interventions in three dimensions: beneficiary, client, and broader market. In all of these, information is needed to 'understand the counterfactual' (i.e., what would have happened without the project?) and where possible it is important to apply 'a rigorous, fact-based approach that generates information on the baseline, the post-project period, and control group'.

Invest in further research

There are many gaps in the knowledge on MSE development and the contribution of business environment reforms to improving MSE competitiveness and growth. The World Bank (2014b) argues for a tailored research agenda to support SME interventions. This should produce more policy and contextually relevant distinctions of the definition of SME and a better understanding of the dynamic contributions of SMEs to economic growth, employment, and poverty alleviation. A 'project-relevant definition of the frontier' is required, providing a clearer view of the correct sequencing and combinations of systemic and targeted approaches. This would include the use of enterprise surveys to better identify market failures and unmet demand for services, along with more use of panel data to better account for firm dynamics and give more confidence to the explanatory factors affecting firm growth and employment.

References

Acemoglu, D. and S. Johnson (2005) "Unbundling institutions", *Journal of Political Economy*, 113(5), pp. 949–995.

Association of Chartered Certified Accountants (2016) *SME development in ASEAN*, ACCA, London: http://www.accaglobal.com/content/dam/ACCA_Global/Technical/smb/pi-sme-development-asean.pdf

Aterido, R., M. Hallward-Driemeier, and C. Pages (2007) 'Investment Climate and Employment Growth: The Impact of Access to Finance, Corruption and Regulations Across Firms', *IZA Discussion Paper* No. 3138, November

Ayyagari, M., T. Beck, and A. Demirgüç-Kunt (2003) 'Small and Medium Enterprises across the Globe: A New Database, *World Bank Policy Research Working Paper* 3127

Ayyagari, M., A. Demirgüç-Kunt and V Maksimovic (2013) 'Size and age of establishments: evidence from developing countries', *World Bank Policy Research Working Paper* 6718, Washington DC

— (2011) 'Small vs. young firms across the world: contribution to employment, job creation, and growth', *World Bank Policy Research Working Paper* 5631, Washington DC

Beck, T., A. Demirgüç-Kunt and V. Maksimovic (2005) Financial and legal constraints to firm growth: does size matter? The Journal of Finance, Volume LX, No. 1, February

Beck, T. and R. Cull (2016) 'SME Finance in Africa' *World Bank Group Policy Research Working Paper* 7018, World Bank, Washington DC

Berg, J. and S. Cazes (2008) 'Policymaking gone awry: The labour market regulations of the doing business indicators', *Comparative Labour Law and Policy Journal*, 29 (4): 349–382.

Besley, T., and R. Burgess (2004) 'Can Labour Regulation Hinder Economic Performance? Evidence from India', *Quarterly Journal of Economics* 119(1): 91-134.

Birch, D. (1981) 'Who Creates Jobs?' *The Public Interest* 65, 3-14.

Boly, A. (2015) 'On the benefits of formalization; panel evidence from Vietnam', UN WIDER Paper 2015/038.

Bromley, D.W. (2009) 'Formalizing Property Relations in the Developing World: The Wrong Prescription for the Wrong Malady', *Land Use Policy* 26(1): 20–27

Bruhn, M. (2013) A tale of two species: revisiting the effect of registration reform on informal business owners in Mexico' *Journal of Development Economics* 103: 275-83

— (2011) 'License to sell: the effect of business registration reform on entrepreneurial activity in Mexico', *Review of Economics and Statistics*, 93(1) pp. 382–386

Calvino, F., C. Criscuolo and C. Menon (2016), "No Country for Young Firms?: Start-up Dynamics and National Policies", *OECD Science, Technology and Industry Policy Papers*, No. 29, OECD Publishing, Paris.

Chakrabarti, S. (2014) 'The formal-informal dichotomy: Revisiting the debate on the agriculture-industry linkage', Economic and Labour Relations Review, 25 (1): 154-178.

Chen, M.A, (2007) 'Rethinking the Informal Economy: Linkages with the Formal Economy and the Formal Regulatory Environment', DESA Working Paper No. 46, July, ILO, Geneva

Chen, M. (2005) 'The Business Environment and the Informal Economy: Creating Conditions for Poverty Reduction', Paper for Committee of Donor Agencies for Small Enterprise Development Conference on 'Reforming the Business Environment' November, Cairo

Commission on Legal Empowerment of the Poor (2008) *Making the law work for everyone; Report on the Commission on Legal Empowerment of the Poor*, United Nations Development Programme, New York

Cousins, B., T. Cousins, D. Hornby, R. Kingwill, L. Royston and W. Smit (2005) 'Will formalizing property rights reduce poverty in South Africa's 'second economy'? Questioning the mythologies of Hernando de Soto', in Programme for Land and Agrarian Studies – PLAAS, "Debating land reform, natural resources and poverty", Policy Brief No 18, October

Criscuolo, C., P. Gal and C. Menon (2014), "The Dynamics of Employment Growth: New Evidence from 18 Countries", *OECD Science, Technology and Industry Policy Papers*, No. 14, OECD Publishing, Paris

de Mel, S., D. McKenzie and C. Woodruff (2011) "Getting Credit to High Return Microentrepreneurs: The Results of an Information Intervention" *The World Bank Economic Review*, Vol. 25, No. 3, pp. 456-485

— (2008) 'Who Are the Microenterprise Owners? Evidence from Sri Lanka on Tokman v. De Soto', World Bank Policy Research Working Paper 4635.

De Soto, H. (2000) *The Mystery of Capital: Why Capitalism Thrives in the West and Fails Everywhere Else*, Basic Books, New York

Donor Committee for Enterprise Development (2017a) Policies that promote SME participation in public procurement, Technical Report, Business Environment Working Group, DCED, Cambridge UK

— (2017b) *What do we know about the effectiveness of business registration support and reforms*, Working Document, August

— (2016a) *Supporting sector-focused business environment reform in developing countries; Annex: Supporting business environment reforms; Practical guidance for development agencies*, Donor Committee for Enterprise Development, Cambridge, UK

— (2016b) *Supporting regional and sub-national business environment reform; Annex: Supporting business environment reforms; Practical guidance for development agencies*, Donor Committee for Enterprise Development, Cambridge, UK

— (2016c) *Gender and business environment reform; Annex: Supporting business environment reforms; Practical guidance for development agencies*, Donor Committee for Enterprise Development, Cambridge, UK

— (2016d) *Business environment reform and gender*; Technical Report, DCED, Cambridge UK

— (2011) *How business environment reform can promote formalisation*; Annex to the Practical Guidance on Supporting Business Environment Reform, Business Environment Working Group, DCED, Cambridge UK

— (2008) *Supporting business environment reforms; Practical guidance for development agencies*, Business Environment Working Group, DCED, Cambridge UK

Doyle, L. Bjerten, E and G. Milante (2016) 'Shadow economies: Informal and illicit markets in fragile contexts', Forum Policy Brief No. 17.

de Mel, S., D.J. McKenzie, and C. Woodruff (2009) 'Are Women More Credit Constrained? Experimental Evidence on Gender and Microenterprise Returns.' *American Economic Journal* 1(3), 1–32

— (2008) 'Returns to Capital in Microenterprises: Evidence from a Field Experiment', *The Quarterly Journal of Economics* 123 (4): 1329–73.

E4D/SOGA Employment and Skills for Eastern Africa (2018) *Annual Progress Report*, March, German Ministry for Economic Cooperation and Development, UK Department for International Development, Norwegian Agency for Development Cooperation, Shell, and Deutsche Gesellschaft für Internationale Zusammenarbeit

Etuk, R.U., G.R. Etuk and B. Michael (2014) 'Small And Medium Scale Enterprises (SMEs) And Nigeria's Economic Development', *Mediterranean Journal of Social Sciences*, 5(7)

European Commission (2012) *Operational guidance on assessing impacts on micro-enterprises in Commission Impact Assessments*, Ref. Ares (2012)557005 - 07/05/2012

European Commission (2012) *Operational guidance for assessing impacts on sectoral competitiveness within the commission impact assessment system; A "Competitiveness Proofing" Toolkit for use in Impact Assessments*, Commission Staff Working Document, SEC (2012) 91 Final, 27-01-2012, Brussels

European Commission (2013) Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions; Smart regulation - Responding to the needs of small and medium - sized enterprises, COM(2013) 122 final, 7 March, Brussels

— (2011) *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions: Review of the* "Small Business Act" for Europe, COM(2011) 78 final, 21 September, Brussels

— (2011) *Minimising regulatory burden for SMEs; Adapting EU regulation to the needs of micro-enterprises*; Report from the Commission to the Council and the European Parliament, COM(2011) 803 final, 23-11-2011, Brussels

European Union (2017) *2017 SBA Fact Sheet and Scoreboard*, Internal Market, Industry, Entrepreneurship and SMEs, Brussels

Fafchamps, M., D. McKenzie, S. Quinn, and C. Woodruff (2013) 'Microenterprise Growth and the Flypaper Effect: Evidence from a Randomized Experiment in Ghana', *World Bank Working Paper*, July

Fajnzylber, M., and Montes-Rojas (2011) 'Does formality improve micro-firm performance? Evidence from the Brazilian SIMPLES program', *Journal of Development Economics*, 94: 262-276.

Fajnzylber, P., W. Maloney and G. Montes Rojas (2009) 'Releasing constraints to growth or pushing on a string? Policies and performance of Mexican micro-firms' *Journal of Development Studies* (45) 1027–1047.

Federal Ministry for Economic Co-operation and Development (2013) *Sector Strategy on Private Sector Development*, BMZ Strategy Paper 9, Federal Republic of Germany, Bonn

Fenwick, C., J. Howe, S. Marshall, and I. Landau (2007) *Labour and labour-related laws in micro and small enterprises: Innovative regulatory approaches*, SEED Working Paper 81, ILO Geneva

Fiala, N. (2015) Rethinking the microfinance model: Returns to subsidized microcredit for male and female entrepreneurs in Uganda, December, IPA, New Haven

Global Affairs Canada's (2017) *Canada's Feminist International Assistance Policy*, Ottawa

Godfrey, S., Maree, J., and Theron, J. (2006) Conditions of Employment and Small Business: Coverage, Compliance and Exemptions.

Hallberg, K. (2000) *A market-oriented strategy for small and medium-scale enterprises*, Washington DC: World Bank.

International Finance Corporation (2013) *Jobs study: assessing private sector contributions to job creation and poverty reduction*, World Bank, Washington DC

International Labour Conference (2015) *Recommendation No. 204 Concerning the Transition from the Informal to the Formal Economy*, Recommendation adopted by the Conference at its 104th Session in Geneva, on 12 June 2015

— (2006) *Business environment and small enterprises*, ILC 95th Session, Geneva.

— (2006) *Debate concerning environment, labour law and micro and small enterprises,* Committee November

— (2003) *A report on micro and small enterprise policy review in Nepal*, SRO New Delhi, September

— (2002) *Conclusions concerning informal economy*, 90th Session, Geneva, 2002 (Geneva)

— (1998) *Job creation in SMEs,* Recommendation Number 189, 86th ILC session, 17 June, Geneva

International Labour Organization (2018a) Women and men in the Informal Economy – A Statistical Picture, ILO, Geneva

— (2018b) *World Employment and Social Outlook: Trends 2018,* ILO, Geneva

— (2017) *World Employment and Social Outlook: Sustainable enterprises and jobs,* ILO, Geneva

— (2016a) *Policies, Strategies and Practices for the Formalisation of Micro and Small Enterprises; Introductory Brief – Enterprise Formalisation*, ILO, Geneva

— (2016b) *SME promotion agencies: is there a best set-up? A quest for good practices*, International Labour Office, Geneva

— (2016c) 'Formalization of SMEs in supply chains in Latin America: what role for multinational enterprises?' *Thematic Policy Brief – Enterprise Formalization*, ILO, Geneva

— (2014) *Policies for the formalization of micro and small enterprises*, ILO Programme for the Promotion of the Formalization in Latin America and the Caribbean, ILO Regional Office for Latin America and the Caribbean

— (2005) *A review of the policy and regulatory environment for MSEs in Uttar Pradesh*, supported by the Norwegian Development Cooperation (NORAD), SRO New Delhi

Japan International Cooperation Agency (2013) *Thematic Guidelines Small and Medium Enterprise (SME) Promotion*, October, JICA, Tokyo

Kanji, I. A. (2015) *Role of Finance in Driving Formalization of Informal Enterprises*, ILO, Geneva

Kar, S. (2016) 'Do economic reforms hurt or help the informal labour market?' IZA World of Labour 263 DOI: 10.15185/izawol.263

Kaufmann, F. and W. Parlmeyer (2006) 'The Dilemma of Small Business in Mozambique: A Research Note', *International Research in the Business Disciplines*, 5, 203-214

Kenyon, T. and E. Kapaz (2005) 'The Informality Trap', Viewpoint Series, Note 301. World Bank Group, Private Sector Development Vice-Presidency, Washington, DC.

Kerekes, C.B. and C.R. Williamson (2008) 'Unveiling de Soto's mystery: property rights, capital formation, and development', *Journal of Institutional Economics*, 4(33), 299–325.

Klapper, L.F. & & S.C. Parker (2011) 'Gender and the Business Environment for New Firm Creation' *The World Bank Research Observer*, Vol. 26, No. 2, pp. 237-257

Klapper, L., A. Lewin, and J.M. Quesada Delgado (2009) 'The Impact of the Business Environment on the Business Creation Process', *World Bank Policy Research Series*, Working Paper 4937.

Klein, M. and B. Hadjmichael (2003) *The private sector in development*, World Bank, Washington DC

La Porta, R and Shleifer, A (2008) 'The Unofficial Economy and Economic Development', Brookings Papers on Economic Activity, Economic Studies Program, The Brookings Institution, vol. 39(2) Fall, 275-363.

La Porta, R. and A. Shleifer (2014) 'Informality and Development', The Journal of Economic Perspectives, Vol. 28, No. 3 (Summer), pp. 109-126.

Loewe, M., I. Al-Ayouty, A. Altpeter, L. Borbein, M. Chantelauze, M. Kern, E. Niendorf, and M. Reda (2013) Which Factors Determine the Upgrading of Small and Medium-Sized Enterprises (SMEs)? The case of Egypt, German Development Institute (DIE), Bonn

Martinez Peria, M.S. & S.Singh (2014) 'The Impact of Credit Information Sharing Reforms on Firm Financing', *Policy Research Working Paper* 7013, World Bank, Washington DC

McCulloch, N., Schulze, G., and Voss, J. (2010) 'What determines firms' decisions to formalize?' *Discussion Paper* Series 13, University of Frieburg, Department of International Economic Policy

McKenzie, D. (2009) Impact Assessments in Finance and Private Sector Development; What Have We Learned and What Should We Learn? *Policy Research Working Paper* 4944, World Bank, Washington DC

Mihaylova, T. (2018) 'Combating corruption through collective action in Armenia' in Centre for International Private Enterprise (2018) *Strategies for policy reform case studies in achieving democracy that delivers through better governance*, Volume 3, Centre for International Private Enterprise, Washington DC

Mihaylova, T. and E. Poff (2018) Formalizing public-private dialogue with the small and medium-sized enterprise sector in Senegal' in Centre for International Private Enterprise (2018) *Strategies for policy reform case studies in achieving democracy that delivers through better governance*, Volume 3, Centre for International Private Enterprise, Washington DC

Monteiro, J.C.M. and J.J. Assunção (2012) Coming out of the shadows? Estimating the impact of bureaucracy simplification and tax cut on formality in Brazilian microenterprise, *Journal of Development Economics*, (99) 1, September, pp. 105–115

North, D. 1990, *Institutions, Institutional Change and Economic Performance*, Cambridge University Press, Cambridge

Organisation for Economic Co-operation and Development (2016) *Preventing corruption in public procurement*, Paris

Payne, G., A. Durand-Lasserve, and C. Rakodi (2009) *The limits of land titling and home ownership, Environment and Urbanization International Institute for Environment and Development (IIED).* Vol 21(2): 443–462

Reinecke, G. and White, S. (2004) *Policies for small enterprises: Creating the right environment for good jobs* ILO, Geneva

Rocha, E.A.G. (2012) 'The Impact of Business Environment on Small and Medium Enterprise Sector's Size and Employment: A Cross Country Comparison', *Procedia Economics and Finance* 4, 335-349

Schleifer, M. and M. Nakagaki (2018) 'Empowering women entrepreneurs in Bangladesh', in Centre for International Private Enterprise (2018) *Strategies for policy reform case studies in achieving democracy that delivers through better governance*, Volume 3, Centre for International Private Enterprise, Washington DC

Shepherd B., O. Cattaneo and C. Tsai (2015) *Regulatory Reform: Case Studies on Improving the Business Environment for Small and Medium Enterprises (SMEs),* Asia-Pacific Economic Cooperation Secretariat

Stupnytska, A., K. Koch, A. MacBeath, S. Lawson and K. Matsui (2014) *Giving Credit Where It Is Due: How Closing the Credit Gap for Women-Owned SMEs Can Drive Global Growth*. Goldman Sachs.

United Nations Conference for Trade and Development (2012) *Entrepreneurship Policy Framework and Implementation Guidance*, United Nations, Geneva

United National Industrial Development Organisation and Unite Nations Office of Drugs and Crime (2012) *Corruption prevention to foster small and medium sized enterprises development*, Vol. 2, Vienna

Vandenberg, P. (2005) 'The relevance of firm size when reforming the business environment', background paper for the international conference 'Reforming the Business Environment: from assessing problems to measuring results', DCED, Cairo, Egypt 29 November –1 December 2005

—(2006) *Poverty reduction through small enterprises: Emerging consensus and key issues*, ILO SEED Working Paper 75

White, S. (2016) Beyond national business environment reform: a review of donor agency support for regional and local business environment reform

— (2015) Supporting sector-focused business environment reform in developing countries, Donor Committee for Enterprise Development, Cambridge, UK

— (2014) *Labour Laws, the Business Environment and the Growth of Micro and Small Enterprises in South Asia*, ILO DWT for South Asia and Country Office for India, New Delhi

— (2005) Assessing the influence of the business environment on small enterprise employment; An assessment guide, ILO SEED, Geneva

White, S. and P. Fortune (2015) *Business Environment Reform and Poverty: Rapid Evidence Assessment.* UK Aid, Coffey International Development, London

White, S., W, Steel and A. Larquemin, (2017) *Financial services and small and medium-sized enterprise growth and development*, Department for International Development, London

World Bank (2017) *Providing essential infrastructure in fragility, conflict and violence-affected states: A toolkit for enabling SME participation*, World Bank Group and Public-Private Infrastructure Advisory Facility

— (2016) *Benchmarking Public Procurement 2017: Assessing Public Procurement in Regulatory Systems in 180 Economies*, World Bank, Washington, DC

— (2014a) Global Financial Development Report; Financial Inclusion, World Bank, Washington DC

— (2014b) *The Big Business of Small Enterprises: Evaluation of the World Bank Group Experience with Targeted Support to Small and Medium-Size Enterprises, 2006–12*, World Bank, Washington DC

— (2013) *World Development Report 2013: Jobs*, World Bank Group, Washington DC

World Intellectual Property Organization (2005) *Intellectual Property and Traditional Knowledge*, Booklet No 2. Publication No. 920(E)

Zinnes, C. (2009) *Business Environment Reforms and the Informal Economy*, DCED, Cambridge.

Annex 1: Term of reference

Creating Better Business Environments for Micro and Small Enterprises

Preparation of a Scoping Report

Introduction

Established by the Donor Committee for Enterprise Development (DCED) in 2002, the Business Environment Working Group (BEWG) serves as a platform for professional peers to share information and knowledge on donor-supported business environment reform (BER) in developing countries and to identify, promote and support good practices in this field. The BEWG strives to help agencies and their programme partners to strategically and effectively position BER as a part of an integrated private sector development strategy and to enhance the synergies between these reforms and broader development objectives. While the BEWG primarily serves the interests of member agencies working in this field, it also endeavours to reach out to programme partners (i.e., developing country governments, business membership organisations and other civil society organisations), to directly learn from and contribute to the work of these actors.

The mission of the BEWG is to serve as a multi-donor platform for sharing knowledge, experience, and best practices in supporting business environment reforms. The BEWG supports its members in their efforts to deal with the political and technical challenges they experience in designing, managing, financing, and measuring BER programmes.

Background

It has long been recognised that a poor business environment can disproportionately affect small enterprise development. However, it is unclear whether this requires reforms that are specifically attuned to the needs, constraints and dynamics of small enterprises or whether these effects are simply a reality small enterprises face due to their size and limited resources. For example, should different legal and regulatory frameworks be created for small enterprises, or do parallel business environments create incentives for staying small?

It is also a challenging fact that in many countries, many if not most, micro and small enterprises (MSEs) are not formal. Thus, BER could be considered as an important contribution for the reduction of informality among MSEs.

The BEWG will examine these issues more closely by commissioning research on the size and type differentiation in legislation and regulations. This will include a focus on informal microenterprises. This research will consider the theory and practice behind these differentiated approaches, and review the published evidence regarding the effects these approaches have on small enterprise growth, employment creation and investment. Special consideration will be given to the influence of the business environment on supporting early-stage business growth (possibly including ‘entrepreneurial ecosystems’) and the effects of labour laws and regulations for small enterprises. Some consideration will be given to promoting high-growth MSEs.

Objectives

The objectives of the study is to:

- Review the literature on BER and its impact on MSEs in developing economies;
- Review donor and development agency BER support programmes and identify the extent to which enterprise size and formality feature and the tools and processes used;
- Prepare a typology of reforms as they relate to enterprises of different size classes and degrees of formality;

Recipient

The recipient of this work will be the BEWG and its members. Other donor agencies, development practitioners and governments interested in business environment reform and investment promotion may also benefit indirectly.

Activities

1. Review literature, programme documents and other resource material;
2. Consult (via email, Skype, telephone and face-to-face interview) selected DCED member agencies on their BER support programmes focused on MSEs and informality;
3. Prepare a draft report for consideration by the BEWG;
4. Review the draft report based on comments received and submit a final version.
5. Conduct a workshop to disseminate the outcomes of the study and discuss the way forward.

Outputs

Three outputs will be produced:

1. Project Inception Report: this will present a detailed framework and approach to the work and will be discussed at the December 2017 BEWG. See Annex 1 for a proposed structure of this report.
2. Scoping Report: this is the main report. It will present the findings of the study and contain lessons and recommendations. See Annex 2 for a proposed structure of this report.
3. Presentation on the Scoping Report: this will be a set of up to 20 presentation slides (MS PowerPoint) containing the main findings, lessons and recommendations of the project.

Methodology and approach

The consultant will mostly base this report on a desk-based literature review, supplemented through email, telephone and Skype exchanges, as well as through face-to-face interviews with practitioners, donor agencies, and other stakeholders or researchers.

Annex 2: Questionnaire and consultation responses

Respondents:

1. Food and Agriculture Organization (FAO)
2. German Technical Cooperation (GIZ GmbH)
3. Global Affairs Canada
4. International Labour Organization (ILO)
5. Japan International Cooperation Agency (JICA)
6. Manuel Associates Ltd. (formerly Law and Development Partnership and managers of the DFID-funded LASER programme)
7. Netherlands Ministry of Foreign Affairs
8. Sweden International Development Agency (SIDA)
9. Swiss State Secretariat for Economic Affairs (SECO)
10. United Kingdom Department for International Development (DFID)
11. United National Industrial Development Organization (UNIDO)
12. World Bank Group
13. United States Agency for International Development (USAID)

Why are donor and development agencies interested in supporting business environment reforms that focus on MSEs?

- Economic development often begins with MSEs, especially in developing countries.
- For some agencies, there is no specific or exclusive rationale for supporting MSEs. This work falls support for inclusive and sustainable industrial development, which is undertaken through technical cooperation projects under various themes, such as creating shared prosperity, advancing economic competitiveness, and safeguarding the environment. Overall, employment creation and income generation are common justifications for supporting business environment reform.
- MSEs are usually the majority of enterprises, and a large source of work, whether formal or informal. Because of the high proportion business failure and high levels of informality MSEs are sensitive to poor business environments.
- Private sector development is directly related to the twin goals of ending extreme poverty and boosting shared prosperity. MSE's and informal firms represent the bulk of firms in developing countries, often about 90%. Agencies are interested in the incentives to formalise and determining factors for firm growth.
- Agency work on women's economic empowerment: many women-headed organisations are micro and small. Thus, agencies focus on identifying the legal and regulatory barriers to women growing their businesses.
- Agencies without a specific focus on MSEs describe how targeting enterprises based on size is dependent on the analysis of national context.
- As MSMEs account for approximately 90% of firms and more than 70% of global employment, they have a key role to play in achieving the SDGs. Improving MSMEs enabling environment and performance can translate into more jobs and help reduce poverty. Benefits are particularly strong for women entrepreneurs - research shows that empowering women-led MSMEs to trade is good for the economy, good for society and good for women.
- Small and medium-sized enterprises (SME) are the backbone of many economies. In partner countries they represent on average more than 90 percent of all enterprises. Formal and informal SMEs employ around 93 percent of the working population and contribute to around 70 percent of the national GDP. In order to promote growth within the SME sector and strengthen its competitiveness and impact on employment in partner countries, the Federal Ministry for Economic Cooperation and Development (BMZ) pursues an integrated approach supporting the SME sector by

means of both technical and financial cooperation. Creating suitable framework conditions and public-private dialogue, improving legislation, administrative provisions and bureaucratic procedures, e.g. registration and licensing, helps to reduce costs and risks for SMEs. By promoting inclusive dialogue mechanisms, the private sector is supported in voicing its interests and in contributing to reform processes.

- The majority of poor people currently work in informal micro and small enterprises (an average of 60% in sub-Saharan Africa). DFID's Economic Development Strategy sets out a vision for improving conditions in the sectors where most of the poor people work to help them increase returns from their existing work. We want to work with partner governments to improve their investment climates to reduce barriers for small firms and create opportunities for more firms to compete on fair terms. With small and medium-sized enterprises predicted to play an important role in economic transformation, DFID wants to ensure that the benefits of formalisation outweigh the costs. However, the majority of DFID's business environment reform programmes do not discriminate based on the size of the business as we focus on making the environment better for all enterprises. Often this will have a particular benefit for smaller enterprises through levelling the playing field or will be accompanied with other private sector development facilities to provide more targeted support to small or medium enterprises.
- Because BERs are an important component of UNCTAD's Entrepreneurship Policy Framework, along with other components looking at entrepreneurship education, finance, innovation and culture
- "It's a tide that lifts all boats". SMEs are the backbone of many emerging market economies; they create jobs and stimulate inclusive growth that comes to the benefit of a broad population.
- Due to a number of reasons, such as:
    - Most of our partner countries' economies are dominated by micro and small firms;
    - Similarly, most of the employment in our partner countries is found among these businesses;
    - Considering that the poor work predominantly in these businesses, if any, it is a more effective poverty reduction tool than focusing on larger firms;
    - Similarly, as above, and given our clear objective to reduce gender inequality, these firms are seen as a constructive area of work considering that women tend to be concentrated in those rather than larger firms;
    - Similarly, as above, it is also a means - or forces us - to reach geographically disadvantaged areas.
- FAO understands that micro and small enterprises represent poor people operating in the informal sector and who use the resources, including labour, at their disposal to make a living.
- The old thinking in our agency was that MSEs employ most of the poor in our host countries, and business registration reforms in particular would make it easier for these firms to formalize and therefore grow. However, with new research showing that these reforms do not address the basic reason microenterprises (and many small firms) don't formalise because they don't want to grow, more attention and resources are turned towards facilitating specific transactions, there's been less interest in BER in general, and targeting MSEs in particular.

Are there any specific concerns (or risks) you have with supporting reforms that focus on the micro and small enterprise sector? What are these concerns and how do you address these?

- The ILO would be concerned about overly simplistic reforms to applicable labour regulation. While it must have some impact on enterprise performance, it should not be looked at in isolation from other factors (as suggested in the previous question). The ILO might consider "reform" approaches that simply move to exclude MSEs from labour regulation as simplistic in this sense. The ILO would support effectively-designed regulation: that is, regulation that can assure protection of fundamental human rights, together with maintenance of an appropriate floor of minimum conditions. Respect for basic rights and minimum conditions does not mean that the regulatory burden can also be reduced – perhaps through attention to the administration of regulation, in addition to consideration of the specific rules.

- No concerns. we want to find new solutions to dealing with informality.
- Across the board reform can in some cases disproportionately assist micro enterprises, e.g., business entry simplification - therefore in some cases no need to play the micro/small card.
- Applying a gender lens is vital on some issues, e.g., property rights/A2F
- Getting BE basics right might simply not be sufficient to trigger the set-up, growth and development of MSEs. Supplementary/additional support programmes/measures will likely be required for this.
- One would like to avoid the situation where it would be attractive for an enterprise to remain an MSE because of the specific benefits that only apply to MSE's.
- In some cases, over-focusing on MSEs may not contribute to enhancing overall dynamics of the private sector as the engine of economic growth.
- German Development Cooperation uses a systemic approach and looking at the whole ecosystem, i.e. working on the macro level with the government on framework conditions and industrial policy advice, on the meso level with business service providers to improve access to to finance, trainings, education, services through value chain development, cluster support, innovation etc., and on the micro level working through support to entrepreneurship, start-up, finance etc. But is is not always easy with the programming cycles and budgets to tackle all necessary issues simultaneously.
- There is a risk that by focusing reforms on smaller enterprises, they are disincentivised from growing if they lose the rights to simplified processes or lower tax burdens; therefore in some instances it may be more harmful to implement legislative reforms that benefit one size of business over another.
- The political instability of some developing countries. If there are elections the momentum for regulatory reforms may be lost
- Striking the balance between supporting micro and small enterprises and not putting other (bigger) players at a disadvantage can be delicate. In the end it should be about promoting a level playing field for all actors.1) E.g. within access to finance, one potential risk is that of supporting businesses that are only viable with subsidized credit, which would not be sustainable. Mitigation would be through avoiding towards direct subsidization, setting up clear criteria on which businesses to support, etc. N.b. This is more of a potential risk rather than self-experienced. 2) Another risk is that of pushing formalization measures too hard. This can stifle entrepreneurship and, if associated with costs or burdensome bureaucracy, make it difficult for entrepreneurs to stay competitive. A better understanding of the dynamics of the informal sector, examining incentives and disincentives in formalization.
- Enabling reforms in one sector may have unintended trade-offs for poor people in another sector or in general.

Are there any specific challenges you face when targeting support for reforms focused on the micro and small enterprise sector? How have you attempted to address these challenges?

- A challenge is the lack of data in developing countries. lack of data in turn does not enable an evidence-based approach in policy making. Also, there are very little insights into the impact of government incentives to SMEs (do firms grow?)
- Key challenge is need for political will and interest. Local content policies can be a useful way in to encourage micro / small enterprise integration into supply chain
- Micro and small enterprises are often operating informally which adds to the difficulty of ensuring their proper involvement in consultative/dialogue processes that seek to determine business environment reform needs and measures on the ground. Otherwise our interventions are often directed at the production/plant level and hence geared more towards technical solutions in the context of enterprise development work.

- Yes, the concerns raised in the previous answers may be also challenges. Considering strengthening linkages between MSE sector and larger enterprise sector including foreign companies may be one of attempts to address such challenges.
- The main challenge is identifying the right incentives/programs to encourage MSMEs to transition from the informal into the formal sector. Many MSMEs in emerging markets try to stay "under the radar" in the non-formal sector due to taxation and corruption issues - the incentives to transition to the formal sector are lacking in many countries. For example, in some countries MSMEs still have to pay taxes once registered in the formal sector even if they produce no profit that year. MSMEs that pay their taxes feel that they become uncompetitive against those that don't pay taxes, as a result there is little or no incentive to do so. GAC has attempted to address this persistent challenge by building the right business enabling environment with programming at the legal, regulatory and policy level, building the capacity of government departments to become more transparent and accountable, and promoting public-private consultative mechanisms with key business institutions and associations to advocate for fair and equal laws and treatment.
- Identifying the right sector to gear support to: we have development guidelines for value chain selection together with ILO, we developed a toolbox for industrial policy support with UNIDO (www.equip-project.com)... Selecting the "right" companies with most potential: we have long-term work relations in most countries and permanent project structures in the countries, use instruments such as competitions, hackathons, labs....
- Lack of solid data, predominance of the informal sector
- informality remains one of the main challenges. Providing incentives to formalize is one potential remedy but eventually one needs to accept that the informal sector is not likely to disappear anytime soon.
- Coordination challenges, since just the amount of micro and small businesses is so high and they tend to be not as well organized as larger firms. This is of course especially true for informal businesses.
- Skills in, and resources for, advocacy and participating in public-private dialogues can be very limited.
- Statistics and information on micro and small businesses' priorities are often lacking. Macro-level indicators tend to be dominated by larger firms (both statistically, e.g. what drives investment or export generation, and information-wise as they tend to be better at influencing policy). In addition, informal businesses' situation is by nature hard to understand from statistics that are based on formal data only. Related, measuring progress of programs is challenging. Additional surveys might therefore sometimes be needed. These factors result in it being more difficult to understand the constraints and priorities for micro and small businesses. Addressing them comes through, firstly, awareness and ensuring a broader participation when e.g. collecting private sector inputs, and secondly designing complementary interventions to actually improve capacity of these businesses to organize, make their voices heard, etc.
- In many countries, the survival rate of micro and small businesses is very low. One challenge is how to actually support the growth and sustainability of firms rather than mere creation. Another challenge is with regard to measuring progress, as we are too often focused on measuring only the number of new businesses rather than looking at what happens to them.
- Finally, and more generally, there is not always an awareness of the fact that smaller businesses might have other difficulties and priorities than larger firms. "Neutral" investment climate programs can sometimes disproportionately benefit larger firms. This must be dealt with through a number of measures, hopefully the brief can contribute to this.
- Micro and small enterprises in agriculture often fall between the mandate crevices of Ministries of Ag and Trade. Measures taken focus on sensitizing both ministries and convening meeting which enable cross-sectoral dialogue

Do you have an opinion on the effectiveness on applying a size differentiation in legislation and specifically targeting micro and small enterprises? If so, please describe this.

- I do not know of much real evidence about this, to be honest. But of course there may be literature (lots of it, even). Any attempt to consider the effectiveness of exemptions from labour regulation should also take into account the relative significance of labour regulation for MSE performance (however measured).
- Beyond incentivizing firms by size we need to think how governments can support firms that have the potential to grow
- The vast majority of businesses in all countries are micro / small. Business legislation should therefore 'think small first' - the exception should be large companies. Eg 'core company law' approach to business entry
- MSEs will likely have specific business environment reform needs that go beyond 'general' business environment reform issues. In principle one could therefore argue that the more differentiated the 'size' criterion is captured the more effective any specific legislation resulting from this could be (we need to remember that there is some legislation in place that is based on company size; not sure about the impact such differentiation has had empirically). At the same time such an approach implies higher demands into business environment reform governance issues (management, implementation) and hence into capacities that may not readily be available everywhere.
- We would think that it could be useful and in fact necessary to take into account specific characteristics with regard to the size of enterprises.
- It totally depends on the national circumstances.
- The majority of DFID programmes do not apply a size differentiation in legislative reforms, but often reforms can have a greater impact on micro, small and medium sized enterprises than larger businesses. A project in Nigeria supported the Corporate Affairs Commission to remove the requirement to use professional intermediaries (e.g. lawyers or accountants) to register a business. This, coupled with a comms campaign, resulted in a 900% increase of business registrations between 2013 and 2014 and an annual saving of £25m to businesses. Whilst this did not apply a different approach in legislation for different business sizes, it would have had a great positive impact on smaller businesses as they are more likely to operate in the informal sector and would have been disincentivised from formalising due to the costs involved. Whilst not a legislative reform, one of our programmes focuses on improving access to finance for small and medium–sized enterprises. Through this programme, DFID and the IFC have worked with local banks to create collateral registries which have helped them assess the credit-worthiness of SMEs. Whilst this programme is only part-way through, it is already showing positive results, with more SMEs able to access finance, and is having a strong impact on women-owned SMEs in particular. The different system for smaller businesses in this instance was necessary as larger businesses had a greater credit history that allowed them to access financing without needing a different approach, therefore there are some instances where applying a differentiated approach is more effective. However, rather than taking a size differentiated approach in legislation, it may be more effective to apply a different process in the ways laws are administered. For example, taking a risk-based approach to company inspections may have a most positive impact on smaller enterprises as they are traditionally less complex and risky than larger businesses. This approach levels the playing field for all but has a greater benefit for smaller businesses.
- I am in favour of specific regulations for start-ups.
- In theory, we think one size should fit them all (level-playing field). Yet on a case-by-case basis differentiation may still be worth discussing (e.g. lower financial reporting requirements for smaller firms; procurement laws, etc.)
- Personal opinion: there is a risk for perverse incentives when creating a threshold of which companies are eligible. Otherwise, more awareness of small businesses is needed in policy and legislation.

- There is the risk that introducing preferential treatment for one group over another may create a 'subsidized' effect, encouraging for instance firms to stay small to retain the subsidy.
- Special considerations are not necessary in most cases except for making a special effort to spread the word to MSEs, and in others would be through, e.g. having simpler procedures for *de minimis* trade, or allowing simpler corporate structures and tax administration for MSEs.

What advice would you have to other donor and development agencies wishing to support reforms that benefit micro and small enterprises? What should they be encouraged to do? What should they take care to avoid?

- Do not overlook the fundamental human rights nature of key elements of labour regulation. The rules within a labour regulatory framework should not be looked at in isolation from this point of origin. They have other policy purposes as well, of course. But compared with, for example, business licensing procedures, it is not as potentially straightforward to lighten a regulatory burden in the field of labour.
- More efforts in proper diagnostics - more focus on quality on data on businesses that can guide policy making
- Encourage across the broad simplification of the regulatory regime: 'think small first'.
- Apply a gender lens to reform: what are the cultural, social or legislative barriers that women headed businesses face?
- Don't look at business environment reform only. While functional areas matter, policies and strategies and a functioning institutional support infrastructure are equally important. Enterprise-level constraints require adequate support as well: for instance, business plans of an enterprise need to make sense and ensure profitability. Much of the cost factors in the profit margin calculations are not only related to business environment but also to intra-firm efficiency of processes, technology used, quality of product, etc.
- At first it needs to analyse carefully national circumstances and contexts. In order to enable better access to finance for MSEs, suitable financial scheme such as non-banking finance and credit guarantee should be created, and collaboration between those financial scheme and technical support (e.g., management skill, productivity improvement, industrial elemental technologies) should be facilitated.
- Donor and development agencies should note the importance of encouraging MSMEs to transition from the informal to the formal sector, and provide them with relevant programs including those that provide better access to capital, access to local and global value chains and markets, digital technology, and business development services and mentorship. The particular needs of women-led MSMEs should also be addressed given their importance to inclusive economic growth and poverty reduction. More than 700 million people around the world continue to experience extreme poverty, and the majority of them are women. The gap between women and men in poverty has continued to widen over the past decade, a phenomenon referred to as the "feminization of poverty." Canada believes that inclusive economic growth is essential, not just for sharing the benefits of growth widely, but for accelerating growth itself. It provides the material basis for progress across all dimensions of development. It enables countries to reduce and even eliminate extreme poverty. It is the surest way for countries to generate the domestic resources and capacity needed to address their development challenges including health, education and environmental protection.
- Avoid single measures, that are not embedded and do not look at the whole ecosystem.
- It is important when implementing reforms to ensure there are regular reviews and robust feedback mechanisms in place to ensure that reforms are achieving their intended outcome and are actually benefitting businesses.
- Encouraged: promote dialogue between the private and the public sector.
- Avoid: don’t push for stand-alone reforms.
- Do not try to pick winners, but help create a level-playing field for all players.

- Not much additional advice, apart from the challenges and broad suggestions for addressing them above.
- Reforms should focus on unleashing potential, reducing bureaucracy and contribute to a more level playing field alongside larger firms for SMEs.

admin@Enterprise-Development.org

www.Enterprise-Development.org
www.twitter.com/TheDCED

Donor Committee for Enterprise Development