OCCASION

This publication has been made available to the public on the occasion of the 50th anniversary of the United Nations Industrial Development Organisation.

DISCLAIMER

This document has been produced without formal United Nations editing. The designations employed and the presentation of the material in this document do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations Industrial Development Organization (UNIDO) concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries, or its economic system or degree of development. Designations such as "developed", "industrialized" and "developing" are intended for statistical convenience and do not necessarily express a judgment about the stage reached by a particular country or area in the development process. Mention of firm names or commercial products does not constitute an endorsement by UNIDO.

FAIR USE POLICY

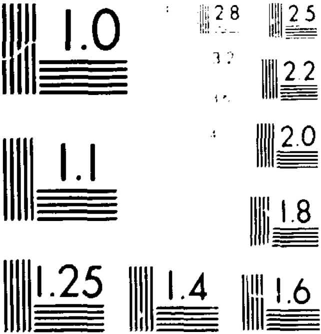
Any part of this publication may be quoted and referenced for educational and research purposes without additional permission from UNIDO. However, those who make use of quoting and referencing this publication are requested to follow the Fair Use Policy of giving due credit to UNIDO.

CONTACT

Please contact publications@unido.org for further information concerning UNIDO publications.

For more information about UNIDO, please visit us at www.unido.org

UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna International Centre, P.O. Box 300, 1400 Vienna, Austria
Tel: (+43-1) 26026-0 · www.unido.org · unido@unido.org


1.0
2.8
2.5
2.2
2.0
1.1
1.8
1.25
1.4
1.6

1C342

Distr.
LIMITED

ID/WG.334/5
10 February 1981
ORIGINAL: ENGLISH

United Nations Industrial Development Organization

Global Preparatory Meeting for the
First Consultation on Industrial Financing

Vienna, Austria, 23 - 25 March 1981

SUGGESTED ISSUE NO. 3: PROSPECTS FOR CO-OPERATION OF SMALL AND MEDIUM-SCALE INDUSTRY IN BOTH DEVELOPING AND INDUSTRIALIZED COUNTRIES*

prepared by

the secretariat of UNIDO

000...

* This is one of three issues suggested by the UNIDO secretariat; the participants are expected to consider these and other issues they may suggest and advise on the selection of priority issues.

This document has been reproduced without formal editing.

V.81-21388

Introduction

The two other issues addressed at this Global Preparatory Meeting may be of less interest to many developing countries, particularly those countries with relatively small populations and those which are at the very early stages of industrialization or are especially disadvantaged. Many of these countries are aware of the balance of payments difficulties which might arise in using external commercial credit, or have few large industrial projects.

In whichever way small and medium-scale enterprises (SMEs) are defined, is evident that the small enterprise in an industrialized country might well be considered large in many developing countries. For this reason activity to promote co-operation between SMEs from industrialized countries and enterprises from developing countries is considered separately from activity through which SMEs in developing countries benefit from international co-operation.

Small and medium-scale industry in developing countries

In very many developing countries, apart from perhaps a handful of large enterprises processing to a limited extent some local raw material for export, major attention is focused on small and medium-scale enterprises. Many countries falling into this category have "special" relationships, perhaps even especially dependent relationships on the developed countries. However, these countries provide significant raw material exports to the North and the natural resource potential of many of these countries is reckoned to be even more significant. In terms of the immediate and future interests of the North, what can be done to finance industry in these countries? More specifically, at a time of static or falling concessional resource transfers, what can the developed countries do to assist their commercial banks and other finance institutions to help in establishing mutually beneficial co-operation for industry in this group of more disadvantaged developing countries?

Small/medium enterprises in developed countries

In considering SMEs of the developed countries, are special measures also necessary to help these enterprises to co-operate with enterprises of developing countries? SMEs in industrialized countries can be classified as those independent enterprises using mature technology (i.e. not sub-contractors or branch plants) and employing perhaps 100 employees in a single location to the independent medium-size enterprises employing many more employees than 100, but having limited international linkages, due to size, whether for the purchase of inputs or the sale of products. Developed countries sometimes recognize that in some industrial sectors the competition offered by the SMEs can be a deterrence to monopoly pressures exercised by large firms, in particular by transnational corporations. Can it be recognized that SMEs in developed countries cannot only survive but also expand through co-operative arrangements of various types with enterprises in developing countries? There may be possibilities for various types of partnership arrangements, joint ventures, subcontracting, marketing, management and technology transfer arrangements: comparative advantage is changing on both the North and the South. What are the possible arrangements, in particular financial arrangements through which industrialized country SMEs can change to a different output product mix through co-operation with enterprises in developing countries? Is it correct that SMEs in the North are often much less bureaucratic, more flexible, effective and motivated than larger enterprises and for this reason might be more willing to enter into various sorts of arrangements with enterprises in developing countries? Can the bilateral or multilateral technical assistance agencies play a special role in fostering the growth of these types of arrangements? Can the provision of finance and/or financial guarantees be part of this role? Would an arrangement whereby a development finance company in a developed country provided a package of complementary finance and technical assistance necessary to encourage such arrangements be acceptable to developed and developing countries? Could bilateral and multilateral agencies take such initiatives? Should they?

Possibilities of assistance to small/medium enterprises in developing countries

The provision of financial assistance to small/medium enterprises has often been through the channel of intermediary financing bodies such as industrial development banks or development finance companies, since the overhead costs involved in the promotion, evaluation and financing of small/medium enterprises are high for external financing institutions (multilateral or bilateral, intergovernmental/governmental/private). That small/medium enterprises often need a co-ordinated package of different complementary assistance measures is well recognized, encompassing their technical, commercial and administrative mangement as well as a more or less packaged financial injection in loan and more especially equity capital.

Are current facilities for the provision of external equity finance to SMEs adequate and sufficiant?

For the Industrial Development Bank or Development Finance Company it is less recognized that financial resources, whether obtained locally or externally, can be more effectively utilized if accompanied by a similar package of complementary assistance measures encompassing the industrial finance institutions' technical, commercial and administrative management. Is not the shortage of these management and financial skills in many developing countries even more acute than the well recognized shortage of production and technological management skills used in industrial production? In many development finance institutions, is it not necessary to package external capital injections with training facilities for groups of local staff? In particular, can a sprinkling of fellowships or an isolated technical assistance project solve this problem? Should not external finance be provided in an integrated package with technical assistance and training? As part of this package, recognition should be given of the very acute shortage of equity finance for SMEs. What possibilities are there in using concessional finance for this "high risk" purpose?

Apart from the packaging of concessionary finance with technical assistance and training, there may be possibilities to provide funds at less than commercial terms to DFCs for SME financing in the more disadvantaged developing countries through tax concessions, direct subsidies to external commercial bank lending and credit guarantees. Can financial assistance in this form be regarded as feasible to the Governments of developed countries? Certainly it could increase in appropriate cases the impact of a given budgetary aid allocation. Would this not be useful and appropriate to many development banks? Would there not be possible benefits of enlarged export markets, sales of know-how, etc. accruing to those countries engaged in such activity? Can this not be regarded as an extension of the idea of export credits and guarantees which most developed country Governments already provide?

Would favourable tax treatment of interest on loans booked in developed country bank head offices by developing country finance institutions be possible? Are subsidies to limit or remove exchange risk, possible? Would credit guarantees be of interest to partners in joint venture and subcontracting arrangements? Can these guarantees be provided by industrialized country Governments via financial intermediaries based in developing countries, i.e. within local development finance institutions or local subsidiaries of the industrialized countries' banks? Should developed country equity participation in joint venture arrangements be fostered by special tax incentives in an enterprise's home country?

<u>Assistance and incentives to small/medium enterprises in developed countries</u>

What is the policy stance for any developed country Government which wishes its SMEs to engage in such co-operative activity? What kind of social and economic environment is there which would encourage firms to carry out the necessary industrial adjustment in terms of product innovation and product mix, relocation of industry, re-employment of labour through new skill formation, the adapting of technology and its maintenance to the requirements of developing countries etc.? Would not such adjustment flexibility be more likely in a situation of high economic growth and dynamism and under generally expansionist fiscal and monetary policies? It may be asked whether restrictive measures in these fields hamper those very natural tendencies of industrial reorganization and adjustment to find more favourable "factor proportions", i.e. ratio of wage costs to capital costs, suited to particular industrial products.

In considering institutional arrangements, would there not be the need to supply some of the critical ingredients, in particular communications and information as well as finance, between potential partners in industrialized and developing countries? Do not these critical ingredients reside in the factors which typify and differentiate the transnational corporation from the merely large enterprise in industrialized countries? It must also be asked whether the provision of institutional incentives and assistance to small/medium enterprises by industrialized country Governments would be an acceptable industrial policy? In certain industrial sectors and branches, can it be that such Governments may prefer small/medium enterprises to react to changing comparative advantage in other ways, e.g. mergers, bankruptcy etc.? Or is it that in providing industrial assistance, some Governments may prefer not to discriminate against big business in favouring small business?