



**Asia-Pacific
Economic Cooperation**

Advancing Free Trade
for Asia-Pacific **Prosperity**

Regulatory Reform: Case Studies on Improving the Business Environment for Small and Medium Enterprises (SMEs)

APEC Policy Support Unit
November 2015

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Produced for:

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APEC#215-SE-01.20



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TABLE OF CONTENTS

EXECUTIVE SUMMARY	IV
ACKNOWLEDGEMENTS	VII
1. INTRODUCTION AND PROJECT OVERVIEW.....	1
PROJECT SCOPE.....	1
BASIC STATISTICS ON SMES AND BUSINESS CONSTRAINTS IN THE ASIA- PACIFIC.....	4
REPORT OUTLINE	6
2. LITERATURE REVIEW: SMES AND THE REGULATORY BURDEN.....	7
3. METHODOLOGY AND APPROACH.....	11
REVIEW OF DATA ON BUSINESS CONSTRAINTS FACING SMES	11
CASE STUDIES.....	12
4. CASE STUDIES	14
DEDICATED AGENCIES TO ASSIST SMES WITH GROWTH, DEVELOPMENT, COMPLIANCE, AND INTERNATIONALIZATION.....	14
AGENCIES AND INSTITUTIONS THAT SPECIALIZE IN SUPPORTING SME FINANCE	28
REGULATORY TIERING.....	41
SME-FRIENDLY RIA	58
5. CONCLUSION AND POLICY IMPLICATIONS	68
REFERENCES.....	71

EXECUTIVE SUMMARY

Developing SMEs is a key priority for many APEC economies, both developing and developed. In particular, enhancing SMEs' participation in the regional and global economies is an important policy issue for the Asia-Pacific, and an area in which some APEC economies have enjoyed considerable success.

SMEs account for the bulk of firms by number in the Asia-Pacific region, perhaps 90%. Most businesses are SMEs, and many large companies start life as SMEs, and then grow as appropriate given demand and other conditions. Providing a business environment that is conducive to starting and growing SMEs is an important priority for APEC economies, and one that an appropriate regulatory stance can do much to support. Similarly, SME internationalization is an important aspect of APEC's broader commitment to free and open trade and investment in the region.

Against this background, this project represents a step towards a better and more comprehensive understanding of the ways in which policies can help promote SME growth, development, and internationalization. Specifically, it addresses the ways in which regulatory reform can help achieve those important objectives. This report is intended both as a discussion of the relevant issues, and also a repository of selected best practice examples from around the region. The examples—presented as part of a set of case studies on regulatory reform and SMEs—can serve as a reference point for technical experts and policymakers in APEC economies as they seek to improve their own business environments for SMEs. The key proposition underlying the report and the case studies it presents is that regulatory reform can be a key driver of SME growth, development, and internationalization, by improving the business environment in dimensions of particular importance to SMEs.

The Terms of Reference (TORs) for the project require a case study approach focusing on the following four issues:

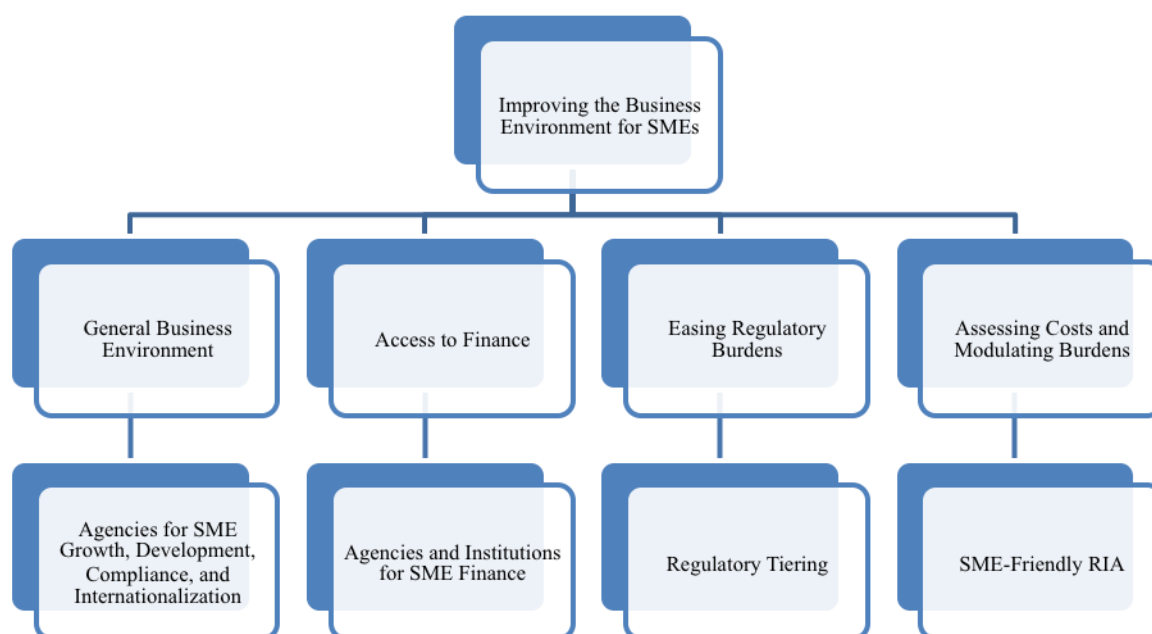
1. Improving the general business environment for SMEs (e.g., corporate law, competition law, business accounting, labor law, and business succession).
2. Improving access to finance by SMEs by incorporating/changing regulations, establishing/improving credit information systems or establishing regulatory guidelines.
3. Easing regulatory burdens for SMEs (e.g., acquisition and maintenance of intellectual property rights, and simplification of trade procedures).
4. Assessing the cost of legislation to SMEs before regulatory proposals are adopted, and when possible, introducing exemptions or lighter regulatory regimes for SMEs in new regulations to prevent SMEs facing an increase of unnecessary regulatory burden (e.g., new or tighter environmental or consumer protections).

In furtherance of the project's overall objectives, the case studies describe the background, highlight the challenges SMEs are facing, and analyze the need for regulatory reforms in order to improve the business environment for SMEs, as well as the process to implement such reforms.

Each of the four areas identified above is broad in scope, and covers numerous potential policy actions by member economies. To ensure that the study is incisive and focused, it is

important to identify a few key types of interventions for further study (see Figure). With that in mind, each issue category is studied with the aim of identifying one key policy measure that has been implemented by more than one APEC economy. The case study then discusses the measure discussed in detail, focusing on its implications for SMEs and its relationship to the issues they face on a day-to-day basis. The detailed study of the measure will then be complemented by references to examples from developing and developed economies, as well as external economies in appropriate cases. The aim is to have multiple examples for each type of measure, to show the different ways in which member economies have operationalized similar best practice principles in their own regulatory, institutional, and developmental contexts.

Figure: Issue Areas and Case Studies.



In addition to conducting case studies, the report also analyzes data from a World Bank survey of developing economy firms. The data highlight a number of policy areas that represent business constraints for firms in APEC economies, and SMEs in particular. Of special note is the finding that tax rates and access to finance are perceived as being more serious business obstacles by SMEs than by large firms. Both issues are dealt with in this report. The quantitative data therefore support the general approach taken here in terms of the issues identified and case study subjects chosen.

Based on the case studies and examples, a number of key findings emerge for APEC economies:

1. Regulatory reform to improve the business environment for SMEs should include aspects of rule making and institution design, including as appropriate the putting in place of specialized agencies. Many APEC economies have dedicated agencies to support SME growth and development, and continued work in areas such as incubators could prove fruitful. Similarly, measures and agencies to promote SME

access to finance can help alleviate a serious business constraint, for example through the provision of market-friendly guarantees, or facilitation of information exchange among private actors through appropriate regulatory frameworks.

2. SMEs need to be included in the reform process, and given a voice. Consultation with the sector is key to a better understanding of the business constraints SMEs face, as well as the measures they see as most needed for overcoming those constraints. A peak body for SMEs can be one way of effectively channeling their views to the government, but other means of consultation can also be effective.
3. The public and private sectors need to work together to promote regulatory reforms that improve the business environment for SMEs. This observation is not limited to SMEs themselves. In terms of internationalization, for example, most SMEs will need to link to larger firms in order to become embedded in GVCs. It is therefore important that governments adopt incentive-compatible regulations that promote linkages between SMEs and lead firms, both domestic and international.
4. Regulatory compliance, and compliance with voluntary standards, can be a major obstacle for SMEs. There is much that governments can do to ease the burden. On the one hand, regulatory tiering can offer SMEs more flexible schedules or structures for dealing with regulatory obligations. For voluntary standards, capacity building exercises that include the private sector can help develop the ability of SMEs to satisfy relevant standards, which in turn facilitates their access to GVCs.
5. Regulatory reform to improve the business environment for SMEs is a process, not a one off event. As such, instruments such as RIA—whether formalized or not—are crucial in helping sustain the momentum behind reforms. Similarly, tracking performance and implementation on the ground is an important element in continuously improving policies that affect SMEs. Measurement and data are key elements both of RIA and of performance monitoring and evaluation. Economies can benefit from increased attention to data collection and publication in relation to SMEs and the regulatory burdens they face.

These findings sit well with APEC's Good Practices on Regulatory Reform. That document emphasizes the role of institutions as part of the regulatory reform agenda, and highlights the important role consultation can play in regulatory design and reform. RIA is also dealt with as part of APEC's Good Practices, and this report again shows the ways in which RIA can contribute to the design and implementation of regulations that are effective (in that they achieve an important social goal) and efficient (in that they do so at minimum economic cost). This report can be read as a set of examples of different ways in which APEC's Good Practices are implemented in practice in developing as well as developed economies from across the region.

This report has shown that APEC economies have been proactive in identifying ways in which SMEs need support in their efforts to grow, develop, and internationalize. This statement is true of developing and developed member economies alike. Although the instruments adopted differ considerably across economies, there is general evidence of an awareness of the need to conduct regulatory reform in a way that both achieves important public policy objectives, and limits the time and cost burden on small businesses. As the SME sector receives greater attention internationally and domestically, APEC member economies can draw on the examples collected in this report to refresh and enhance their existing programs, and thereby give SMEs throughout the region an important boost that can translate into improved economic and social outcomes.

ACKNOWLEDGEMENTS

The authors are grateful to the following people who provided important background information for the case studies, either through correspondence or interviews: Li Kuan Chen (Small and Medium Enterprise Administration, Chinese Taipei), Goh Hui Tong (Ministry of Finance, Singapore), Justin Lee (National Association of Small and Medium Enterprises, Chinese Taipei), Bev Postma (Food Industry Asia), Kavita Prakash-Mani (Grow Asia), Pia Bernadette Roman Tayag (Bangko Sentral ng Philippines), Dean Naoyuki Yoshino (Asian Development Bank Institute), Ching-Hsin Wu (Small and Medium Enterprise Administration, Chinese Taipei), Moonshine Wu (Jordan Accounting, Chinese Taipei), and the Canada Revenue Agency. In addition, Carlos Kuriyama of the APEC Policy Support Unit provided assistance in making contact with relevant officials, as well as many helpful comments and suggestions on the text of the report.

1. INTRODUCTION AND PROJECT OVERVIEW

Developing SMEs is a key priority for many APEC economies, both developing and developed. In particular, enhancing SMEs' participation in the regional and global economies is an important policy issue for the Asia-Pacific, and an area in which some APEC economies have enjoyed considerable success.

SMEs account for the bulk of firms by number in the Asia-Pacific region, perhaps 90%. Most businesses are SMEs, and many large companies start life as SMEs, and then grow as appropriate given demand and other conditions. Providing a business environment that is conducive to starting and growing SMEs is an important priority for APEC economies, and one that an appropriate regulatory stance can do much to support. Similarly, SME internationalization is an important aspect of APEC's broader commitment to free and open trade and investment in the region.

Against this background, this project represents a step towards a better and more comprehensive understanding of the ways in which policies can help promote SME growth, development, and internationalization. Specifically, it addresses the ways in which regulatory reform can help achieve those important objectives. This report is intended both as a discussion of the relevant issues, and also a repository of selected best practice examples from around the region. The examples—presented as part of a set of case studies on regulatory reform and SMEs—can serve as a reference point for technical experts and policymakers in APEC economies as they seek to improve their own business environments for SMEs. The key proposition underlying the report and the case studies it presents is that regulatory reform can be a key driver of SME growth, development, and internationalization, by improving the business environment in dimensions of particular importance to SMEs.

Concretely, the objectives of the project, as embodied in this report, are as follows:

1. To conduct case studies describing and analyzing the role of regulatory reforms and practices in improving the business environment for SMEs.
2. To show through case studies how well designed regulations can contribute to improving the business environment for SMEs; boosting productivity, competitiveness, and participation of SMEs in the economy; and facilitating their participation in global value chains (GVCs).
3. To draw lessons and suggest policy recommendations based on previous experiences in implementing regulatory reforms to improve the business environment for SMEs.

PROJECT SCOPE

The Terms of Reference (TORs) for the project require a case study approach focusing on the following four issues:

1. Improving the general business environment for SMEs (e.g., corporate law, competition law, business accounting, labor law, and business succession).

2. Improving access to finance by SMEs by incorporating/changing regulations, establishing/improving credit information systems or establishing regulatory guidelines.
3. Easing regulatory burdens for SMEs (e.g., acquisition and maintenance of intellectual property rights, and simplification of trade procedures).
4. Assessing the cost of legislation to SMEs before regulatory proposals are adopted, and when possible, introducing exemptions or lighter regulatory regimes for SMEs in new regulations to prevent SMEs facing an increase of unnecessary regulatory burden (e.g., new or tighter environmental or consumer protections).

In furtherance of the project's overall objectives, the case studies describe the background, highlight the challenges SMEs are facing, and analyze the need for regulatory reforms in order to improve the business environment for SMEs, as well as the process to implement such reforms.

Each of the four areas identified above is broad in scope, and covers numerous potential policy actions by member economies. To ensure that the study is incisive and focused, it is important to identify a few key types of interventions for further study. With that in mind, each issue category is studied with the aim of identifying one key policy measure that has been implemented by more than one APEC economy. The case study then discusses the measure discussed in detail, focusing on its implications for SMEs and its relationship to the issues they face on a day-to-day basis. The detailed study of the measure will then be complemented by references to examples from developing and developed economies, as well as external economies in appropriate cases. The aim is to have multiple examples for each type of measure, to show the different ways in which member economies have operationalized similar best practice principles in their own regulatory, institutional, and developmental contexts.

In undertaking the case studies and compiling examples, the report is mindful of the breadth of the issue area. In particular, it takes an expansive approach to the issue of regulatory reform, in line with the APEC-OECD Integrated Checklist on Regulatory Reform. That document defines regulatory reform as: "changes that improve regulatory quality to enhance the economic performance, cost effectiveness, or legal quality of regulations and related government formalities. Reform can mean revision of a single regulation, the scrapping and rebuilding of an entire regulatory regime and its institutions, or improvement of processes for making regulations and managing reform." Importantly, this definition highlights the fact that regulatory reform is not just about changing laws on the statute books. It is also about the institutions and agencies that administer those laws on a day-to-day basis. This report therefore examines legal changes designed to support SMEs, as well as institutional changes and alterations in governmental procedures that are designed to make life easier for small businesses around the region.

The project revolves around SMEs, but does not have any sectoral limitations. Indeed, it is important to cast the net wide in terms of sectors, in order to have best practice examples that resonate with the largest possible set of member economies. With that in mind, the report includes both manufacturing and services examples, when it comes to discussion of the concrete implementation of SME-friendly regulatory reforms in particular contexts.

Another issue of particular relevance to APEC developing economies is agriculture. That sector can account for a significant share of economic output and employment in developing economies, and increasing productivity is crucial to achieving sustainable and inclusive growth over the medium to long term. In some developing member economies, like Indonesia and Viet Nam, agricultural activity is dominated—in numerical terms—by smallholders. For the purposes of this report, it is important to include agricultural smallholders within the scope of SMEs. A more traditional definition would perhaps exclude the agricultural sector and focus only on manufacturing, and perhaps services. A broad view is important from a development perspective, because smallholders in developing economies in fact have many issues in common with SMEs in other sectors, most particularly difficulty in accessing finance. Moreover, the agricultural sector has seen important initiatives in the region over recent years, and it is important to reflect this good work in the project outputs.

Although the primary focus of this project is on case studies and examples, which require the use of appropriate qualitative methodologies, there is scope to use quantitative data to demonstrate the importance of the underlying issues for APEC economies, and to give SMEs themselves a chance to speak to the business constraints they face in the region. With the aim of complementing the case studies and adding value to the project consistently with its overarching goals, this report leverages the World Bank's Enterprise Surveys (WBES) as a source of data on the business constraints facing SMEs in the region. The WBES project has collected data from over 130,000 firms in 135 mostly developing economies. Data are available for eight APEC members, i.e. the following economies: Chile, China, Indonesia, Mexico, Peru, the Philippines, Russia, and Viet Nam. The data represent a variety of income and development levels, and can therefore be used to give a broad picture of the state of play for SMEs in the APEC region, focusing in particular on developing economies.

The WBES data contain a wealth of information gathered from individual firms in each economy. This report focuses in on one particular aspect of those data as a complementary tool for this project: firm perceptions as to the seriousness of various business constraints. Clearly, it is important for SMEs to have a voice in this project, and in APEC's SME work more generally, so that they can point policymakers to the areas in which regulatory reform can have maximum impact. The WBES data are useful in this regard, because firms are asked to assess the seriousness of various factors as business constraints, using a five point scale. A higher score indicates a more serious constraint. These data can be used by way of background in the report, to paint a picture of the most serious regulatory issues facing SMEs in the region.

Concretely, the WBES data ask firms to indicate the seriousness of the business constraints they face in the following areas:

1. Access to electricity, as an example of core infrastructure.
2. Transportation of goods, supplies, and inputs, as an area in which sectoral regulation affects the ability of businesses in other sectors to prosper.
3. Customs and trade regulations.
4. Access to land, as a core area of general business regulation that affects the ability of SMEs to get established and grow.

5. Tax rates and tax administration.
6. Business licensing and permits.
7. Access to finance, including availability and cost.
8. Labor regulations.

These areas dovetail well with the case study areas identified for the purposes of this project. This report therefore reviews the relevant data and presents summary statistics for the APEC region by way of background to the case studies. The value added of this exercise is that it contextualizes the case studies, and shows their relevance to SME activity on the ground in member economies. For the same reason, the report also reports results from an additional WBES question that asks firms to identify the three most serious problems facing their business. In all cases, results are presented for APEC as a whole, not individual member economies, which is in keeping with the collaborative nature of the forum. Of course, individual economy results can be made available privately on request from the economy concerned, for potential use as a diagnostic tool that can give impetus to further regulatory reform.

BASIC STATISTICS ON SMES AND BUSINESS CONSTRAINTS IN THE ASIA-PACIFIC

By way of introduction to the report itself, it is useful to undertake a brief analysis of the WBES data. The objective is to provide some basic information on APEC SMEs and the business constraints they face, as well as the relation of those constraints to issues of regulatory reform.

APEC economies apply different approaches to the question of identifying what constitutes an SME for statistical and policy purposes. In the context of analytical work at the domestic level, each definition is important, and reflects the reality on the ground in each economy. However, for a broad based, regional project like this one, it is important to introduce an element of comparability into the analysis. For that reason, in analyzing the WBES data, this report defines an SME as a company employing less than 250 people, which is in line with the definition most commonly used by the OECD and EU. It represents a reasonable compromise in respect of the various definitions used by APEC economies,¹ and provides a rational benchmark from which statistical work can be undertaken.

As a first step, and a useful piece of background, it is useful to present statistics on SME prevalence and internationalization (export behavior). The WBES data disclose that 89% of APEC firms in economies for which data are available are SMEs. It is important to highlight that due to the sampling framework and approach used to create the WBES dataset, this number is probably understated, particularly for economies where informality is an issue. In any case, by number SMEs are well and truly the majority of firms in APEC, even though it is typically large firms that account for the bulk of industry value added.

In terms of firm internationalization, only 13% of SMEs export directly—even counting very small percentages of total sales—compared with 32% of large firms. This evidence clearly

¹ For an overview of the various criteria used in APEC economies to define SMEs, see Zhang (2014).

suggests that SMEs are less internationalized than large firms, probably because of the significant fixed costs involved in entering foreign markets. Again, it is important to emphasize that the data collection approach underlying the WBES tends to over-sample exporting firms, so the true degree of internationalization of APEC SMEs is probably less than these data indicate. Of course, one of the primary ways in which SMEs internationalize indirectly is through linkages with larger firms that export finished or more advanced goods. These types of links are not picked up in the WBES data, but represent an important way in which SMEs in many APEC economies have become integrated in GVCs. The example of the traditional organization of key sectors such as automobiles and electronics in Japan particularly stands out in this regard.

The starting point for the analysis of SMEs and regulatory reform is to examine the principal business obstacles identified by APEC SMEs in the sample, using the size definition discussed above. Table 1 presents results, showing the percentage of surveyed firms that identify the particular issue as the most serious constraint affecting their business. Out of the 15 issues provided as a list by the surveyors used by the World Bank, only the top five are retained here. Cumulatively, they account for 67.69% of surveyed SMEs in APEC economies.

It is immediately clear from Table 1 that the top five issues confronting SMEs are all intimately tied to questions of regulatory reform. Two of them—tax rates and access to finance—relate to issues that were identified in the TORs for this project, and will therefore be addressed in depth in the sections on regulatory tiering (scheduling of tax payments), and access to finance. The other issues, although not directly related to the four questions identified for this project, are nonetheless affected by regulatory reform. For example, the ease of starting a business in the formal sector affects the decision of firms to be formal or informal. APEC's EoDB initiative can likely help formalize a significant proportion of economic activity in some developing economies, which will in turn loosen the constraint represented by practices of competitors in the informal sector. Similarly, human capital development policies—and the regulations that support them—affect firms' ability to access the skilled labor they need to expand. This issue is firmly on the policy agenda of developing and developed member economies alike, and is given particular treatment as well at the APEC level. Finally, electricity is an example of a core infrastructure sector upon which businesses, including SMEs, depend. Although there is a "hard" component to electricity supply, in the sense of physical infrastructure, there is also a regulatory reform aspect that determines the competitive conditions under which infrastructure development and power supply take place. Ensuring the existence of competitive backbone services markets such as electricity is an important way of improving access for consumers, including SMEs. The key finding from this first review of the data is therefore that regulatory reform is an important underlying factor in the main business constraints facing APEC SMEs.

Table 1: Business constraints identified by APEC SMEs.

Issue	Percent of SMEs Identifying Issue as the Major Constraint on their Business
Tax rates	18.70%
Access to finance	17.43%
Practices of competitors in the informal sector	15.59%
Inadequately educated workforce	10.07%
Electricity	5.90%

Source: WBES and authors' calculations.

REPORT OUTLINE

This section has given some preliminary context for the relationship between SMEs and regulatory reform in the Asia-Pacific, including through a review of some basic data from the WBES. The key point to emerge is that the four issue areas identified in the TORs indeed reflect matters of concern for APEC SMEs—which means that regulatory reform in these areas, based on emerging regional best practice, stands to bring important economic benefits that will truly be felt on the ground.

Against this background, the report proceeds as follows. The next section presents a literature review focusing on the regulatory burden facing SMEs. Section 3 discusses methodology and approach, dealing with qualitative and quantitative aspects. Section 4 presents the four case studies that are the core of this report, with one subsection devoted to each issue category. Finally, Section 5 concludes and discusses policy implications.

2. LITERATURE REVIEW: SMES AND THE REGULATORY BURDEN

Policymakers all around the world, and particularly in the Asia-Pacific, are alive to the need to reduce regulatory burdens. They are also aware that SMEs suffer disproportionately from regulatory burdens. Larger firms are better able to absorb a given regulatory cost than smaller firms, and indeed it may even be marginal for them, whereas it might be a significant cost factor for SMEs.

The total regulatory burden facing SMEs can be large. Industry Canada (2013) uses a survey methodology to provide some quantitative context. Based on the responses of over 10,000 Canadian firms, the authors estimate that Canadian SMEs faced the equivalent of CAN\$4.76bn in regulatory compliance costs in 2011, or about CAN\$3,500 per business, CAN\$370 per employee, or 0.29% of business sector revenues. Although it is impossible to extrapolate directly from the Canadian experience to APEC as a whole, it is likely that these estimates, although very significant, are lower in relative terms than the regulatory burdens faced in other economies, particularly developing economies where red tape restrictions can remain significant. The net conclusion to be drawn is that the regulatory burden is a key factor that potentially restrains the creation of new SMEs, as well as the growth and expansion—including job creation—of existing businesses.

The available evidence suggests that SMEs in all parts of the Asia-Pacific face difficulties in expanding and, especially, in internationalizing through participation in GVCs. IDB (2014) examines the case of SMEs in Latin American and the Caribbean, including in APEC member economies Mexico, Chile, and Peru. The authors find that SMEs are underrepresented in the region's export sector, as indeed is the case in most economies elsewhere around the world. SMEs constitute more than 95% of the region's companies, but only 13% of them export. In the APEC region, the comparable figures are just as striking: SMEs account for 90% of businesses and 60% of employment, but only 30% of exports (APEC SMEWG, 2011b).

Moreover, those firms that do export tend to send only a small product range to a limited group of economies, thus giving rise to concerns about export concentration and market risk. The IDB report argues that regional economies, including APEC member economies, stand to gain significantly from promoting the internationalization of SMEs. Many factors related to policy make the business environment less supportive to SME internationalization: high transportation costs, difficulties crossing borders, and compliance with trade rules, particularly rules of origin, loom large. These examples all highlight the point that regulation affects SMEs differently from other companies, and can act as a particular impediment to their growth and development.

A particular regulatory issue that hinders SMEs in their efforts to expand and internationalize is access to finance. IDB (2014) indicates that regional SMEs face high finance costs, even though access to the banking system is relatively good. SMEs are often not in a position to offer established businesses or valuable collateral as a basis for a financing transaction that could be growth enhancing. This report will discuss creative mechanisms governments have used to give SMEs greater access to finance, including in developing member economies through institutions such as microfinance. Emerging funding sources such as crowdfunding

are also likely to grow in importance in the coming years, and the regulatory stance will need to be appropriate to facilitate this development. The novelty of this exercise means that specific regulations are likely to be in a catch up phase with regards to practice in the market. Nonetheless, regulators in the United States and Europe have been active in taking the first steps towards establishing appropriate frameworks for crowdsourcing, in recognition of the potential benefits it can bring to SMEs, while remaining mindful of the need to appropriately protect investors (OECD, 2015).

Outside the APEC regional context, the regulatory burden facing SMEs is also high on the policy agenda. In the EU, Expert Group (2007) found that for every euro per employee a large firm spends on regulatory compliance, a medium sized firm might have to pay four euros, and a small business up to ten euros. These numbers starkly bring out the disproportionate regulatory burden facing SMEs. One reason for this outcome is that many regulatory costs are fixed, and not paid in proportion to size or sales. Second, larger businesses can employ compliance specialists, or even outsource the compliance function, at lower cost; those options are typically not available to SMEs. Third, in the smallest SMEs, it can be the entrepreneur herself who is responsible for dealing with compliance issues, thus tying up the company's most valuable asset at a critical point in its growth.

Expert Group (2007) collects over 100 good practice examples. They can be distilled into a number of groups, some of which reflect the areas under consideration in this report:

1. Size related exemptions.
2. Reduced obligations (partial exemptions).
3. Simplified obligations.
4. Temporal exemptions.
5. Administrative coordination, especially one stop shops.
6. Common commencement dates.
7. Tailor-made information, coaching, and training.
8. Electronic services.
9. Privileged treatment of small businesses.
10. Early evaluation of regulatory impact on small business.

As can be seen from this list, there is obviously considerable commonality of experience between APEC and other regions, such as the EU. The areas covered by APEC SMEWG (2011b), for example, are fairly similar, although the emphasis and layout of the issues takes a different approach. This commonality of experience is again evident in OECD (2008), which reports on SME internationalization. Like IDB (2014), it shows that relatively few SMEs are engaged in exporting. The reasons are many. For businesses considering exporting but not yet able to do so, finance and market access barriers loom large. For businesses

actively exporting, those barriers become less important, and ones related to the business environment and lack of capabilities are more serious.

OECD (2008) highlights the fact that it is important for governments to tailor programs to the concrete needs of their SMEs. Indeed, only 34% of SMEs responding to the publication survey had made use of government support programs, despite a significant concentration of effort in this area across the OECD zone. The reasons for this relatively low uptake rate appear to be largely firm specific, according to OECD (2008), but it seems likely that this figure should give cause for reflection in respect of the targeting and design and government programs, so as to make them as responsive as possible to the actual needs of SMEs.

The needs of SMEs in terms of general regulatory reform have been recognized at APEC level by APEC EC (2008). That document states that one of the objectives of a regulatory reform program can be controlling regulatory costs so as to improve productive efficiency by reducing unnecessary costs (in particular for SMEs). APEC EC (2008) also counsels prudence in putting in place public private dialogue mechanisms, to ensure that SMEs are included—if they are not, the dialogue process risks being “captured” by large businesses.

An important source of detail on SME-friendly regulatory options is APEC SMEWG (2011a). That document collects lessons learned from a review of the ease of doing business in the APEC region, including aspects that touch on the ability of SMEs to commence doing business, expand, and internationalize. Many of the issues that will be discussed in this report in terms of improving the business environment for SMEs are reflected in that document. Among the most important lessons for making it easier to do business identified in that document are the following:

- Using technology to improve efficiency, with an emphasis on online services.
- Offering single window or one stop shops to access and process documents.
- Providing comprehensive and customized information to entrepreneurs.
- Engaging stakeholders when contemplating and undertaking regulatory reform.
- Generating new and improved resources and services for entrepreneurs.
- Improving coordination between government agencies.
- Simplifying and streamlining regulatory and administrative processes.
- Setting service standards and introducing performance based systems.
- Using risk based systems to improve the use of resources.

Against this background of a considerable literature on the regulatory burdens facing SMEs, as well as the constraints on their ability to internationalize, there is scope for this report to add value in the following ways:

1. Its focus on SMEs only, as opposed to SMEs as one type of business facing constraints. This focus facilitates the identification of examples and drawing of conclusions that respond directly to SME needs and experiences.
2. The selection of four areas gives the project analytical focus. Other contributions have attempted to “cover the field” in their chosen area, and as a result, have had to sacrifice some level of detail. This report, by contrast, focuses on a limited number of areas, but treats each one in depth.
3. The focus on case studies, backed up by examples from a wide range of economies. Many of the publications reviewed distill best practice lessons and general tendencies, or experiences in single economies, but none brings together concrete examples of government action in developed and developing economies in the way this report does.

3. METHODOLOGY AND APPROACH

This report's approach focuses on the identification of case studies and examples in the four areas identified in the project Terms of Reference, namely:

1. Improving the general business environment for SMEs (e.g., corporate law, competition law, business accounting, labor law, and business succession).
2. Improving access to finance by SMEs by incorporating/changing regulations, establishing/improving credit information systems or establishing regulatory guidelines.
3. Easing regulatory burdens for SMEs (e.g., acquisition and maintenance of intellectual property rights, and simplification of trade procedures).
4. Assessing the cost of legislation to SMEs before regulatory proposals are adopted, and when possible, introducing exemptions or lighter regulatory regimes for SMEs in new regulations to prevent SMEs facing an increase of unnecessary regulatory burden (e.g., new or tighter environmental or consumer protections).

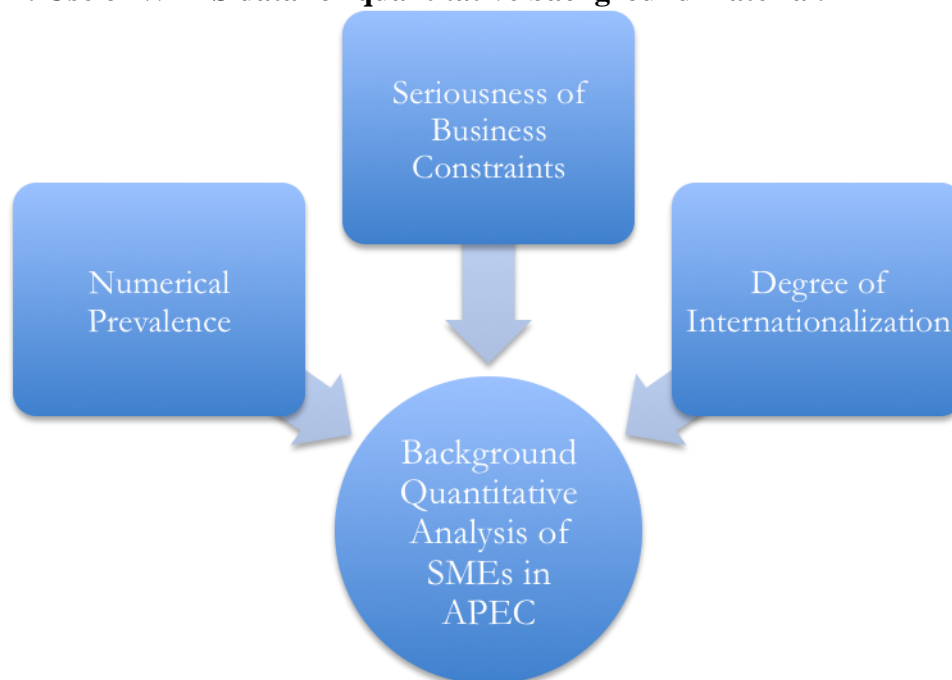
The above items represent broad areas of interest. It is not possible to address every aspect of each issue in detail in a single report. The approach taken here is therefore to be selective, and present case studies and examples that best highlight government efforts to improve the business environment in the areas that matter most to APEC SMEs.

Governments all around the region, and outside it, have been active in trying to support SME growth and development in recent years. SMEs are the backbone of the economy, and development of the sector means more jobs for workers. In addition, the right kinds of policies can support productivity upgrading, which is associated with higher wages—and is the basis for sustainable and inclusive economic growth. The policy importance of these issues informs the methodology and approach of the report.

REVIEW OF DATA ON BUSINESS CONSTRAINTS FACING SMES

To ensure maximum policy impact, it is important to make clear from the outset that the issues being addressed—and the subjects of the case studies—really deal with the questions that are of the greatest importance to SMEs in the Asia-Pacific. The first analytical part of the report will therefore leverage the WBES data to provide a picture of the seriousness of various business constraints for APEC SMEs, as well as to paint a brief quantitative picture of SME prevalence and degree of internationalization in the region (Figure 1).

Concretely, each case study will be introduced by a short quantitative analysis of the WBES data, by way of background. Simple statistical analysis will be used to present information on the average seriousness of various business constraints for SMEs in the region. The data will also allow a comparison to be made with the case of large firms, which will further highlight the real-world relevance of the report.

Figure 1: Use of WBES data for quantitative background material.

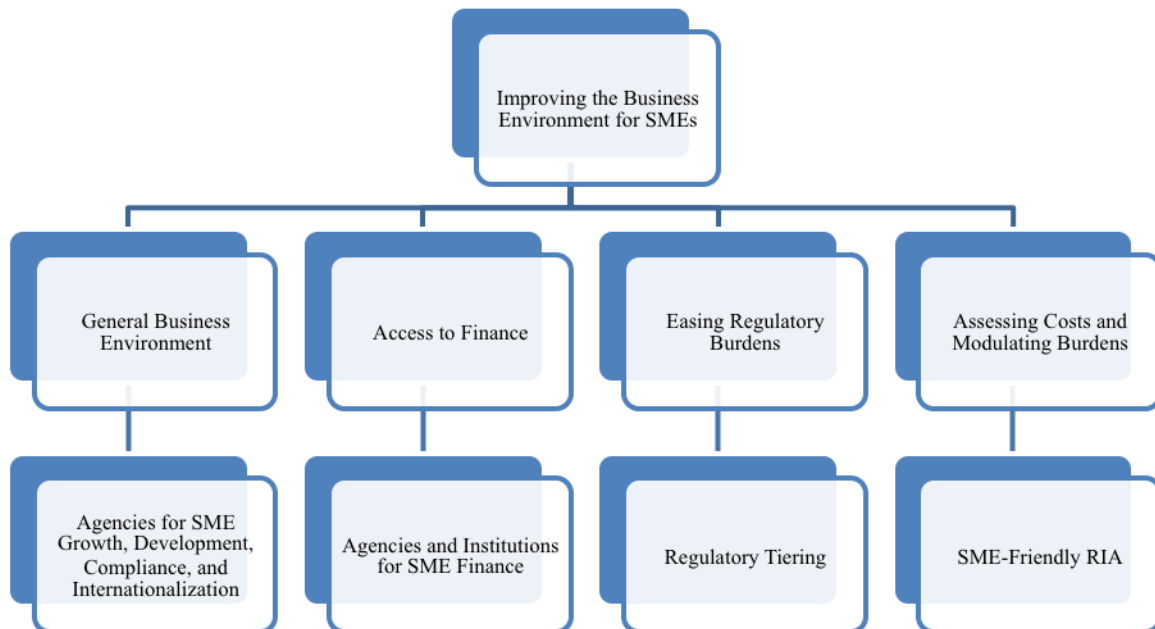
CASE STUDIES

The four issue areas specified for the case studies are broad. The approach of this report is to provide a succinct discussion of each issue in general terms, and then to present a number of examples from APEC developing and developed economies, as well as, if appropriate, external economies. The essence of the report's approach is therefore to choose one type of critical policy intervention for each area to serve as the unifying theme for the case study, and to illustrate it with concrete, real world examples from a variety of economies. The focus is at all times on SMEs themselves, and their day-to-day efforts to grow and expand, providing employment opportunities and fueling economic growth within the region. Whenever possible, reference is made to APEC SMEs that have been able to internationalize, in particular through becoming part of global and regional value chains (GVCs), as the business constraints addressed in this report are particularly relevant to this type of activity.

In terms of methodology, the report's approach to the case studies will be qualitative. Many APEC economies make information available on regulatory reforms relevant to SMEs, and some have specific agencies that deal with SME issues. Intergovernmental organizations are also active in this area. There is thus a wealth of primary and secondary information that the case studies can draw upon using a desk review methodology. In addition, the report uses the most relevant criteria from the APEC Good Regulatory Practices document, such as transparency, alignment among authorities, and cost-benefit analysis, to structure the qualitative work for the case studies. In addition to a desk review, the case studies and examples are supported as appropriate by interviews with government officials, practitioners, and academics. The purpose of the interviews is to provide additional background information, and in particular to address issues of on-the-ground implementation of regulatory reforms. The result of this two-pronged methodology—interviews and desk review—is case studies and examples that are on point, up to date, and relevant to the real world of SME experience and policymaking.

The report focuses the case studies on one particular cluster of examples each. In choosing the subjects for the case studies, care has been taken to ensure that the resulting study and set of examples is as relevant as possible to all APEC member economies, and is reflective of issues that are of genuine importance to SMEs. The report's approach to the case studies, and their relation to the issue areas mentioned in the TORs, is set out in Figure 2.

Figure 2: Issue Areas and Case Studies.



The introduction to each case study will provide a general overview of its relationship to the issue area from the project TORs. In addition, it will draw together a short selection of implications for the region of the economy-level experiences set out in the examples. The examples are drawn from developing and developed economies all across the region. They do not seek to cover the field in terms of experience or best practice, but instead to provide informative examples of concrete ways in which APEC member economies have tackled the issue of using regulatory reform to improve the business environment for SMEs.

In analyzing pro-SME regulatory reforms in these areas, the case studies will be informed by the definition of regulatory reform given in the APEC-OECD Integrated Checklist on Regulatory Reform (see above). The main element of that definition that is important for the case study exercise is that regulatory reform includes changes to institutions and agencies, as well as rules. Indeed, the first two case studies focus on institutions that support market transactions, or correct market failures. The approach taken in this report is to analyze institutional aspects of reform whenever relevant, and to link those changes back to reforms in the regulations and laws that govern the agencies in question. The approach taken to regulatory reform is therefore a broad one, but one that is in keeping with past practice in APEC, and is reflective of the types of interventions that can make it easier for SMEs to do business.

4. CASE STUDIES

This section presents the four case studies that are the core of the report. Each case study is divided into two parts. The first one provides an introductory overview of the general issue area, and the specific cluster of examples used to construct the case study. It also relates the issue back to the concerns expressed by APEC SMEs in the context of the WBES surveys. In the second part of the case study, individual examples of best practice are given from around the APEC region. The examples are drawn from a wide variety of circumstances, and are designed to be illustrative of general points rather than exhaustive in their coverage of existing practice in the region. Together, the two parts of each case study provide an analysis of the regulatory reform issues arising in relation to specific aspects of the business environment as it affects SMES, along with examples of the ways in which APEC economies have successfully tackled those issues in the context of their own reform programs. Although the examples are economy specific, an important aspect of the case studies is to draw out lessons that may be of more general application, of course with adaptation, around the region.

DEDICATED AGENCIES TO ASSIST SMES WITH GROWTH, DEVELOPMENT, COMPLIANCE, AND INTERNATIONALIZATION

Regulatory reforms are key to improving the business environment, and thereby competitiveness of SMEs as well as their ability to join and move up GVCs. They cannot achieve this objective alone, however. A number of other factors enter into account, such as SMEs' capacity to innovate and meet international standards, the availability of essential human resources, and connections with international markets (Cattaneo et al., 2013). To enable SMEs to grow, develop, comply with relevant standards, and enter foreign markets, a broad approach is required including an appropriate basis of rules, as well as focused institutions and agencies.

Small businesses face many hurdles in the areas of growth, development, and internationalization. To export, for example, they must overcome the sometimes very large fixed costs associated with entering a foreign market. Compliance with overseas standards is one example of such a cost. Another is acquiring market information, or developing a distribution network. Costs such as these make it impossible for most SMEs to export directly, although a larger number export indirectly (through a wholesaler), and an even more significant proportion export value added embodied in goods exported by larger domestic firms.

To get a first idea of some of the business constraints faced by SMEs in their growth and development, it is useful to review the WBES data. Table 2 breaks out the data by firm size, so that differences in the seriousness of constraints can be analyzed. Firms report on a five point scale ranging from zero (no constraint) to four (very serious constraint). Each figure represents the average seriousness of each business constraint across all APEC firms for which data are available. In most cases, responses are quite similar across firms of different size, which indicates that business constraints are relatively common to both types of firms, even though the burden is known to be relatively larger on SMEs in some cases. Nonetheless, the evidence from the business survey shows that SMEs confront a variety of issues in doing business, and in seeking to grow, develop, and internationalize. The case study examples

examine those issues in more detail, and provide instances in which APEC economies have found innovative ways of dealing with them.

The case of tax rates is of particular interest because SMEs report a greater level of burden than large companies. In other cases, the lower scores of SMEs may be endogenous, in the sense that they reflect special assistance that is available to them to lessen what would otherwise be burdensome constraints, for instance through dedicated agencies to support their growth, development, and internationalization. The pattern of business constraints identified by SMEs suggests that agencies with a broad remit of advice and support can, even if they do not regulate in particular areas, help SMEs overcome the issues they confront on a day-to-day basis.

Table 2: Seriousness of business constraints for large firms and SMEs, 0-4 scale (higher score indicates a more serious constraint).

Constraint	Large Firms	SMEs
Electricity	1.24	1.14
Transport	1.14	1.00
Customs and Trade Regulations	0.90	0.58
Access to Land	0.81	0.76
Tax Rates	1.34	1.60
Tax Administration	1.09	1.01
Business Licensing and Permits	0.88	0.79
Labor Regulations	1.09	0.77

Source: WBES and authors' calculations.

Regulatory reform to assist SMEs in these areas has to establish a clear framework for their operation, and will often require specialized agencies designed to give SMEs the very concrete help they need to grow, develop, and enter foreign markets. The examples presented in this case study bring out these points well. Figure 3 sets out the examples presented in this first case study.

Figure 3: Case Study One Examples.

Case Study One: Agencies for SME Growth, Development, Compliance, and Internationalization

- Chinese Taipei
- Mexico
- Viet Nam and Southeast Asia
- Malaysia
- The Philippines

Chinese Taipei—an economy where the SME base is particularly important—has a well-developed regulatory structure, including dedicated agencies. This structure makes it possible for SMEs to link with other actors in the economy, such as universities and technical specialists, who can assist them in their development and growth. In terms of specialized agencies, Chinese Taipei has dedicated government resources, as well as incubators designed to assist SMEs particularly through the process of rapid growth that some experience early on. The system is designed to promote transition for successful SMEs from that status, to larger businesses. Of course, not all SMEs can make that transition, but particularly in the age of technology based startups, it is important to have policy and institutional settings right, so that companies with a strong basis in the market can overcome the barriers posed by small size, and succeed over the medium term.

Whereas the Chinese Taipei example primarily addresses issues of growth and development, the Mexico example shows that SMEs can connect to GVCs—with the right support, combined with strategic decisions at a senior management level. Mexico has put in place a variety of structures, some in cooperation with other member economies, to support SMEs looking to internationalize, in particular targeting the US market. The aerospace sector, which is the subject of the case study, is a successful example of this strategy in operation. Mexican agencies have supported the development of firms to a point where they can join GVCs in the sector, supplying important component parts to major multinationals in the industry. The case study is an example of some of the ways in which developing member economies can support internationalization of SMEs by putting in place appropriate support structures in terms of institutions and agencies, which is one aspect of regulatory reform.

The next case study example looks at the World Economic Forum's Grow Asia program. It is active in Southeast Asia, including in APEC member economies like Viet Nam. The important point about this case study is that it highlights the need for private sector

participation in programs designed to support SMEs—in this case in the agricultural sector. Grow Asia is a partnership model and a space for dialogue, which also demonstrates the need for transparency in regulatory reform efforts. The case study discusses a variety of ways in which the program has been set up to make a concrete difference to operators on the ground, including through supporting changes in the regulatory structures that surround their activities, including through the development of voluntary standards as a type of “soft” regulation, as opposed to mandatory standards that can be more inflexible and less oriented towards the needs of global buyers.

The Malaysian example makes clear that regulatory reform to support SMEs requires a holistic approach. SME Corp. Malaysia is an agency that has been given responsibility for a variety of initiatives designed to support the growth and development of SMEs. This kind of “one stop shop” approach has important benefits in terms of reducing the costs for SMEs to access information, and increasing the visibility of government actions in their favor. In addition, Penang has implemented a partnership involving a wide variety of stakeholders, including SMEs, built around the “three I’s”: institutions, infrastructure, and incentives. Indeed, these three terms summarize a number of business constraints facing SMEs, and action in these areas can greatly assist their growth and development.

The final case study example is from the Philippines. The 2011-2016 MSME Development Plan serves as the framework for the convergence of initiatives adopted and implemented by multi-stakeholders towards the growth and development of the MSME sector in the economy. Key areas of action include the cost of doing business for SMEs, institutional supports for startups in particular and SMEs more generally, soft and hard infrastructure for SME growth and development, information availability, and gender inclusion and environmental sustainability. This last case study makes clear that in developing economies, development of the SME sector can be one important lever in the promotion of sustainable and inclusive development. In addition, it shows the importance of a broad based approach that covers a variety of issue areas, including rules as well as institutions.

The main lessons drawn from the examples for the first case study include:

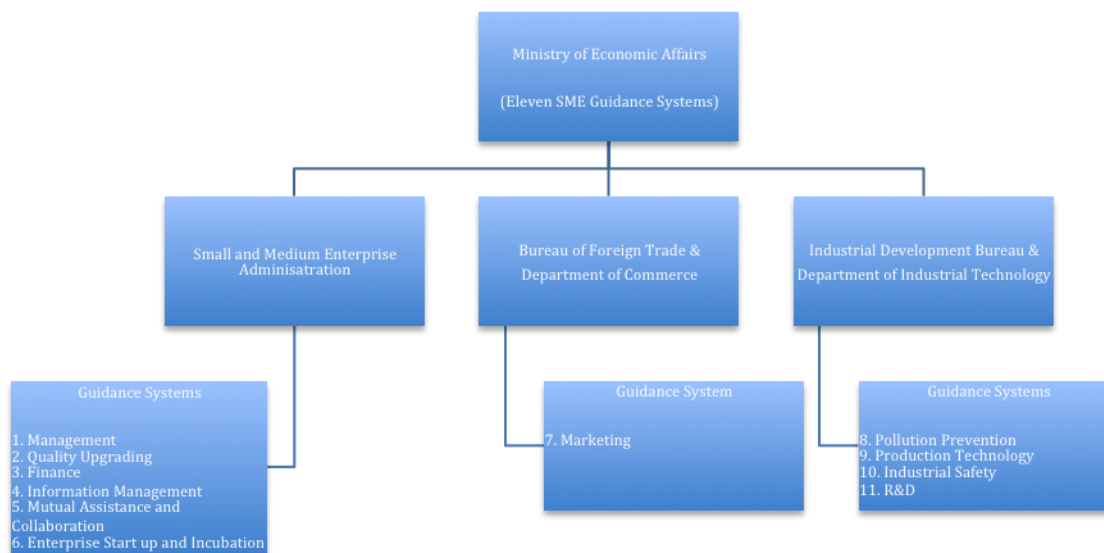
- The regulatory framework governing SME activities is important, and gains can be reaped from having targeted rules designed to loosen the business constraints SMEs face.
- Rules are not enough on their own, however. Dedicated government agencies are also typically required to support SME growth, development, compliance, and internationalization. These agencies need to be responsive to SME needs, and provide tailor made services such as management consulting and capacity building.
- Transparency and dialogue with the private sector, including SMEs, are key factors supporting the success of the programs reviewed in this case study. Transparency is an important part of any regulatory reform, but it is all the more pressing an issue in the SME context, when accessing information is often costly in terms of an entrepreneur’s time—a barrier that successful programs need to overcome, so that SMEs can fully take advantage of what is on offer.

Example 1: Support for SMEs in Chinese Taipei

The importance of SMEs to Chinese Taipei is evident in the scope and depth of subjects covered in the *Act for Development of Small and Medium Enterprises* (the Act). The Act

identifies the Ministry of Economic Affairs (MOEA) as the “competent authority” at the central government level. The MOEA has in turn articulated the far ranging provisions of the Act into eleven “SME Guidance Systems” (Figure 4) and has delegated responsibility for their administration to one or a combination of government bodies. Chinese Taipei has therefore crafted comprehensive regulatory reforms, covering institutions (agencies) as well as rules, dealing with the issue of SME growth, development, compliance, and internationalization.

Figure 4: SME Guidance Systems in Chinese Taipei



Source: SMEA website, www.moeasmea.gov.tw/ct.asp?xItem=2579&CtNode=322&mp=2.

In practice, the Small and Medium Sized Enterprise Administration (SMEA) under the MOEA provides the bulk of day-to-day support measures under the Act relating to SME growth, development, compliance, and internationalization. Specifically, it is responsible for administering a majority of the eleven SME Guidance Systems (Figure 2). The SMEA also serves as the general coordinating body working with central, sub-central and non-governmental agencies in policy areas relating to SMEs.

Emblematic of the SMEA’s support for SME growth is the dynamic network of domestic “incubator” programs numbering over 130 in 2012.² In that year, the SMEA provided funding to over half of all incubators comprised by networks of government agencies, research institutions, universities, and private-sector companies. Many of the SME Guidance Systems are provided in part through the incubators primarily on an on-demand basis. They offer a wide range of services from office space on university campuses to management consulting and access to R&D facilities in an integrated and economic manner. Their performance can be deduced from the growth beginning from 2008 through 2013 of total client start-ups to 1,354, or more than a doubling during that period.³

² SMEA (2014), p. 193.

³ SMEA (2014), p. 194.

The dynamism of the incubation sector is also clear in the variety of geographic specialisations that have evolved from the Nanking Software Incubation Center⁴ to the Hsinchu Biomedicine Industrial Incubation Center⁵ expected to open towards the end of 2014. On average, 4-5 incubated SMEs achieved stock market or OTC listings yearly from 2008 through 2013.⁶

Although incubators support SME development, the SMEA also implements a distinct “accelerator” program designed to concentrate and intensify the application of resources to select SMEs for rapid development. The “Star-Up” accelerator program builds on existing incubation programs, but unlike incubation programs, is highly selective and lasts only 3 to 6 months as opposed to years. The objective of the accelerator is to address “all organizational, operational, and strategic difficulties that might be facing the business.”⁷ It is essentially a comprehensive management consulting service designed to fit the best among qualifying SMEs. The Star-Up program also has an internationalization element addressed below.

A variety of agencies throughout Chinese Taipei support internationalization of SMEs. The SMEA provides Star-Up SMEs with access to its network of partner incubation platforms in the United States, Europe, and Asia, with the intention of supporting their access to international venture capital and ultimately integration into international supply chains.⁸ Also outwardly focused, the Taiwan External Trade Development Council (TAITRA), a non-profit organization with close links to the BOFT, supports SME internationalization by hosting domestic and international trade shows. Leveraging its network of overseas offices, TAITRA also provides research on foreign markets via the internet, and introductions to foreign business partners that would otherwise be difficult for SMEs to develop independently. TAITRA also implements the International Trade Institute (ITI), which provides an array of education programs for degrees in international languages and business that are synchronized with the needs of domestic enterprises via its Pre- and On-the-Job Training programs.⁹ In 2014, TAITRA organized 131 trade promotion events including its key domestic Sourcing Taiwan trade event, which it credits with generating a total of USD \$5.23 billion for domestic enterprises.¹⁰

Main Lessons Learned on Regulatory Reform

The successful experience of Chinese Taipei in supporting the development of SMEs resides in the capacity of the government to establish a system with clear areas where the assistance is going to take place, as well as the responsibilities that each of the public sector institutions involved are going to be in charge. In this specific case, the leadership by the Ministry of Economic Affairs has been critical and its use of good regulatory practices, such as the effective inter-institutional coordination with other responsible entities (as seen in Figure 4), has been an important factor to achieve SME policy objectives. More broadly, the Chinese

⁴ Areas covered: E-commerce, Embedded Systems, Software, and Network Communications. SMEA (2014), p. 193.

⁵ Provides “one-stop shop” support and regulatory verification services. This will deepen biotech research capabilities, accelerate the commercialization of R&D results, and enhance production efficiency. It will focus on Optoelectronic Imaging, Information Technology, Biomedical Chips, Biomedical Materials, Regenerative Medicine, Orthopaedics, and combination products. SMEA (2014), p. 193.

⁶ SMEA (2014), p. 194.

⁷ SMEA (2014), p. 195.

⁸ SMEA (2014), p. 196-7.

⁹ TAITRA website, “Trade Education”, www.taitra.org.tw/services_08.asp.

¹⁰ TAITRA (2014), Annual Report 2014, p. 4, www.taitra.org.tw/download/report2014_e_p04-05.pdf.

Taipei example shows the importance of institutions and rules working together as part of a broad-based approach to regulatory reform, and highlights the positive role that transparency—through the design of the SME support system—can play in maximizing the gains from reform.

Example 2: Helping SMEs Join GVCs—The Aerospace Sector in Mexico

The experience of the aerospace sector in Mexico shows that regulatory reforms are most efficient when part of a holistic strategy to develop a sector that includes both soft (regulations, training, etc.) and hard (infrastructure, enhancing manufacturing capacities) components. With a view to defining and implementing such a strategy, coordination among the various public and private stakeholders is needed, and dedicated agencies often need to be put in place. Regulatory reform needs to be tackled in the broadest possible sense, covering institutions as well as rules. This example highlights the fact that coordination between the public and private sectors is crucial—and can potentially even include foreign firms. Secondly, it shows the importance of moving towards international standardization, accreditation, and certification, so producers can be part of GVCs.

Mexico has become firmly established as one of the most important global players in the aerospace sector. It has reported a growth rate of 17.2% annually since 2004. Currently, there are 287 companies and support organizations most of which have NADCAP and AS9100 certifications. They are mainly located in six states, and employ more than 32,600 high-level professionals. Mexico was fully integrated in the major aerospace GVCs, and its aerospace exports amounted to USD \$5.463 billion in 2013 (ProMexico, 2014). While big companies are established in Mexico (e.g. Honeywell, GE, SNECMA), they rely on a large number of smaller suppliers.

With a view to helping Mexican SMEs take advantage of the opportunities offered by the aerospace sector, the government has developed a strategy to support companies already in this sector as well as companies wishing to migrate into it. Companies like Soisa (now 150 employees) could move from the jeans/textile maquila to the manufacture of products for lead aerospace firms like Boeing, Airbus, and Bombardier. The Mexican aerospace strategy included efforts to improve the economy's accreditation, certification, standards, methodology and testing capabilities, including the signing of the Bilateral Aviation Safety Agreement (BASA) for the mutual recognition of certification systems, and the development of a large network of research centers and certification laboratories. Through dedicated agencies or programs, the government and its trading partners have also attempted to address the specific needs of SMEs. For example:

- The Mexico-European Union Competitiveness and Innovation Program (PROCEI), managed by ProMéxico (a trust fund of the Mexican government and sub-division of the Ministry of Economy), has developed different projects aimed at reinforcing Mexico's aerospace sector, including the development of studies, certification programs, supplier identification, consulting and infrastructure, which has helped SMEs strengthen their capacities and raise their competitiveness. Among others, an initial phase of the project involved a diagnosis of 51 metalworking SMEs from seven central states, in order to identify the feasibility of this group of companies obtaining AS9100 certification. Of the 51 SMEs, twenty were selected to continue through the second phase of mentoring and a third phase of AS9100 certification for them to join the aerospace sector supply chain. An innovative FabLab (flexible manufacturing laboratory) was installed in the Chihuahua

region that enables SMEs to carry out innovation, design, and development activities for new products.

- The General Directorate of Civil Aviation addressed the growing demand for aerospace related services in Mexico by opening regional decentralized offices, thereby facilitating SMEs access to those services, including certification requirements under BASA.
- The United States-Mexico Foundation for Science (FUMEC) is a bi-national nonprofit organization (funded by the US and Mexican governments as well as private sector and philanthropic organizations) created in the context of NAFTA, which had a number of activities in the aerospace sector. For example, FUMEC identified both niche opportunities in the sector and, starting from there, SMEs with a high potential, either already operating in this niche or interested in migrating from other areas such as automotive, IT, or machining. It then helped those SMEs comply with relevant regulations (increase quality and seek certification), manage resources for working capital, machinery acquisition, and innovation.
- Once strengthened in their natural markets, the more mature SMEs are pushed towards international markets via the International Technology Business Accelerator (TechBA) – a business accelerator that aims to facilitate Mexican SMEs’ access to the most dynamic business ecosystems in the world through a range of services ranging from work and market penetration plans to sales support and business maturation.
- Mexico has also implemented different programs aimed at developing suppliers to strengthen the national productive chain. One, led by the Ministry of Economy in cooperation with the United Nations Development Program (UNDP), resulted in the joint suppliers’ development model. The program is based on training certified consultants with the necessary skills to improve production chains. Meanwhile, ProMéxico implemented the methodology of the Transnational Corporations Partnerships (ACT, acronym in Spanish) model, which seeks to leverage the strong interest of large companies established in Mexico to grow their business, particularly through domestic supply and transfer of operations.

Main Lessons Learned on Regulatory Reform

Interestingly, the reform of the relevant Mexican regulations and the upgrading of local SMEs have been done in coordination with major trading partners and lead global firms, thereby securing market access and demand for Mexican products. In this regard, the coordination to execute reforms has been not only among public sector institutions, but also between the public sector and the private sector.

Regulatory reforms at the domestic level have also been taken in parallel with improved trade policies (adjustment of the export control regimes, tariff simplification, exemption schemes, customs and foreign trade facilitation, SEZs) and regulatory convergence efforts at the international level, such as the ratification of BASA (mutual agreement) or compliance with international certifications. Dedicated agencies implemented the government’s strategy, providing technical and business expertise that together have made the environment much easier to navigate for SMEs, which has greatly contributed to their notable success. In terms of APEC’s good regulatory practices, this example again highlights the role of institutions in addition to rules as part of the process, and emphasizes the role that dialogue—both inside an

economy and with external partners—can play in designing and implementing successful regulatory reform.

Example 3: Improving Standards for SMEs—Regulation Versus Private Voluntary Standard Setting

Another important aspect of supporting SME growth and development, as well as internationalization, is the role of standards and compliance. This example highlights the need for multi-stakeholder dialogue as part of the regulatory reform process, construed broadly to include changes to rules and market institutions.

The role of GVCs in international trade and investment stresses the role of global lead firms in development through transfers of all kinds: capital, know-how, knowledge, and technology. Regulatory reforms could therefore aim to promote foreign investment and establishment, as well as linkages with local SMEs, and facilitate transfers benefiting the upgrading of local SMEs to meet higher standards. In turn, regulatory convergence appears increasingly important to reduce intra-GVC trade costs and increase competitiveness. The most efficient way to achieve these results is to establish a system for multi-stakeholder dialogue, where all the partners can bring their own resources and expertise. Grow Asia, convened by the World Economic Forum and the ASEAN Secretariat, is a good example of this type of dialogue, bringing together lead global firms, civil society organizations, local governments, and businesses/farmers.

Grow Asia's vision is to contribute to food security, environmental sustainability and economic growth through agricultural development in Southeast Asia, including some APEC member economies. Its purpose is to enable development of environmentally sustainable and inclusive agriculture through innovative multi-stakeholder partnerships and scalable solutions, with a specific focus on smallholder farmers. Its target is to reach 10 million smallholder farmers by 2020, and enable them to increase their yield and profits by 20%, using 20% less water, and emitting 20% less greenhouse gases per ton of production.¹¹ Its role is to facilitate multi-stakeholder partnerships, catalyze investment, solve problems, and monitor impact.

Multi-stakeholder partnerships on various cross-cutting issues contribute to improving the business environment and enabling smallholder farmers to join and increase the benefits of participation in GVCs. Projects include: farmer capacity building, empowering women, knowledge and technology dissemination, access to financial services, environmental management, and investment in processing and logistics. It also fosters cross-border collaboration, and supports the delivery of the ASEAN Integrated Food Security (AIFS) Framework that aims to achieve food security and nutrition, at the same time as improving the livelihood of farmers in the region.

This partnership has been a significant push in favor of regulatory reforms benefiting both global lead firms and their local suppliers, in particular towards the reform of laws pertaining to investment in R&D and technology, as well as greater integration, cooperation, and harmonization of food standards (compliance). Sustainability standards have also significantly increased as a result of the diffusion of best practices (management and technologies). The diffusion of voluntary (private) standards has contributed to increasing

¹¹ <http://growasia.org/partnership>.

SMEs' compliance independently of public reforms. Projects developed under the Grow Asia umbrella clearly have the capacity to contribute to the adoption of a regulatory framework that is more supportive of SMEs' development and integration into GVCs. For example, in Viet Nam:

- A project with the Ministry of Agriculture aims to review the potato seed registration process to make it faster and more efficient.
- The Minister of Agriculture and Rural development successfully launched the first ever public-private Coffee Coordination Board in Viet Nam (VCCB) and is now in the process of approving a coffee National Sustainability Curriculum that forms the backbone of future sustainability activities and training.

Another key regulatory reform prompted by the partnership pertained to land rights: to support farmers in gaining land rights, land use plans need to be clearly developed and monitored via mapping and resource inventory. Land rights also need to be institutionalized through legal contracts and collectivization needs to be allowed.

Main Lessons Learned on Regulatory Reform

Major lessons to be drawn for regulatory reforms from this new generation of PPPs include:

- The necessity to have regulatory reforms driven by and adapted to market needs, rather than single-handed by governments. Sometimes, regulatory reforms aimed at creating new certification/accreditation processes could be counterproductive if those certifications/accreditations are not recognized by the markets.
- A culture of evaluation or results-orientation for regulatory reforms—as is the case in projects driven by the private sector—is essential to success. Good regulatory practices such as cost-benefit analysis, ex ante and ex post, should be an important part of the decision making process.
- Another aspect of APEC's good regulatory practices that is highlighted by the example is the use of alternatives to regulation, such as private standards. It is not always necessary that mandatory rules be changed in order to improve the business environment for SMEs: attention to areas such as private and voluntary standards can also be of assistance.

Example 4: A Holistic Approach to Regulatory Reform for SMEs—The Case of Malaysia

Malaysian regulatory reforms in favor of SMEs highlight the three pillars of many successful approaches: institutions, infrastructure, and incentives. It is important to address all three aspects in developing broad-based regulatory reforms to promote SME growth, development, and internationalization.

SMEs operate across all sectors, so issues of coordination naturally arise in the design and implementation of regulatory reforms. In 2007, Malaysia created a single dedicated agency (SME Corp. Malaysia) to formulate overall policies and strategies for SMEs and to coordinate across all related Ministries and Agencies. Its prerogatives include:

- Coordination of policies and programs (formulate broad SME policies across all sectors; coordinate, monitor and evaluate effective implementation of policies and programs across relevant Ministries and Agencies).
- Center on advisory and information (provide business advisory through the “One Referral Center”; disseminate information on government funds and incentives on SMEs; act as a channel for feedback on SME issues; liaison for domestic and international communities on SME matters).
- Management of data, dissemination of information, and research on SMEs (manage the National SME Database, undertake research on SMEs; publish SME-related reports and statistics; undertake outreach programs).
- Business support (nurture and develop competitive SMEs through specific capacity building programs and financial assistance; enhance competitiveness of SMEs using the SME Competitiveness Rating for Enhancement (SCORE) diagnostic tool; provide infrastructure support for SMEs; facilitate linkages with large companies and multinationals).
- Secretariat to the National SME Development Council (NSDC) (propose policies and ensure decisions of NSDC are effectively implemented; provide administrative support for NSDC).

Among the initiatives to adapt business law to SMEs’ needs, the government introduced an incentive for mergers and acquisition of SMEs in the services sector that is open until July 2015 and for which SME Corp. Malaysia serves as a one-stop center for processing, verification, and endorsement of the incentive. The objective is to help SMEs better face global competition through economies of scale, access to new customer bases in domestic and external markets, and diversifying their portfolio of brands and services. Government incentives include a flat tax rate of 20% on all taxable income for a period of five years from the date of merger, and a stamp duty exemption on the merger document. The eligible companies must be SMEs in the services sector and be 100% Malaysian owned.

The example of the Penang region suggests again that smart partnerships between government, global firms/investors, and local SMEs are the key to success in promoting business linkages, technology transfers, and competitiveness in the global market place (Khoo Cheok Sin, 2010). The Penang process for technology upgrading was based on the three I’s:

- **Institutions:** The State government, through the Penang Development Corporation (PDC) created free-trade zones to encourage FDI, and acted as a one-stop shop that interfaced between potential investors, the local authorities, and the local SMEs, thereby significantly reducing their administrative burden. A Global Supplier Program was launched that included a skills development (training) component and the pairing of successful SME graduates with global firms.
- **Infrastructure:** The Penang government has put great emphasis on ensuring good transportation facilities and links, utilities, and other physical infrastructure for the business sector. The regulatory aspects were not neglected, and the government made

sure, for instance, that the water supply met WHO standards, and that the partnerships in the telecoms sector resulted in better service.

- Incentives: Various attractive tax incentive packages were provided to approved projects in order to ensure that start-up and operating costs were competitive. While the incentives applied to both the global firms and the SMEs, the latter heavily relied on them to maintain cash flow and invest in R&D so they could meet the global firms' requirements.

Main Lessons Learned on Regulatory Reform

Linkages with global firms, and the role of the government in encouraging and facilitating them, have been essential for local SMEs to gain access to new technologies and management know-how. While regulatory reforms were part of the picture, again, their success was due to a more holistic approach that included capacity and skill-building components, to make sure that supply matches the needs of the market. As a result of these policies, the number of companies in the State of Penang multiplied 35 fold in two decades, sustaining an 8 percent growth rate, and reducing significantly the unemployment rate from 16 to 4 percent.

This example also shows that regulatory reforms are not a one-off event, but they are a continuous process. In this sense, flexibility was incorporated as one of the good regulatory practices in policymaking to achieve policy objectives after changes in market trends. As global competition increased, the government adjusted the business law to SME needs in order to encourage SMEs to make decisions that will put them in a better position to face the new global business environment. Another good regulatory practice that this example demonstrates is transparency, through the emphasis on information dissemination to business.

Example 5: From National to Local—The Example of the Philippines

In the Philippines, the MSME sector accounts for 99.6% of total establishments in the economy, and contributes 61.2% of the economy's total employment and 35.7% of total value added.¹² Government policies for SMEs are embodied in Republic Act 9501. The Micro, Small, and Medium Enterprise Development (MSMED) Plan 2011-2016 was put in place to promote, support, strengthen, and encourage the growth and development of Micro, Small, and Medium Enterprises (MSMEs) in all productive sectors of the economy. The plan serves as the framework for the convergence of initiatives adopted and implemented by multi-stakeholders towards the growth and development of the MSME sector in the economy.

The MSMED Plan has four major outcome or result portfolios, namely Business Environment (BE), Access to Finance (A2F), Access to Markets (A2M), and Productivity and Efficiency (P&E). It will also take into consideration global themes and cross-cutting issues related to gender, climate change, corporate social responsibility, and migration.

With regard to business environment, more specifically, the results framework for the plan includes the following outcomes:

- The cost of doing business (taxes, fees, etc.) is affordable to MSMEs.

¹² http://publications.apec.org/file-download.php?filename=015_Philippines_ANSSR.pdf&id=1206_toc.

- The institutional support structures for the development of start up and existing MSMEs are in place.
- The policies necessary to develop the MSME sector are crafted and being fully implemented.
- Support for MSME development is results-based, coordinated, harmonized, and sustained by capable stakeholders at the national and local levels.
- An entrepreneurial mindset is pervasive among MSMEs and other MSME stakeholders.
- Soft and hard infrastructures for MSME development are established.
- The information required by MSMEs is available and accessible.
- MSMEs are gender-responsive and environment-friendly.

In June 2013, the Department of Trade and Industry (DTI) conducted a mid-term review of the MSME Plan (Table 3). According to the government, conclusions were positive under the four pillars of the plan, as illustrated in table below. This review focuses on outputs rather than outcomes, however, and while significant institutional efforts were made, the real impact of these efforts is still to be determined.

Table 3: MSMED Plan Mid-term Review (2011-2013).

Overarching objective: Create 2 million jobs in MSMEs by 2016			
Mid-term results: Between 2011 and 2013, more than 1.5 million jobs were generated, i.e. 75% of target objective			
Objective 1 Business-Enabling Environment (BEE): Help create an enabling environment for the establishment, development and sustainability of MSMEs	Objective 2 Access to Finance (A2F): Help increase MSMEs' access to financial products, services, and support programs	Objective 3 Access to Markets (A2M): Help increase MSMEs access to domestic and international markets	Objective 4 Productivity and Efficiency (P&E): Help increase the level of productivity and efficiency of MSMEs
Mid-term results: 926 local government units had streamlined their business registration process by June 2013 from just 82 in 2010. With the passing of the Republic Act 10644 otherwise known as "The Go Negosyo Act" (see below), this statistic was expected to improve further.	Mid-term results: The amount of loans granted by government financial institutions (GFIs) and government owned and controlled corporations (GOCCs) to MSMEs increased from PhP100Bn in 2010 to PhP257Bn in 2013. The number of MSME borrowers from both types of institutions also increased from 2011 to June 2013.	Mid-term results: The government's strategy was to focus on lesser but bigger export marketing events since 2011. For example, it helped the furniture industrial cluster generate USD 1,340,000 in exports - this industry cluster was prioritized by the DTI and one of the top exports of the Philippines. Domestic sales were likewise generated from trade fairs and expositions in the amount of PhP 431,000,000.	Mid-term results: The number of training programs increased. The three institutions covered in the review, namely, the Philippine Trade Training Center (PTTC), University of the Philippines Institute for Small Scale Industries (UP-ISSI), and the Bureau of Micro, Small and Medium Enterprise Development of the Department of Trade and Industry (BMSMED-DTI) provided capacity building for a total of 52,586 beneficiaries.

Source: MSMED Council, 2014

The MSMED created the MSMED Council, which is attached to the Department of Trade and Industry. The Department's Secretary serves as Chairman. The Council was mandated to carry out the provisions of the law and be primarily responsible for the development of the Philippine MSME sector. The Council focuses, however, on the strategy and outcome level, leaving the management of the action plans to local and regional stakeholders. It was recently restructured to include the representation of vulnerable groups, such as women and youth.

Negosyo Centers were established in 2014 (*Go Negosyo Act* n° 10644). They are responsible for promoting "ease of doing business and facilitating access to services for MSMEs within their jurisdiction", such as business registration assistance, business advisory services, business information and advocacy, monitoring and evaluation. For example, the Negosyo

Centers will be linked to the Philippine Business Registry System (PBRs) to make it easier and faster for entrepreneurs to start and register their businesses at the local level: the government will develop a unified and simplified business registration form based on the current form being used for the business process and licensing system. Some 100 Negosyo Centers are expected to be established in the economy.

The Negosyo Centers provide a good example of agencies set up at the provincial or city level that help SMEs jump the several hurdles they face in their business environment.

Main Lessons Learned on Regulatory Reform

It is premature to determine the success of the MSMED Plan. The plan is still under implementation. However, this example explains what steps the central government is taking to implement it. This process includes a mid-term review of the plan, which provided an assessment of its implementation. This review is a sort of a cost-benefit analysis in the sense that it allows the authorities to identify what has worked and what has not, in line with good regulatory practice. The reviews provide the authorities with evidence to propose and implement adjustments to the existing policies or plans.

AGENCIES AND INSTITUTIONS THAT SPECIALIZE IN SUPPORTING SME FINANCE

All business require finance of some kind in order to grow and develop, as well as to enter international markets. Access to finance is therefore a crucial variable determining a company's ability to succeed in its plans for expansion. The issue is particularly critical for SMEs, because they typically lack established relationships and valuable collateral that large business have. In addition, some small businesses often have business plans that are riskier or less fully developed than those of large businesses, which again leads to difficulties in obtaining finance on reasonable terms. In many cases, entrepreneurs are required to put their personal assets behind the business in order to secure financing at all, which represents a serious assumption of risk in the case of failure.

The importance of access to finance as a constraint facing SMEs comes out clearly in the WBES data. Again, Table 4 presents the data broken out by company size category. In this case, there is a clear difference between SMEs and other firms: the former indicate that access to finance is a more serious constraint than is the case for large firms. Based on what APEC SMEs are expressing in this survey, the issue of access to finance is obviously a critical one for governments to address in their regulatory reform efforts in favor of SMEs, in collaboration with the private sector, especially financial institutions.

Table 4: Seriousness of business constraints for large firms and SMEs, 0-4 scale (higher score indicates a more serious constraint).

Constraint	Large Firms	SMEs
Access to Finance	0.99	1.18

Source: WBES and authors' calculations.

As with the first case study, this one presents a number of examples from around the APEC region to showcase ways in which governments, in league with the private sector, have responded to the challenge of SME financing. Figure 5 sets out the case study examples used in this section.

Figure 5: Case Study Two Examples.

Case Study Two: Agencies to Support SME Finance

- Japan
- Mexico
- China
- Chinese Taipei

The first case study example comes from Japan. Under the initiative of the Ministry of the Economy, Trade, and Industry, the private and public sectors collaborated on the development of a Credit Risk Database for SMEs. The objective of the project is to make data on SME performance available to lenders through an IT-based platform, thereby making it possible for them to make more informed decisions on risk and creditworthiness. The database has been very successful in recruiting lenders and SMEs, with 174 members and coverage for over 50% of all SMEs in the economy. Indications are that the Credit Risk Database goes some way towards overcoming a problem of information asymmetry that plagues financial markets, and is a particular problem for SMEs: the borrower is always in a much better situation than the lender to assess creditworthiness, but the latter is dependent on what the former says in order to make its own determination. The result of this asymmetry is that beneficial market transactions may not take place. The Database can therefore be seen as a useful initiative to deal with a widespread and well-known type of market failure that disproportionately affects SMEs that do not have audited accounts.

In Mexico, Nacional Financiera (NAFIN) has become a key pillar of the financing environment for SMEs. It provides a guarantee program that in 2010 backed up over half of all loans made to SMEs by the banking sector. It offers a wide variety of credit guarantees, direct financing, and sector-based programs. Clearly, government intervention in financial markets needs to be managed carefully to ensure that it does not distort the incentives of economic actors. But measures such as the provision of guarantees for creditworthy companies that may not be recognized as such by the financial sector is a case of correcting a market failure due to information asymmetry, and is thus an example of regulatory reform that promotes market efficiency. These kinds of measures can help loosen the financial constraints under which most SMEs operate, and assist them in their efforts to grow, develop, and overcome the costs associated with internationalization.

As noted above, SMEs typically do not have immovable assets to offer as collateral for a commercial loan. Innovative programs in China and Mexico have faced up to this constraint by developing the use of movable assets as collateral for SMEs. Regulatory reforms have made it possible for SMEs to use assets like accounts receivable to support credit applications. In China, the system has enjoyed widespread success, with \$1.5 trillion in loans on receivables extended during the first three years of operation of the system. Use of receivables as collateral requires development of a registry, which has taken place in both case study economies. In Mexico, reforms to the registry system—an important regulatory institution—saved businesses \$3.45 billion over a two-year period, thanks to lower registration fees. The primary beneficiaries of these changes have been SMEs.

In Chinese Tapei, the Small and Medium Enterprise Credit Guarantee Fund plays an important role in SME financing. It is established based on an extensive network of regulations designed to support the growth and development of SMEs. The Fund provides direct and indirect loan guarantees for SMEs, which makes them more viable applicants for credit via traditional channels such as banks. By the end of June 2014, more than 354,000 SMEs had received \$283 billion in credit guarantees—a substantial easing of the burden facing SMEs when it comes to seeking access to financial markets. Of those firms, over 2,000 have succeeded in graduating from SME status, which is a clear sign of the system's success in supporting innovative, high potential SMEs in their overall strategy of growth and development.

Example 1: Information and Regulatory Gaps—The Japanese Credit Risk Database

Asian economies are often characterized as having bank-dominated financial systems and underdeveloped capital markets, and as a result, banks are the main source of financing for SMEs. However, the financial health of SMEs is difficult to evaluate since many do not have solid accounting systems and many SMEs in Asia resort to borrowing money from money lenders at high interest rates. Even when firms are able to borrow money from banks, they face high collateral requirements.

Strict regulatory solutions to these problems are difficult to put in place, since they would affect banks' freedom to operate and assess risks, and potentially challenge their profitability. Banks also have to respect regulations pertaining to capital adequacy, stress testing, and market liquidity risks (e.g. Basel III) that affect their lending decisions and might increase their risk aversion.

The Japan Credit Risk Database (CRD) offers an innovative solution to these difficulties by offering banks more information on SMEs, and helping financially sound firms raise money more easily and at lower cost.

In 2001, the CRD was established as an association in Japan, at the initiative of the Ministry of Economy, Trade and Industry (METI) and the Small and Medium Enterprise Agency (SMEA) by 52 credit guarantee corporations as well as financial and non-financial institutions, both public and private, following a 1.3 billion yen government investment in the CRD's computer system and other operational costs. Its aim was to promote the streamlining and efficiency of SME financing by measuring credit risk and assessing business conditions based on data. The CRD collects data from credit guarantee corporations throughout Japan, as well as government-affiliated and private financial institutions involved in SME business,

and provides its members with assessments of SME business situations and credit risk. Its membership grew quickly, to reach 174 members in 2015, and its database covers more than 50% of all SMEs in Japan (more than 15 million), making it the largest database for SMEs in Japan.

The main purpose of developing such databases is to create the infrastructure for improved credit rating of SMEs. Members of the CRD Association use scoring models to enhance the efficiency of credit evaluation, check the validity of internal rating systems, and make loan pricing in line with credit risk. In addition, the CRD Association provides consulting services for SME management support, with a view to reducing credit risk for member financial institutions and strengthening the business operations of SMEs. Services have also been offered to member financial institutions to help them promote the implementation of Basel II and III.

Having centralized SME databases like the CRD remains a long-run target for many governments. In the short run, there are a variety of available database that can be used for assessing SMEs' credit ratings. For example, government and private institutions have financial statements of their SME customers that can be used for the credit rating of bank customers. In many Asian economies there are also databases on SMEs kept by the respective tax bureaus of the ministries of finance that could be also used as databases for the credit rating of SMEs.

Policy conditions, including the legal and regulatory frameworks, can greatly affect whether credit reporting develops in an economy, how it develops, and whether credit reports are useful for predicting risk. According to the World Bank, critical policy issues that governments ought to consider in developing credit registries include the following:

- *Enabling legal and regulatory framework.* Such a framework is necessary to encourage information sharing among lenders, and facilitate the flow of credit information. This often requires reviewing bank secrecy laws, permitting and providing incentives for the sharing of both positive and negative information, and eliminating restrictions on access to public records. Bank secrecy laws in many developing economies effectively prohibit or limit the operation of private credit bureaus.
- *Balance between protecting privacy and consumers' rights and the need for information sharing.* Consumer protection concerns include issues such as fairness in the treatment of borrowers and lenders, accuracy in credit information, types of information collected, and non-invasion of privacy. Credit bureaus must follow reasonable procedures to ensure that the information they obtain is accurate, relevant, and unbiased. In addition, laws and regulations should provide sufficient protection to consumers by ensuring that data are not misused, creating a balance between privacy protection and effective information sharing, allowing borrowers to access their own credit reports, and prescribing clear procedures for borrowers to challenge and correct incorrect information.
- *Balance between reasonable penalties for noncompliance and overly restrictive regulations.* An adequate legal and regulatory framework ensures the health and robustness of credit bureaus; however, legislation must be carefully crafted so that it is not overly restrictive, unnecessarily severe in relation to penalties or sanctions, or too complicated, and so that procedures for information collection and exchange are not too extensive and expensive. The impact of overly restrictive rules can be severe. In Thailand,

two credit bureaus that had operated for several years shut down when a new law was passed in 2003 that imposed large fines and criminal liabilities on participating financial institutions for minor violations in sharing information. The two bureaus did not reopen until five months later, when clarifying regulations were issued.

- *Public versus private credit bureaus.* Public and private credit bureaus are not considered substitutes, but rather complements to each other. Governments in many economies have been prompted to establish public credit bureaus, typically through the central bank or the banking supervisor, to overcome the limitations of private bureaus or legal and regulatory restrictions on information sharing in the private sector. In some poor economies and those with highly concentrated lending markets, there may not be sufficient interest in the private sector to set up credit bureaus. Under such circumstances, the establishment of a public registry may offer the advantage of rapid setup, and direct enforcement by bank supervisors can counter lenders' unwillingness to comply.

Main Lessons Learned on Regulatory Reform

This example again highlights the importance of the public and private sectors working together to support SMEs. The precise mix of inputs from the two sources depends on individual economy characteristics. However, there is considerable scope to adapt the CRD approach to other contexts within APEC. Thailand, for example, is currently working to develop a system like the Japanese CRD in the context of its overall economic development objectives. Given the range of institutions—both public and private—that are involved in developing an instrument like the CRD, coordination is crucial.

In terms of APEC's good regulatory practices, this example demonstrates a number of important points. First, the key innovation is in some ways an alternative to regulation: the CRD exists under private law, albeit within a broader regulatory enabling framework to deal with issues like confidentiality and use of data. Transparency is also key to the initiative—businesses need to be sure that their information is being appropriately dealt with, and banks need to trust the information that is fed to them through the system. Finally, as already mentioned, coordination is a notable aspect of this example, given the large number of agents involved.

Example 2: Promoting SMEs Factoring in Productive Chains—NAFIN in Mexico

In Mexico, Nacional Financiera (NAFIN) has become a fundamental pillar in providing financing to MSMEs. During 2014, NAFIN fulfilled the goals it established and registered an annual growth of 17.1% in the total amount of credit and guarantees provided, without neglecting the bank's financial sustainability. It increased its total amount of financing to 283,816 million pesos, assisting nearly 200,000 businesses with development financing and almost a million clients with micro-financing.¹³ NAFIN offers a wide variety of credit guarantees, direct financing and sector-based programs.

In 2001, NAFIN developed an online Program for Factoring in Productive Chains that works by leveraging the links between large corporate buyers and small suppliers. The program allows small suppliers to use their receivables from big buyers to obtain working capital financing, effectively transferring suppliers' credit risk to their high-quality customers to access more and cheaper financing. SMEs in production chains have immediate liquidity for

¹³ <http://www.nafin.com/portalnf/content/sobre-nafinsa/otra-informacion/informes-anuales.html>.

receivables through an electronic discount on their invoices before the due date. In practice, NAFIN, which is a second-tier institution encourages the participation of other bank and non-bank financial institutions with attractive interest rates. The program thus provides a supplier with more liquidity more quickly than traditional factoring and avoids the problems of costs and maturity dates that affect credit for SMEs (OECD/ECLAC, 2013). NAFIN offers two types of supply chain finance on its online platform: (i) factoring offered to SMEs without any recourse, collateral, or service fees, at variable risk-adjusted rates; and (ii) contract financing, which provides financing up to 50 percent of confirmed contract orders from big buyers with NAFIN supply chains, with no fees or collateral, and a fixed rate. Through the Federal Government Purchases Program, this mechanism was also used to support SMEs supplying public offices and entities.

As of December 31, 2013, the Network of State Representatives completed the installation of 54 chains in 18 Mexican states, as a result of knowledge of local markets, the maturity of this product, and local companies' knowledge and use of this product. With 11,115 affiliated suppliers, the Productive Chains Program was considered a success.

The NAFIN success primarily is one of regulatory reforms that created the enabling environment for online factoring services to thrive and that could be a model for other economies. According to Klapper (2004) and World Bank (2006), the NAFIN factoring program has succeeded primarily because of supporting electronic security laws and taxation. Use of the Internet for online transactions not only reduced costs, but also increased the program's ability to reach SMEs in remote and rural areas. Previously, the owners of many rural SMEs had to travel to the cities to present bills to their urban customers and collect payments. By factoring their receivables, the suppliers eliminated trips to customers and collection costs.

In Mexico, the NAFIN factoring program is now used as a model for automating the services of other service providers and government agencies. In May 2000, reforms in legislation pertaining to e-commerce gave data messages the same legal validity as written documents, thereby making electronic factoring possible. Passage of the Law of Conservation of Electronic Documents established the requirements for conserving the content of data messages regarding contracts, agreements, and accords. In April 2003, the Electronic Signature Law was enacted, which allows the substitution of electronic signatures for written signatures and permits the receiver of a digital document to verify the identity of the sender. In January 2004, modifications to the Federation Fiscal Code included amendments necessary to complete electronic transactions, including factoring.

NAFIN charges no commission (to the seller) and offers capped interest rates. In addition, favorable taxation treatment helps keep factoring costs low for SMEs and provides incentives for them to participate in the factoring program. All interest charges that the small suppliers pay to their factors are tax deductible.

Concretely, the NAFIN website has a dedicated page for each big buyer, while small suppliers are grouped into chains with those big buyers with whom they have business relationships. The suppliers and NAFIN sign an agreement allowing the electronic sale and transfer of receivables. Once a supplier delivers goods and its invoice to the buyer, the buyer posts a negotiable document equal to the amount that will be factored on its NAFIN webpage. In general, this is equal to 100 percent of the value of the receivable. The supplier can then access NAFIN's webpage to see which participating banks and finance companies are willing

to factor its receivables, and at what interest rate. Picking the one it deems has the most favorable terms, the supplier clicks on the name of the factor, and the amount of the negotiable document less interest is transferred to the supplier's bank account. When the invoice is due, the buyer pays the factor directly. The efficiency of the electronic platform means that small suppliers typically receive money within one business day.

Main Lessons Learned on Regulatory Reform

The reforms implemented in Mexico that encourage the appearance of online factoring services were successful for a myriad of reasons. The factoring program was designed in a way that incorporated transparent features in a competitive market, so SMEs could benefit by having access to information that allows them to choose the institution offering the best conditions for their accounts receivable. In addition, and in line with good regulatory practice, implementation of the factoring program required coordination among the public and private sectors, institutions within the public sector, and federal and state governments.

Before and after the reform, the main benefits for SMEs include:

- Choice of best available rate on the market place—higher transparency.
- Open market and higher competition among bank and nonbank institutions—lower rates.
- Immediate payment of receivables—within one business day compared to 30 to 120 days before.
- Electronic transaction—reduction of costs and increased time efficiency, outreach to remote areas without bank offices.
- No need to collect payment from buyer—cost and time saving, default payment risks transferred from the SME to the lending institution.
- Strengthened relationships between suppliers and buyers.
- Positive spillover effects—helps building credit history and reduce costs of other loans.

Example 3: Changing Regulations to Improve Access to Finance by SMEs—Unleashing the Potential of Movable Assets as Collateral in China and Mexico

China

In 2005, China embarked upon a reform of its movable collateral regulatory framework to encourage financing against valuable movable assets. Based on recommendations of the People's Bank of China and the National People's Congress Legislative Affairs Commission, the NPC passed the historic Property Law, which adopted a number of important principles of modern secured transactions laws. Before the reform, use of movable collateral, especially intangible collateral such as accounts receivable was a key constraint for SME financing, as bank lending was largely based on real estate collateral, which SMEs typically do not possess. The reform model had three phases:

- Development of the property law.

- Creation of an electronic registry for accounts receivable and leases.
- Training of lenders to use movable assets as a basis for lending.

Following China's reform of its movable collateral regulatory framework and establishment of the registry, SMEs can now use a wider range of assets, such as accounts receivable and changing pool assets as a basis for borrowing. In the first three years (2008-2011) of operation of the new system, lenders granted more than USD \$1.5 trillion in loans secured with receivables to more than 100,000 businesses, more than half of them SMEs. The percentage of movable-based lending in China went from 12 percent pre-reform and prior to the creation of the receivables registry, to 20 percent after the creation of it.¹⁴ As a result, leasing and factoring industries have developed and grown substantially. In 2012, the Chinese consumer credit reporting system and the Account Receivables Registry were evaluated and deemed by the Banking Technological Result Appraisal Committee as being "of world-class standards" and "leading domestic standards" respectively. The two systems were also awarded the Grand Prize and the Second Prize at the Banking Technological Development Awards 2012 respectively.

Regulatory reforms continued to improve the system. In 2013, the movables financing registry began accepting the registration of four new types of movables-backed financing, including retention-of-title financing, hire purchase financing, liens, and financing involving other types of movables. It also started the provision of its service through its website. In 2014, China improved its credit information system again by introducing credit information industry regulations, which guarantee borrowers' right to inspect their data.

Main Lessons Learned on Regulatory Reform

The Chinese experience with regulatory reform to support SME financing highlights the importance in some economies of leadership from the top. In appropriate cases, high level involvement can support the implementation of complex reforms involving a wide range of actors. The appropriate mix of top-down and bottom-up reform processes varies from economy to economy, and depends on the nature of domestic political and regulatory institutions. Reforms need to be adapted to that context in order to be effective. In addition, the Chinese experience shows the importance of sequencing reforms, and rolling them out in a coordinated way. This approach allows the authorities to learn from experience, and tailor interventions to be as effective and efficient as possible, in line with good regulatory practice.

Mexico

Under the decisive lead of the Ministry of Economy, Mexico has progressively introduced reforms in its secured transactions legal system over the past few years. But the reform that transformed the lending scenario for SMEs was the creation of a nationwide movable collateral registry in October 2010. Before the Ministry of Economy took this action, only a few creditors registered collaterals (the old Registry was expensive, delayed and impractical), and transferred the costs of the credit risk they assumed to their debtors. The new Registry is simpler, more reliable and less expensive, with a 24/7 online service to register all security interests and liens over movable property and to gain publicity and legal effects before third

¹⁴ <https://www.wbginvestmentclimate.org/advisory-services/regulatory-simplification/secured-transaction-and-collateral-registries/more-examples-of-our-work.cfm>.

parties. By improving the credit's terms and conditions, the Registry reduces risks on providing credits.

Table 5: Before and after reform.

	Before regulatory reform	After regulatory reform
Proceeding	<ul style="list-style-type: none"> - Paper based - Subject to approval by State officials - Over 260 different registration offices 	<ul style="list-style-type: none"> - Online registration - Immediate registration - Single national database for all security interests
Fees	<ul style="list-style-type: none"> - Different rates by State - Fees based on a percentage of registered amount (avg. 2%) 	<ul style="list-style-type: none"> - No registration fee required
Time	<ul style="list-style-type: none"> - Average registration time over 17 days 	<ul style="list-style-type: none"> - Minutes

Source: Sanchez Araujo, 2012.

With the new registry, the monthly number of loans to businesses has increased by a factor of four. In the first two years of operation (2010-12), over 117,068 transactions and 66,901 collaterals were registered. In its first year of operation alone, 23,000 loans generated more than USD \$70 billion in financing to businesses, SMEs accounting for more than 90 percent of the firms receiving those loans. The reform has also led to a cumulative estimated saving for borrowers of USD \$3.45 billion in registration fees associated with the registration of the security interest in the previous system (for the period 2010-12). About half of the loans granted have gone to agri-businesses and farmers.¹⁵

Main Lessons Learned on Regulatory Reform

One of the main lessons in this example is that the effectiveness of policies to streamline access to credit depends on reforms in the legal framework. The use of modern technologies to increase access to information needs to be developed in hand with regulatory changes to establish what type of information can be incorporated in the registry and how this information will be used.

As Table 5 shows, the introduction of reforms not only facilitated the development of an online registry system, but also made it easier, faster, and cheaper to register collateral. The benefits to registering collateral seem to have outstripped the costs. The savings for borrowers after the reform have been impressive, and the results achieved in terms of increasing the number of loans to SMEs have been very encouraging.

Example 4: Supportive Regulatory Infrastructure in Chinese Taipei

Cognisance of difficulties facing SMEs seeking finance is apparent in Chapter 2 of the *Act for Development of Small and Medium Enterprises* (the Act). It not only specifies a budget allocation for credit guarantee institutions facilitating SME access to finance, but also authorizes the Ministry of Economic Affairs (MOEA) to “solicit donation from private

¹⁵ <http://www.ifc.org/wps/wcm/connect/b68da5004bea0a39a1e0e71be6561834/Day1-session3-Gabriel-A-S-Araujo-Mexico+experience.pdf?MOD=AJPERES>.

businesses” in further support of them. The MOEA is additionally instructed to “help” SMEs secure loans from banks and is required to “review and report” its progress at the end of each fiscal year to the Legislative Yuan.¹⁶

The Act also clarifies three headings under which loans or facilities for providing loans should be pursued including: “special financing”, “emergency financing facilities”, and “business converting projects”. *Special financing* encompasses five subjects including: 1) enhancing competitiveness, 2) R&D, 3) innovation, 4) factory relocations due to government policies (e.g. urban planning), and 5) ad hoc “projects as approved by the central authority.” *Emergency financing facilities* address three situations including “significant economic crisis”, “significant natural disaster”, as well as other “emergency events”. Finally, *business converting projects* is defined as three items including: 1) a “revolving fund” to support SMEs during “economic recession”, 2) loans to support replacement of existing or procurement of additional equipment during a “business conversion”, and 3) loans to procure equipment for “improv[ing] [] productivity.”¹⁷

The MOEA has assigned general administrative duties to the Small and Medium Enterprise Administration (SMEA). Acting as a coordinating agency for the bulk of provisions in the Act, the SMEA also works closely with a number of governmental and non-governmental organizations in carrying out its provisions relating to SME finance. The most instrumental of the non-governmental organisations supporting SME access to finance is the Small and Medium Enterprise Credit Guarantee Fund of Taiwan (SMEG).

Established initially under the Ministry of Finance in 1974, the SMEG with its currently 300 plus strong administration came under the oversight of the MOEA in 2003. The SMEG is able to provide both direct and indirect loan guarantees to SMEs, and applies them in pursuit of three basic organisational objectives. First, the SMEG seeks to address the deficiency in collateral SMEs often face in securing loans. By providing indirect and direct loan guarantees, the SMEG also increases the overall attractiveness of SMEs as potential recipients of loans from banks. Finally, the SMEG seeks to leverage its experience and technical capacity to enhance the efficiency of projects undertaken by other SME guidance organizations.¹⁸

SMEs are able to apply for Indirect, Direct and Package Guarantees. In the majority of instances, SMEs apply for Indirect Guarantees and do so through one of the 3,000 branches of 40 contracted financial institutions (CFIs - including both public and private banks). Select SMEs considered as having “significant R&D, operational or market development potential” are able to apply for Direct Guarantees from SMEG. Successful applicants then present the Direct Guarantees to financial institutions in support of loan applications. Finally, SMEs in specific industries receiving government assistance may apply for Package Guarantees through a “dedicated window” of relevant government institutions such as in the case of Cultural and Creative Industries. A “Guarantee Fee” normally from 0.3 to 1.75 percent is levied each year on value of the guaranteed amount of the loan.¹⁹

¹⁶ *Act for Development of Small and Medium Enterprises* (the Act), Article 13, www.moeasmea.gov.tw/lp.asp?ctNode=299&CtUnit=78&BaseDSD=7&mp=2.

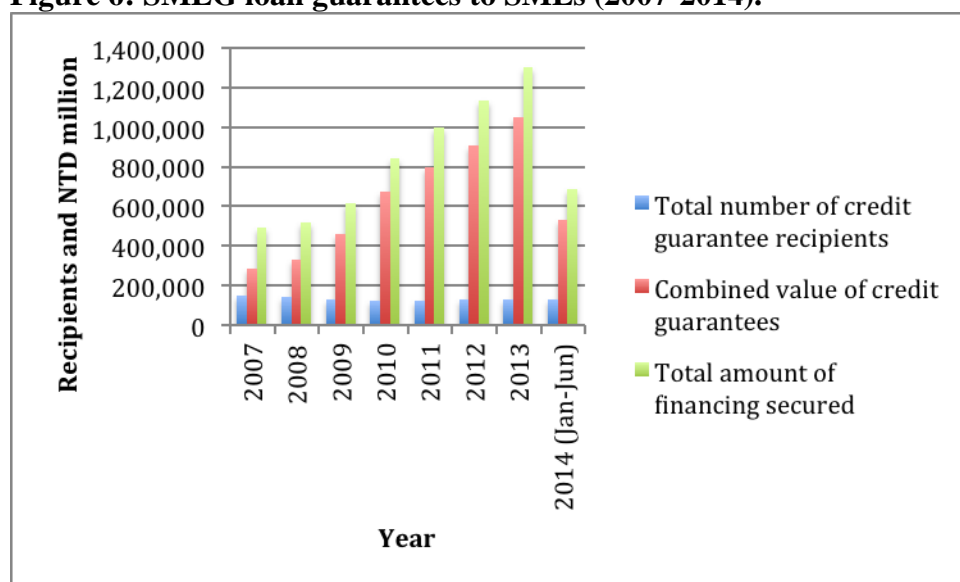
¹⁷ The Act, Articles 15-18.

¹⁸ SMEA (2014), *2014 White Paper on Small and Medium Enterprises in Taiwan*, SMEA, Taipei, pp. 167-8, http://book.moeasmea.gov.tw/book/doc_detail.jsp?pub_SerialNo=2014A01205&click=2014A01205.

¹⁹ SMEG (2013), *2013 Annual Report*, SMEG, Taipei, pp. 7-9, www.smeg.org.tw/doc/annual_report_2013_English.pdf.

Funded by both the public and private sectors, the SMEG provides substantial support to SMEs judging from the size of its capital stock and cumulative value of loan guarantees (Figure 6). By the end of 2013, the SMEG's cumulative total paid-in capital reached NTD 114.6 billion (USD \$3.6 billion) of which 78 percent had been provided by central and local governments, and over 21 percent had been provided by CFIs. The total net worth of the SMEG at the end of that year was NTD 52 billion (USD \$1.7 billion).²⁰ In terms of cumulative value of credit guarantees by the end of June 2014, nearly 354,000 SMEs had received nearly 5.4 million credit guarantees valued at NTD 8,776 billion (USD \$283 billion) for loans totalling NTD 12,276 billion (USD \$396 billion).²¹

Figure 6: SMEG loan guarantees to SMEs (2007-2014).



Source: SMEG (2014), p. 171

The efficacy of the SMEG can be gleaned from a number of indicators relating to the performance of SMEs during the economic downturn in 2009. Although the total number of credit guarantee recipients declined overall from 2007 through 2013, total applications accepted and combined value of credit guarantees increased without pause throughout. The total number of loan guarantee recipients declined from a high of close to 155,000 in 2007 to a low of close to 136,000 in 2010. A partial recovery to over 145,000 by 2013 stood in contrast to the figures for total applications accepted which increased without pause from roughly 239,000 to 395,000 per year during the same period from 2007 through 2013. Indeed, despite the decrease in loan guarantee recipients during this period by seven percent, the combined value of loan guarantees increased by well over three-fold to NTD 1,056 billion (USD \$34 billion).²²

Of course the ultimate objective of support to SMEs should be their graduation to large enterprise status including their ability to independently raise capital on the private market. In recounting experience with recipients of SMEG loan guarantees, the SMEA 2014 White Paper indicates that “within a few years, they [loan guarantee recipients] were able to raise money on the capital markets or obtain loans directly from banks.” In terms of graduation to

²⁰ SMEG (2013), p. 4.

²¹ SMEA (2014), p. 170.

²² SMEA (2014), pp. 170-1.

large enterprise status, 2,550 SMEs that had received credit guarantees had completed the transition by June 2014, and 814 had secured a stock market or OTC listing.²³ Although the number of graduating SMEs is relatively small compared with the total number of businesses aided through these schemes—something on the order of 2%, approximately—the evidence suggests that the programs have been effective in helping a significant number of SMEs access capital markets more effectively over the medium term.

Although certainly the backbone of the domestic regulatory infrastructure supporting SME access to finance, the Small and Medium Enterprise Credit Guarantee Fund of Taiwan (SMEG) is by no means the only policy apparatus the Ministry of Economic Affairs (MOEA) employs to “help” SMEs secure loans from banks.²⁴ Notable concomitant policy streams include the Financial Supervisory Commission’s (FSC’s) *Program to Encourage Lending by Domestic Banks to Small and Medium Enterprises* (the Program)²⁵ and the Joint Credit Information Centers’ (JCICs’) *SME Financial Services Platform* (SME Platform), which enables rapid searches of government databases for information on specific SMEs in support of loan applications.²⁶ Also worthy of note is the *Plan for Promoting Investment in SMEs* (the Plan), which seeks to foster increased direct investment from the private sector in SMEs.²⁷

The importance of credit guarantees provided by SMEG to SMEs is reflected in anecdotal evidence and historical growth trajectories. Anecdotal evidence from an accounting firm serving SMEs in the central Chinese Taipei city of Taichung reflects that the vast majority or roughly 80-85 percent of client SMEs do not rely on loans but on existing capital and revenue for operations and growth.²⁸ However, of the 15-20 percent that do utilize financing, upwards of 60 percent are reliant on SME credit guarantees to secure loans. Although not all SMEs are dependent on credit guarantees to secure financing, a considerable proportion of them are, and loans with a SMEG credit guarantee component totalled NTD 13,124 billion (USD \$423 billion) in 2013.²⁹ Historically, this figure represents an increase of 561 percent from 2001 through 2013, or an average annual rate growth rate of 46 percent throughout that twelve-year period.

Administered by the FSC, the Program although reliant on credit guarantees to encourage public and private banks to loan to SMEs is nevertheless also charged with a mission to facilitate non-credit guarantee backed loans to SMEs. As early as 2005, the FSC supported bank loans to SMEs by developing “performance appraisal standards” as well as implementing “different levels of *incentive* measures”. (Emphasis added) In that year, the FSC established an objective of increasing bank loans to SMEs to NTD 200 billion (USD

²³ SMEA (2014), p. 171.

²⁴ *Act for Development of Small and Medium Enterprises* (the Act), Article 13, www.moeasmea.gov.tw/lp.asp?ctNode=299&CtUnit=78&BaseDSD=7&mp=2.

²⁵ Financial Supervisory Commission (FSC - 2005), *Financial Supervisory Commission, Taiwan: 2005 Annual Report*, FSC, Taipei, p. 20, www.fsc.gov.tw/uploaddownloadoc?file=endownload/2011052303180630.pdf&filedisplay=Financial+Supervisory+Commission+-+Annual+Report+2005.PDF&flag=doc.

²⁶ Joint Credit Information Center (JCIC - 2013), *JCIC Annual Report 2013*, JCIC, Taipei, p. 8, www.jcic.org.tw/jcweb/zh/publications/quarterly/files/102x_xOK.pdf.

²⁷ The Small and Medium Enterprise Administration (SMEA - 2014), *2014 White Paper on Small and Medium Enterprises in Taiwan*, SMEA, Taipei, p. 174, http://book.moeasmea.gov.tw/book/doc_detail.jsp?pub_SerialNo=2014A01205&click=2014A01205.

²⁸ Interview with head accountant on 8 May 2015 at Jordan Accounting. Wu, Moonshine (2015), Jordan Accounting, Taichung.

²⁹ SMEA (2014), p. 171.

\$6.5 billion).³⁰ Testimony to the potency of the Program can be found in the ratio of loans to SMEs versus non-SMEs which rose from 37 percent in 2004 to over 50 percent at NTD 4074 billion (USD \$131 billion) by 2010.^{31,32} In 2013, total outstanding loans to SMEs totalled NTD 4761 billion (USD \$154 billion)—an increase of NTD 313 billion (USD \$10 billion) from the previous year, and far surpassing the target of NTD 240 billion (USD \$7.7 billion) set the year before.³³

Whereas the SMEG provides loan guarantees reducing the risk of default to lenders and the FSC facilitates bank lending to SMEs via incentives, the JCIC, the Bankers Association and the SMEA have tackled the challenge of SME transparency. These three organizations have jointly developed the SME Platform, which consolidates a wide array of information collected by various government agencies within a single electronic database that can be easily and quickly searched at the request of a lender.³⁴ Implemented in 1999, the SME Platform significantly reduces time and costs associated with performing “due diligence” when assessing creditworthiness in SME loan applications. Initially provided as a free service to lenders assessing SME loan applications, the SME Platform recorded an average of 3,276 queries per year from 1999 through 2014. Yielding a 65 percent success rate in terms of successful SME loan applications per query during that 15 year period, it has facilitated over 32,065 loans totalling NTD 325 billion (USD \$10 billion). In 2014, the service become pay per query based with a minimal charge of NTD 300 to 600 (USD \$10 to \$20) per search request.³⁵

In response to consistent requests from SMEs for support in stimulating direct investment by venture capital firms and other private-sector enterprises, the Plan for Promoting Investment in SMEs was approved in 2007 with a ten-year implementation period and a budget of NTD 10 billion (USD \$323 million). The Plan targets four categories of SMEs for investment including enterprises 1) at the seed-capital / start-up stage 2) in the cultural and creative industries, 3) in key service industries and 4) that have added 30 new employees in the previous year. Under the Plan, the Executive Yuan National Development Fund matches direct investments from the private sector by a ratio of 3:1 for the first two categories of SMEs and 1:1 and 2:1 for the next two, respectively. With matching investments activated only upon private sector commitment, the Plan supports investment only in the most

³⁰ SMEA (2005), *2005 White Paper on Small and Medium Enterprises in Taiwan*, SMEA, Taipei, p. 294, www.moeasmea.gov.tw/ct.asp?xItem=354&ctNode=307&mp=2.

³¹ FSC (2010), *2010 Financial Supervisory Commission, Taiwan: Annual Report*, FSC, Taipei, p. 17, www.fsc.gov.tw/uploaddowndoc?file=endownload/201110261457480.pdf&filedisplay=Financial_Supervisory_Commission_-_Annual_Report_2010.pdf&flag=doc.

³² FSC (2012), *2011-2012 Financial Supervisory Commission, Taiwan: Annual Report*, FSC, Taipei, p. 4, www.fsc.gov.tw/uploaddowndoc?file=endownload/201210311721550.pdf&filedisplay=%E5%94%90%E6%BD%AE%E8%A8%AD%E8%A8%88_%E9%87%91%E8%9E%8D%E7%AE%A1%E7%90%86%E5%A7%94%E5%93%A1%E6%9C%83_2011%E8%8B%B1%E6%96%87%E5%B9%B4%E5%A0%B1_%E5%85%A7%E9%A0%81.pdf&flag=doc.

³³ FSC (2014), *2013-2014 Financial Supervisory Commission, Taiwan: Annual Report*, FSC, Taipei, p. 41, www.fsc.gov.tw/uploaddowndoc?file=endownload/201411031058400.pdf&filedisplay=Financial+Supervisory+Commission%2C+Taiwan+2013%7E2014+Annual+Report.pdf&flag=doc.

³⁴ The inquiry channel integrates business taxes, income taxes, tax certification and other important financial ratios and receipt information from the Fiscal Information Agency; electricity and utility consumption information from Taipower and water companies; and labor insurance enrollment information from the Bureau of Labor Insurance. JCIC Annual Report 2013, JCIC, Taipei, p. 2, www.jcic.org.tw/jcweb/zh/publications/quarterly/files/102x_xOK.pdf.

³⁵ Data on the SME Platform provided during an interview on 25 May 2015 at National Association for Small and Medium Enterprises facilities by Wu, Ching-Shin, Financing Division Specialist, SMEA, Taipei.

economically viable SMEs as judged by the market. Where investments are successful, a management fee is assessed with the National Development Fund eventually exiting the investment. At the end of June 2014, 177 enterprises had received funding under the Plan and total induced investment from the private sector had reached NTD 39 billion (USD \$1.3 billion).³⁶

Main Lessons Learned on Regulatory Reform

Chinese Taipei's regulatory reforms to support SME financing offer a good example of the need to ensure alignment among agencies and institutions to ensure a conducive business environment for SMEs, which facilitates their access to finance. Anecdotal evidence shows that the use of credit guarantees provided by SMEG to SMEs has increased loans to SMEs. In addition, the development of performance appraisal standards by the FSC also contributed to increase non-credit guarantee backed loans to SMEs. Like the Japan CRD example, it also shows that IT solutions can be leveraged to improve information flow between borrowers and lenders, which has the effect of making it easier for SMEs to access finance when they need it.

In terms of good regulatory practices, the Chinese Taipei example emphasizes coordination across agencies to ensure coherence. In addition, it shows that non-regulatory measures—such as the use of information technologies—can help achieve important economic objectives. SME take up has been impressive, which indicates that the measures are viewed as sufficiently transparent and easy to use by the business community.

REGULATORY TIERING

Regulatory tiering is varying regulatory requirements according to firm size, with a view to reducing compliance costs for SMEs in particular. It could include exemptions (i.e., small businesses may be exempted from the substantive requirements of a regulation, or from associated regulatory requirements such as record-keeping or inspection programs) and/or lighter regulatory requirements (e.g. less stringent standards, or less onerous reporting and record keeping requirements for small businesses).

It is important for regulatory burdens to be modulated to firm size because compliance costs can be relatively much higher (e.g., in terms of percentage of sales, or rate per employee) for small firms as opposed to large ones. Moreover, small firms have less scope for outsourcing compliance functions, so it is sometimes the entrepreneur himself who is required to invest time in dealing with record-keeping and other compliance burdens that can be lessened by appropriate regulatory tiering.

To be clear, regulatory tiering can be implemented in a way that is in line with underlying regulatory exemptions. It clearly does not amount to giving *carte blanche* to some businesses to behave in a way that is contrary to the public policy purpose of a given regulation or set of regulations. Instead, it is a regulation that there may often be strong incentives to comply with regulation in any event, and the public interest in subjecting small firms—which may not have direct contact with the public—to the same requirements as large firms can be counterproductive. The key to successful regulatory tiering lies in identifying issue areas where burdens for small business are particularly large in relative terms, and then designing

³⁶ SMEA (2014), p. 174.

graduated structures based on firm size that maintain the regulatory purpose that is being promoted.

One important area in which regulatory tiering is used in some APEC economies is tax compliance. The WBES data indicate that tax is one area where small businesses feel a considerable burden relative to their larger counterparts. Table 6 shows that the difference is particularly stark in relation to tax rates. There is thus considerable scope for regulatory tiering to create an environment that is more conducive to SME growth and development in this and related areas.

Table 6: Seriousness of business constraints for large firms and SMEs, 0-4 scale (higher score indicates a more serious constraint).

Constraint	Large Firms	SMEs
Tax Rates	1.34	1.60
Tax Administration	1.09	1.01

Source: WBES and authors' calculations.

As for the first two case studies, examples for this section are drawn from a variety of APEC economies, both developing and developed. Figure 7 presents the case study example structure for this section, which draws on a range of substantive areas, from tax to intellectual property.

Figure 7: Case Study Three Examples.

Case Study Three: Regulatory Tiering

- Canada
- Chinese Taipei
- The Philippines
- Singapore and Other APEC Economies
- Japan and Other APEC Economies
- China

The first example in this case study is from Canada. The Government of Canada has recognized that the area of tax compliance is one where the burden can be substantial on small businesses. As part of its overall strategy to ease the costs of doing business while maintaining regulatory and revenue raising objectives, it has introduced regulatory tiering as

a way of simplifying the business environment for SMEs. For example, SMEs are eligible to report their Goods and Services Tax/Harmonized Sales Tax compliance information less frequently than larger businesses, thereby reducing their costs.

Regulatory tiering is also used in Chinese Taipei. Tax compliance is again one area in which flexibilities for SMEs have been introduced, with a view to reducing their administrative burdens, as well as making it easier to do business. Flexibilities cover administrative issues, as well as favorable tax treatment for SMEs in some cases. Core to the approach of Chinese Taipei has been an evolving definition of what constitutes an SME, and thus is entitled to special treatment. The definition has been revised on numerous occasions with a view to ensuring that it reflects the economy's reality. Another important feature of regulatory tiering in Chinese Taipei is the involvement of the National Association of Small and Medium Enterprises. This body puts forward the concerns of SMEs in consultative settings, and has been successful in ensuring alignment between government policies, and the reality of running an SME on a day-to-day basis. Consultants with SMEs, facilitated by the existence of a national association, have helped the government of Chinese Taipei develop regulatory reforms, including tiering, that are well adapted to the needs of the economy's small business sector.

The next example of regulatory tiering comes from the Philippines. It involves the microfinance sector, which is of particular importance in developing member economies. Of course, financial system stability is a vital policy goal that all member economies strive to achieve. To this end, regulations regarding capital adequacy and other financial institution characteristics are justified and necessary. However, it may be possible in appropriate cases to put in place a tiered regulatory structure that allows for the coexistence of large traditional lenders, as well as smaller microfinance institutions. The latter typically lend to customers considered too risky for the traditional financial system due to their lack of collateral. With the aim of facilitating microfinance transactions for development, at the same time as ensuring financial system stability, the Philippines has adopted regulatory tiering in favor of these institutions, which primarily lend to SMEs and solo entrepreneurs. In this case, an example of regulatory tiering overlaps with one of the other areas discussed in this report, namely access to finance. It is an example of how a graduated and adaptable approach can promote positive outcomes.

The SME sector is also important to Singapore, as is made clear by recent reforms to the Companies Act. An existing exemption for small companies in the area of audited accounts has been broadened, in recognition of the fact that auditing represents a significant expense, and may have limited benefits for the public in the case of SMEs that primarily deal with other businesses, not consumers directly. The government projects that the reforms will exempt an additional significant number of SMEs from the statutory auditing requirement, with substantial savings to follow in terms of the cost of doing business. Other APEC economies have also paid attention to their company legal codes with the aim of facilitating SME activities.

The last two examples relate to intellectual property, and come from Japan and China respectively. In both cases, the aim of reform has been to better enable SMEs to protect their intellectual property. The Japanese system includes reduced fees and faster processing for SMEs, as well as special assistance with searches, and capacity building activities. In China, regulatory reform to the model patent system has made it very popular among SMEs, with over 1.1 million valid model patents granted in 2011. Innovation is a key part of the business

model for SMEs in some sectors, such as information technology, so ensuring that they can protect their intellectual property simply, rapidly, and at relatively low cost is a key part of an overall policy stance that encourages innovating activity—the cornerstone of development and income transition over the medium to long term.

Example 1: Tax Reporting in Canada

The Government of Canada has adopted a number of policy responses to reduce regulatory burden that fall into three broad categories:

- Policies favoring small business in the application of regulations ("regulatory tiering").
- Initiatives that attempt to reduce the cost of compliance and other regulatory costs ("regulatory flexibility").
- Broad-based approaches aimed at easing compliance, cutting red tape and generally reducing the regulatory burden for all businesses.

An example of regulatory tiering is the reporting of Goods and Services Tax/Harmonized Sales Tax (GST/HST). Smaller firms can qualify to report their GST/HST on an annual basis, while medium-sized firms have to report on a quarterly basis, and large firms on a monthly basis. As a result, the compliance burden is reduced for SMEs: their accounting processes are simplified, and ongoing operational funding is made more straightforward by not having to make tax payments as frequently as large companies.

Generally, efforts to reduce regulatory burden should benefit all businesses. Policies that are targeted towards small business need to be carefully considered since tiering can ultimately weaken the standard or objective of a particular regulation. Therefore, justification for regulatory tiering needs to be supported by compelling data.

The case for regulatory tiering depends on there being a significant difference in regulatory costs across firms of different sizes, and this difference has an economic effect. Special treatment for small business may be justified if the evidence indicates that:

- It is justified on equity grounds, i.e. the regulations place an unfair burden on small businesses relative to larger ones, or
- It is justified on efficiency grounds, i.e. the compliance costs per unit of output confer a competitive advantage on larger firms that reduce the viability of small firms, thereby reducing competitive pressures and leading to less efficient outcomes.

For example, regulatory tiering based on equity considerations could be defended if the following factors exist:

- The disproportionate costs of new regulations or compliance requirements can lower the returns of owners and managers of small businesses.
- Entrepreneurs must typically work longer hours in complying with the regulations.

- The compliance costs may be considered "unfair" in the sense that smaller businesses face higher proportionate compliance costs (measured against turnover) than larger firms.

Main Lessons Learned on Regulatory Reform

Regulatory tiering that enhances efficiency can be justified. For instance, the following circumstances would suggest that tiering is appropriate:

- The cost differences between small and large firms in complying with a uniform regulation substantially reduces the competitiveness of small businesses, thereby leading to the dominance of a few large firms that are able to exercise market power, or
- The regulatory cost per unit of output varies significantly with firm size, and large firms do not provide close substitutes for the goods and services of small firms in a particular industry (e.g., some service activities—such as hair salons—are more efficiently provided by small business).

There are other factors that need to be taken into account. For instance, businesses can shift some of their compliance costs to customers by raising prices. Tiering can have its own re-distributional effect, which may or may not be desired. Consequently, when developing a case of tiering, all the factors have to be considered on a case-by-case basis. Regulatory tiering can usefully be linked to RIA, in line with good regulatory practice: its justification on the basis of a regulatory cost-benefit analysis can be a useful piece of information for government in designing an appropriate strategy.

Example 2: The Topography of Regulatory Tiering in Chinese Taipei, and the Role of the National Association of Small and Medium Enterprises

Representing over 97.6 percent of all enterprises and 78.3 percent of total employment, SMEs are an ever-present shadow over the minds of lawmakers and regulators in Chinese Taipei.³⁷ It is thus not surprising that to the extent that the concept of regulatory tiering refers to differing regulatory treatment between SMEs and non-SMEs. In essence, the *Act on Small and Medium Enterprises* (the Act) is a topographical map of regulatory tiering in Chinese Taipei. Beneficiaries of its provisions are explicitly limited to enterprises defined as SMEs in accordance with the *Standards for Identifying Small and Medium-sized Enterprises* implemented in 1991. To the extent that the concept of regulatory tiering refers to differing regulatory treatment between SMEs and non-SMEs, regulatory tiering in Chinese Taipei long predates the Standard with a definition for SMEs going as far back as 1967.³⁸ With at least eight changes in the definition of SMEs through 2005 (which included expansion into sectors not covered in 1967 such as mining and quarrying), the practice of regulatory tiering in Chinese Taipei suggests consistent attention to maintaining its relevance to evolving economic circumstances facing SMEs. The issue also highlights the importance of SMEs in

³⁷ Small and Medium Enterprises Administration (SMEA – 2014), *2014 White Paper on Small and Medium Enterprises*, SMEA, Taipei, p. iii,

http://book.moeasmea.gov.tw/book/doc_detail.jsp?pub_SerialNo=2014A01205&click=2014A01205.

³⁸ SMEA (20??), "The Evolving Definition of SMEs in Taiwan", SMEA, Taipei, www.moeasmea.gov.tw/public/Data/78114433171.pdf.

Chinese Taipei's economy, and the consistency with which the government has sought to improve conditions on the ground for them.

Among myriad regulations the Act implements in favor of SMEs, perhaps the most vivid are the Articles of its Chapter 4 on Tax Remittance. The contours of tax incentives in this chapter appear designed to address economic challenges likely to disproportionately impact SMEs including: supporting land acquisition for productive purposes, moving facilities due to new regulations (e.g., environment), and deferring distributions of surplus earnings. To facilitate SME access to land for facilities, Article 33 of the Act provides that where investments in SMEs take place via the transfer of land, tax normally due in full upon transfer may instead be paid in five equal annual installments. By reducing the immediate financial burden of such transactions, they become more attractive, thus facilitating SME access to land. Moving facilities due to changing zoning or environmental regulations can be a disproportionate economic burden on SMEs, which often have limited financial reserves. Article 34 blunts the impact by reducing the tax on the sale of the land originally occupied by the SME—in effect subsidizing the removal.

The tax code in Chinese Taipei sets limits on earnings that an enterprise may withhold from distribution in a given year. Article 36 of the Act allows SMEs to retain a larger proportion of their surplus earnings than non-SMEs, thus allowing for deferral of taxes that would otherwise be due in a given year. By thus increasing the amount of working capital available, the law makes it possible for SMEs to engage in investments that might otherwise not be feasible if surplus earnings were distributed.

In 2014, Chapter 4 grew in scope and purpose with additional tax incentives which sought to support SMEs to make advances on structural challenges in relation to: R&D, general investment as well as increasing employment. Article 35 of the Act appears designed both to support increases in R&D by making investments in R&D that would not otherwise have been economically rational, viable. It may well also catalyze SMEs to assess new investments in R&D that they otherwise would not have considered. Allowing enterprises to receive credit of up to 30 percent of their annual income tax for investments in R&D, the economic law additionally provides for accelerated depreciation on equipment procured in relation to R&D. Perhaps the most notable feature of this policy design is that it explicitly leaves the choice of what subject the R&D is to address to the SME, in effect enabling only the most market viable R&D that otherwise might not have occurred.

Commercializing the results of R&D is the clear purpose of Article 35-1. Like Article 35, its sub-article does not seek to distort, but to enhance the commercialization of R&D that might not occur in the absence of this law, but in accordance with market principles and policy objectives. The law exempts from income tax shares issued by an enterprise in return for intellectual property rights on the results of R&D created by an SME or individual. This exemption from income tax seeks to enhance the likelihood that developers of viable R&D to allow enterprises more adept and well resourced to commercialize and market it. Yet, the law also introduces an interesting tier in that the tax exemption to the SME or individual is conditional on the enterprise receiving the R&D not being “listed in the Taiwan Stock Exchange, OTC, or the emerging market”. In short, the law appears also to have a second policy objective in providing SMEs and relatively smaller large enterprises an advantage in accessing R&D results that it seeks to support.

To encourage investment in general by SMEs, Article 36-1 conditionally allows enterprises to write off losses from investments at rates higher than normally allowed under the domestic tax code by enough “to compensate for *actual* loss.” (Emphasis added) In reducing the economic cost of unproductive investments, this law encourages increased overall investment in a market conforming manner. Also coming into force in 2014, Article 36-2 encourages SMEs under certain conditions to deduct up to 130 percent of the gross salary payments to new domestic hires from taxable income. This law appears designed to encourage increased employment by reducing risk for SMEs posed by new hires, subsidizing on-the-job training for citizens and enhancing SME access to manpower.

In addition to these measures, a sanctioned departure from Chinese Taipei’s standard tax code exists for small, unincorporated businesses with monthly revenues of less than NTD 200,000 (USD \$6,452). Qualifying businesses are exempt from monthly submission of official receipts for assessing taxable revenue, but are instead assessed a fixed levy determined by tax authorities that is paid on a quarterly basis. Unless businesses are large enough to be able to afford sophisticated electronic equipment, the norm in Chinese Taipei is to use official blank receipts provided by tax authorities that are numbered as a risk measure. Businesses using the official paper receipts are required to complete them in triplicate (using two sheets of carbon paper) clearly indicating: 1) an itemized list of purchase(s), 2) total value of transaction, 3) 5 percent VAT; and 4) customer contact details including a complete address and telephone number. The economy wide benefits of this policy can be considered in terms of the fact that 55.7 percent of the 1.3 million SMEs in Chinese Taipei are sole proprietorships and a significant proportion of them are small retail shops or food service operations.³⁹

An important dynamic in the evolution of regulatory tiering in Chinese Taipei is consultations between SMEs and regulatory authorities facilitated by the National Association of Small and Medium Enterprises (NASME). NASME is a 700 staff strong non-governmental organization headquartered in Taipei that has advocated for changes in regulations to benefit SMEs, but which are not necessarily limited in application to them. Located in the same building as the Small and Medium Enterprise Administration (SMEA), NASME’s physical proximity to SMEA is indicative of organizational objectives it shares with SMEA in providing support to SMEs. Among the many functions NASME performs, many in coordination with SMEA and others under contract by the SMEA, is the annual exercise of assessing trends in the economic environment facing SMEs. During the period between March and July each year, NASME staff visit and conduct face-to-face meetings with anywhere between 30 and 50 SMEs based in northern, central and southern Chinese Taipei. With the objective of assessing the economic, commercial, and regulatory conditions facing SMEs from their perspective, the meetings often result in requests for adjustments in regulations SMEs view as unnecessarily burdensome.

On regulatory issues, NASME acts both as counsellor and advocate vis-à-vis SMEs. When faced with a request for adjustment of regulations, NASME’s standard operating procedure is to organize meetings under the supervision of SMEA normally inviting academics specialised in the field of the request to study the merits and feasibility of reform. Where reform is considered warranted and feasible, NASME prepares and submits an official request to the regulatory authority governing the subject matter of the request. Not all requests are

³⁹ Interview with head accountant on 8 May 2015 at Jordan Accounting. Wu, Moonshine (2015), Jordan Accounting, Taichung.

successful, and indeed the process of changing regulations is often lengthy meaning that requests may be in progress at any given time.

Among the recent regulatory issues raised by SMEs are one related to the permitted Initial Public Offering (IPO) valuation of shares on the Chinese Taipei stock market, and two related to manpower. Although the examples presented below do not meet the conventional definition of tiering, they are cases in which changes in regulation would be of little or no benefit to large enterprises, but are certainly of benefit SMEs requesting the change. In the case of stock market share valuation, regulations previously disallowed enterprises from making IPOs of stocks below NTD 10 (USD \$0.33) per share. This posed difficulties for SMEs, which considered the option of lower valuations of strategic interest. This regulation was successfully amended in 2014 and IPOs of stocks in Chinese Taipei of under NTD 10 are now legal.

Due to the expansion of SMEs into new areas of business, they are experiencing manpower shortages relating to foreign white-collar workers with specialised skills and knowledge of foreign markets unavailable in Chinese Taipei. Applications for foreign white-collar workers to work in Chinese Taipei must meet three criteria including: 1) the foreign worker must have a minimum of 2 years' professional experience in a field of relevance to the applying enterprise, 2) the company must have an annual revenue of NTD 10 million (USD \$323,000); and 3) the foreign employee must receive a minimum monthly salary of NTD 47,971 (USD \$1,547). For large enterprises, these requirements would normally not be of concern but for SMEs, such as shoestring internet start-ups servicing foreign markets, the second and third criteria have been viewed as unnecessarily stringent. Following negotiations with the Council of Labor Affairs, a change in the interpretation of existing regulation provided possibilities for relaxing criteria on a case-by-case basis.

Chinese Taipei has among the lowest birth rates in the world and is ageing rapidly. Increasing affluence has also dramatically increased the proportion of young people with college educations and aspirations for white-collar jobs. The results of these trends can be seen in the significant increase in foreign workers in 2013 alone of 15 percent, to a total of 269,131.⁴⁰ With SMEs relying on 60 percent of foreign workers working in Chinese Taipei, the importance especially of senior foreign workers that have developed critical job skills saw SMEs request an extension to the maximum cumulative period of work from 12 to 15 years. At present, this request remains under assessment by the Council of Labour Affairs due to the fact that the Labor Law requires the extension of pension benefits to workers who have accumulated a full 15 years of work in Chinese Taipei.⁴¹

Main Lessons Learned on Regulatory Reform

If lessons on good regulatory practices can be drawn from the development of tiering in Chinese Taipei, among the most useful would be that of allowing sufficient flexibility for regulators to adjust the mechanisms and objectives of tiering in relation to the evolving economic environment facing SMEs. From the enlargement of the definition of SMEs through the introduction of Article 4 of the Act, attention to issues such the increasing cost of land faced by SMEs due to the modernizing economy were identified and addressed. The new provisions to Article 4 implemented in 2014 reacted to the erosion of labor cost

⁴⁰ SMEA (2014), p. 75.

⁴¹ Data on National Association for Small and Medium Enterprises (NASME) work provided during an interview on 25 May 2015 at NASME facilities by Lee, Justin (2015), Researcher at NASME, Taipei.

advantage that once sustained SMEs as the economy matured, by supporting an offensive approach for SMEs to increase value added via investments in R&D and human resources. The manner in which the application of taxes on SMEs versus non-SMEs suggests attention and effort to understanding and ameliorating the particular challenges SMEs face. Indeed, the 2014 provisions outline an effort to facilitate the ability of SMEs to overcome and grow out of their disadvantaged state. Little data is available on the results of the reforms due to their recent introduction in 2014. However, the consistent effort to harness market conforming design in regulatory instrumentation to obtain transparent policy objectives is noteworthy.

The Chinese Taipei example demonstrates a number of aspects of good regulatory practice, but among the most prominent is consultation. The peak SME association is seen as a serious interlocutor by the government, and a valuable source of information and assistance. This kind of transparent and inclusive approach can be one of the bases for the design of effective and efficient interventions.

Example 3: Regulatory Tiering and Proportionality—Access to Finance in the Philippines

Financial inclusion is a serious challenge in the Philippines. It is estimated that 37% of the municipalities in the country are unbanked and only 26.6% of the population has a formal account.⁴² Lack of access to finance is also a main obstacle to growth, in particular for SMEs that are the core of the economy but present higher risks for lenders. In 2006, the International Finance Corporation (IFC) found that only 12-21% of Philippine MSMEs obtained funding from formal financial institutions/banks. Hence, MSMEs largely relied on internally generated funds, loans from family, friends, or other informal lenders, thereby limiting their capacity to grow and suffering higher transaction costs.

The government has adopted a number of regulatory reforms to address the financial inclusion issue, and mainstream MSMEs into the formal financial system. In particular, incentives were put in place to encourage SME lending, and a new regulatory framework designed to promote microfinance. A salient feature of these measures was the proportionality principle: regulatory tiering and other policies aimed at promoting MSME lending in an environment of healthy competition had to be balanced with the overall safety and soundness of the financial system. Incentives could be provided, but not at the expense of distorting fundamental credit decisions that are best left to financial institutions.

With due respect to this proportionality and risk-based approach, the government initiated several policies to support SMEs. For instance, a mandatory credit allocation of 8% and 2% of the banks' total portfolio was put in place in favor of micro, small and medium enterprises, respectively (Republic Act 9501). Regulatory incentives for SME lending included the reduction of the risk weight for SME loans from 100% to 75% (Circular 364) excluding SME receivables purchased by banks and other financial institutions from the single borrower's limit, and exempting normal documentation applicable to regular loans for SMEs registered under the Barangay Micro-Business Enterprise Act (Circular 374). The Central Bank has also liberalized the reserve requirements for thrift banks and rural banks, and there is a total exemption from reserve requirements of the borrowings of accredited banks under the wholesale lending program of the Small Business Corporation. These regulatory measures were supplemented by technical assistance programs and advocacy for increased access to

⁴² <http://www.bsp.gov.ph/downloads/Publications/2012/Financial%20Inclusion.pdf>.

financial services by SMEs, as well as the creation of a Credit Surety Fund that provides a maximum of 80% surety cover for loans granted by banks to borrowers that would otherwise have difficulties accessing such credit facilities.

The promotion of microfinance has paralleled these efforts to develop an SME-friendly regulatory framework in the financial sector. Microfinance has quickly developed to fill in a financing gap: microfinance is both a technical and regulatory solution, allowing for differentiation/tiering in favor of the smallest lenders and borrowers. In 2014, global growth in the microfinance market exceeded 15%. There are an estimated 10,000 microfinance-institutions (MFIs) globally, reaching 100 million poor people. They comprise a wide range of institutions, from credit unions and cooperatives to non-government organizations (NGOs), government agencies, private companies, and commercial banks. For the vast majority, they are micro-entities, once donor-driven and NGO-dominated. Regulation of this sector has therefore always been a challenge, with the necessity for governments to strike the right balance between outreach (promoting a sector that was long ignored by the banking sector) and sustainability (prudential and non-prudential regulation to protect microfinance clients). Early on, donors called for the removal of legal provisions (e.g., interest ceilings) or adapting regulatory provisions (e.g., banking regulations) inconsistent with financially sustainable rural and micro finance. Regulatory tiering has been one of the solutions adopted by governments to promote microfinance (and MFIs that are often too small or remote for effective regulation under traditional banking laws), for example in the Philippines.

As early as 1997, the Philippine Government gave high-level recognition to the importance and relevance of microfinance by adopting a National Policy on Microfinance, which was supplemented by the specific inclusion of microfinance policy and activity in the amended General Banking Law (2000), and the promulgation of microfinance-friendly circulars of the Central Bank on microfinance transactions by licensed banks and non-banking financial institutions. Thereafter, the Government prioritized the need to accelerate the use of microfinance and expand its reach across the economy. In 2005, more than two-thirds of poor families, or 17 million people, did not have access to microfinance. The government efforts were successful, and the number of active microfinance clients in the economy quickly doubled, from 2.4 million in 2006 to 5.5 million in 2008. Subsequently, new legislation was introduced, as well as a dedicated regulatory agency, and consumer protection was increased. Today, MFIs in the Philippines represent USD \$1.3 billion in loans (4.6 million borrowers) and USD \$883 million in deposits (8.2 million depositors).⁴³

The overall policy framework for microfinance in the Philippines is informed by the overall framework and strategy for poverty alleviation, safety nets and rural development, which seek to balance growth and macroeconomic stability with human development and empowerment in such a way as to positively impact the reduction of the economy's poverty levels in the medium term. The Philippines has a comparatively wider range of formal, semi-formal, and informal institutions providing microfinance services to the urban and rural poor and underserved sectors of the economy. Financial intermediation and credit activities are under the regulatory jurisdiction of the Central Bank. The regulatory framework under the General Banking Law of 2000 (which repealed the General Banking Act of 1949) and a number of parallel Laws governing specialized banks and non-banking financial institutions have made room for a tiered structure of licensed financial intermediaries and of financial regulation.

⁴³ <http://www.adb.org/features/microfinance-philippines-report-card>.

Table 7: Strategy for developing sustainable microfinance in the Philippines (1997-2000)

- | |
|--|
| <ul style="list-style-type: none"> • Adopted National Policy on Microfinance (1997-98) • Established Central Policy Coordination Office at Department of Finance and at Bangko Sentral • Introducing amendments to banking laws and regulations responsive to microfinance (minimum capitalization and adequacy requirements; liquidity management standards; loan collateral, classification and loss provisioning guidelines) • Simplifying (1) reporting standards, chart of accounts; (2) external audit requirements; (3) microfinance manual for Central Bank examiners and inspectors |
|--|

Source: Gallardo, 2001

A tiered structure of institutions and graduated regulation existed even before the government gave formal recognition to microfinance in 1997 and through the new Central Bank regulations pertaining specifically to microfinance. The regulatory (and tax) preferences enjoyed by thrift banks, rural banks, and credit unions in combination with the operation of a graduated/tiered system have made it easier for NGO MFIs to transform into licensed institutions. This has been an indispensable element for substantially expanding the ability of MFIs to mobilize financial resources beyond traditional grants and donations. For example:

- The minimum capitalization requirements for licensed institutions with a specialized microfinance focus—Private Development Banks, Rural Banks, and Cooperative Banks—are significantly lower than those for commercial banks and savings banks (from USD \$50,000 to USD \$260,000 depending on the location compared to USD \$100 million for universal banks and USD \$48 million for commercial banks).
- Under present Central Bank regulations on mandatory liquidity reserves, thrift banks and rural banks continue to enjoy preferential reserve requirement levels, relative to universal banks and regular commercial banks.

The tiered regulatory approach has promoted the development of sustainable microfinance in the Philippines, by clearly identifying pathways for NGOs and semi-formal MFIs to become legitimate institutions under the regulatory framework with greater ability to access financial resources from commercial markets. For example, one of the main actors of the sector in the country, CARD Rural Bank, was formed by the Center for Agricultural and Rural Development, an NGO working with women in rural villages under a group-based microfinance model.

Among the risks that a graduated and tiered regulatory framework may present is that of regulatory arbitrage. Investors and stakeholders in a financial institution seeking to be authorized and licensed might choose to be established and constituted under an institutional format that is subject to least possible external regulation and supervision, as well as the lowest possible amount of capitalization at entry. This does not appear to have been experienced by the Philippines, with respect to the MFIs obtaining status as licensed specialized banks.

Main Lessons Learned on Regulatory Reform

Regulatory tiering has been a success, and The Economist Intelligence Unit has ranked the Philippines among the best-regulated microfinance markets for several years in its annual review of the state of the sector. There are now around 200 banks engaged in microfinance, reaching nearly a million clients in the country. With due respect to the proportionality principle, this increased financial inclusion has not compromised, but rather increased, the country's institutional stability. Still, the regulatory framework needs to be improved, and reforms made in order to catch up and keep in step with growth of the microfinance industry, and the Philippines still have a long way to go towards financial inclusion. As part of this, the government wants to learn from the achievements of the successful microfinance experience to respond to some of the needs of the SMEs at large. For instance, in 2011, Circular 744 on "microfinance plus" created loans to micro-enterprises that have grown and graduated from microfinance programs and may be prepared to take on larger loans.

Notable in the microfinance experience in the Philippines is the way in which different governments have shown leadership in promoting regulatory frameworks that have supported development of the sector, and deployment of microfinance solutions. In line with good regulatory practice, there is evidence of coordination among government agencies, and a whole of government approach to supporting the sector, which in turn promotes SME development. These features are crucial to sustaining the momentum behind an ongoing reform package that adapts to current circumstances. The success of the sector suggests that the government has not only been successful in developing an appropriate regulatory framework, but also in promoting microfinance as a development tool, and assuring that interested parties are aware of the sector's relevance for them, an important element of transparency in this area.

Example 4: Regulatory Tiering for Accounting and Auditing in Singapore and Other APEC Economies

In October 2014, Singapore adopted the most ambitious revision of the Companies Act since it was enacted in 1967. The wide-ranging changes are expected to reduce regulatory burden and compliance costs, provide greater flexibility for companies, and improve corporate governance. It will bring benefits to various stakeholder groups, including SMEs that will benefit from a new audit exemption regime.

Previously, Singaporean companies with an annual turnover of less than SGD \$5 million that have less than 20 non-corporate shareholders (i.e., individuals) were exempt from statutory audit requirements. Instead of filing audited annual accounts, those companies simply submitted a declaration of solvency signed by the directors and company secretary. If, for any reason, the company was unable to submit the declaration, it had to submit its unaudited accounts to the Accounting and Corporate Regulatory Authority (ACRA). There was no need for those companies to appoint auditors.

Under the new regime, SMEs stand to benefit if they qualify under a new, broader set of criteria for exemption from statutory audit. To qualify as a "small" company, a company must fulfill at least two of the following three criteria:

- Total revenue of not more than SGD \$10 million.

- Total assets of not more than SGD \$10 million.
- Total number of employees of not more than 50.

The intention is to reduce the regulatory burden on small and medium companies and move further towards a risk-based approach. In addition, the qualification criteria have been brought in line with those used for the Singapore Financial Reporting Standards for Small Entities. As SMEs have limited public interest, there is no compelling need to mandate an audit. SMEs may still choose to have their accounts audited based on business needs. According to ACRA, an approximate additional 10% of companies or about 25,000 more companies will enjoy exemption from audit and lower the costs of compliance with the Companies Act. It is estimated that cost savings would be of the order of SGD \$3,000 per company.

By adopting regulatory tiering in favor of the audit exemption of SMEs, Singapore aligned its regulatory framework with a number of other APEC economies, including Australia. In Malaysia, for example, the statutory requirement for all companies registered with the Companies Commission of Malaysia to have their annual accounts audited had long been criticized, including by the 2012 Report on the Observance of Standards and Codes (ROSC), and the 2008 Companies Commission of Malaysia (SSM) consultative report “On Creating a Conducive Legal and Regulatory Framework for Business”, which recommended new criteria to define SME status and eligibility for an exemption from the statutory audit requirement (total revenue of not more than RM 10 million; total assets of not more than RM 5 million; and not more than 50 employees), as well as to give the Registrar the power to exempt companies that meet certain criteria from the statutory audit requirement. This exemption regime was ultimately incorporated in the new Companies Bill that was submitted to consultations in 2013 and is due to be adopted by the Parliament in 2015.

Main Lessons Learned on Regulatory Reform

One key lesson to take away from these examples is that the way in which SME is defined for particular purposes can effectively create a kind of regulatory tiering. When it comes to accounting requirements, for example, most economies have different regimes for public and private companies, and size-dependent rules regarding audits and statutory accounts. The Singaporean example shows that paying attention to the breadth of the definition of an SME can bring important benefits to additional companies, with savings in regulatory costs.

Another example of good regulatory practice in action is the consultation process that led to the adoption of the reforms in Singapore. The Ministry of Finance conducted a public consultation in 2011 that elicited substantive comments from 70 respondents, a mix of companies, associations, auditing firms, law firms, individuals, and other government agencies. The government responded to concerns raised by stressing the existing protections for shareholders and other company stakeholders in relation to account keeping requirements, and highlighting the existence of similar rules in other jurisdictions, such as Australia and the UK. In addition, ACRA will monitor implementation of the new regime, and will be in a position to assess costs and benefits in an ongoing manner, and to propose changes if necessary.

Example 5: Intellectual Property Regimes—Flexibilities for SMEs

The Japan Patent Office and other APEC Best Practices

The protection of intellectual property rights is essential to SMEs, whose assets are most often immaterial, in particular in the area of services, new technologies, software, R&D, etc. The ability to file a patent or secure a copyright could be one of the first steps leading to the creation of a small business. Regulatory tiering in favor of SMEs in the area of intellectual property is in the interest of the smaller firms and the economy at large, fostering innovation and its diffusion.

Support for enhancing intellectual property management by SMEs was one of the four strategic pillars of the Japan 2014 *Intellectual Property Policy Vision*. According to this document:

“SMEs and venture companies play an important role as sources of Japan’s industrial competitiveness in creating innovative technologies and in supporting local economies. The revitalization of their business activities is absolutely necessary for the growth of the Japanese economy. In the management strategy of SMEs and venture companies, intellectual property management to effectively utilize the excellent intellectual property rights they hold is extremely important in dealing with economic globalization. However, due to a lack of funds, know-how, and human capital, the intellectual property management that is essential to secure competitiveness in the current business environment is not necessarily being conducted in an appropriate manner. Therefore, there is an expectation that, while raising awareness about the importance of intellectual property management among SMEs and venture companies, the Government of Japan will provide detailed support for intellectual property activities according to the individual needs of companies, and remove various obstacles that hinder the intellectual property activities of these companies. The Government of Japan will make efforts including enhancing incentives for the intellectual property activities of SMEs and venture companies, and establishing a system that will provide thorough support from the acquisition of rights to their utilization overseas.”

The Japan Patent Office (JPO) provides comprehensive support through various measures to SMEs that sustain the industrial foundation in Japan and play a significant role as the driving force of regional economies, as well as to venture companies that are expected to create new industries. Through the right mix of regulatory tiering and other accompanying measures, the objective is to reduce the administrative burden and facilitate the process of patent filing for SMEs. According to the JPO (*2014 Annual Report*), support and initiatives in favor of SMEs fall under the following heading: (i) support by providing information; (ii) support in terms of fees, etc.; (iii) support through consultations; (iv) support by experts; (v) activities for raising awareness on intellectual property systems; and (vi) regional support system.

According to the JPO’s *2014 Annual Report*, regulatory tiering in favor of SMEs includes the following:

- The JPO grants an exemption from or a 50% reduction of examination request fees for individuals or companies that lack funds if they comply with certain requirements. In addition, the JPO grants a 50% reduction of examination request fees for SMEs dedicated to R&D. During FY 2013, 2,315 exemptions from examination request fees were granted under the first scheme (resources-based), and 4,839 under the second scheme (R&D).

- In cases in which a patent applicant is an SME or an individual, or if the applicant is already employing the invention, examination or appeal/trial examination is conducted more quickly than in the case of regular applications if the applicant submits an “explanation of circumstances concerning accelerated examination (accelerated trial/appeal examination)”.
- The JPO grants an exemption from or a 50% reduction of patent annual fees (from the first year to the tenth year) to individuals or companies that lack funds if they comply with certain requirements. In addition, the JPO grants a 50% reduction in annual patent fees (from the first year to the tenth year) to SMEs dedicated to R&D. During FY 2013, 2,160 exemptions from annual patent fees were granted under the first scheme (resources-based), and 11,956 under the second scheme (R&D).

Taking into account opinions received from SMEs and other actors, the government expanded and enriched the fee reduction/exemption system (see table). In 2014, in its Intellectual Property Policy Vision, the government stressed the need to go even further and to review the fee reduction/exemption system to make it more user-friendly for SMEs and more effective at facilitating innovation.

Table 8: Expansion of the JPO Benefits in Favor of SMEs after 2012.

Before March 2012	After April 2012
<p>Who is eligible?</p> <ul style="list-style-type: none"> - SMEs with no corporate tax imposed - R&D-based SMEs with R&D ratio over 3% - Universities and university researchers, etc. 	<p>Who is eligible?</p> <ul style="list-style-type: none"> - Same as previous - Same as previous - Same as previous - SMEs that have been in business not more than 10 years
<p>What is reduced?</p> <ul style="list-style-type: none"> - Half of the fee for requesting an examination - Half of the annual patent fee for the first 3 years - Total patent maintenance fees for 10 years are reduced by 5,000 yen from 226,000 yen to 221,000 yen 	<p>What is reduced?</p> <ul style="list-style-type: none"> - Same as previous but annual patent fee reduction extended to 10 years - Total patent maintenance fees for 10 years are reduced by 113,000 yen from 226,000 yen to 113,000 yen
<p>Procedures</p> <ul style="list-style-type: none"> - SMEs are required to submit a Certificate of Employee Invention and a Document for Proof that SMEs have an agreement to succeed to the right of an employee’s invention. 	<p>Procedures</p> <ul style="list-style-type: none"> - These documents are not required to be submitted anymore

Source: Japan Prime Minister’s Office, *Intellectual Property Policy Vision*, 2013.

This regulatory tiering is supplemented by a number of services specifically targeted at SMEs. These include: explanatory meetings and seminars for SMEs who wish to learn about

IP; free consultation sessions and workshops to teach SMEs basic matters from the filing of applications to registration and the actual procedure for filing an application; support from patent information and licensing advisors that is free of charge for SMEs; and, support of prior art searches for SMEs. These services and training/outreach efforts should be an integral part of any successful regulatory reform, since they allow SMEs harness the benefits of the reform. For example:

- The IP Comprehensive Support Counters are established in each prefecture to give consultation to SMEs on issues related to intellectual property. The IP Comprehensive Support Counters, in collaboration with related support organizations, provides a solution to various issues, from the time they create ideas up to when they establish their business operations outside Japan without charge, and confidentiality is maintained
- The JPO has industrial property right specialists who provide comprehensive support to SMEs. They serve as lecturers at various seminars designed for SMEs and local government staff; and they visit SMEs to provide individual counseling, with the objective of raising awareness on the IP system, giving information on types of support available.

Other APEC best practices identified by the World Intellectual Property Organization (WIPO) to assist SMEs in their use of the intellectual property system include:

- IP awareness and educational activities by the Canadian Intellectual Property Office.
- Technology transfer and intellectual property activities in the Engineering Institute of the National Autonomous University of Mexico (UNAM) or the Baltimore School of Law in the US.
- Activities of the Hong Kong Productivity Council, including the attribution to SMEs of patent application grants.
- IP Australia awareness and education programs for SMEs.
- The Singapore Patent Application Fund for SMEs, and the “SurfIP Marketplace” that enables IP owners, potential buyers and sellers, and licensees to come together and commercialize IP assets.
- The numerous initiatives and services of the Korean Intellectual Property Office (KIPO) that includes regulatory tiering in a similar way to the JPO. SMEs are eligible for free patent management services, and fee reductions for SMEs. The Fee Regulation (approved on December 23, 2000), provided fee reductions for SMEs to encourage IP creation & acquisition activities. Any SME, excluding micro enterprises, which meets the requirements as an “SME” prescribed by the “Framework Act on Small and Medium-sized Enterprises” can obtain a 50% reduction in the application fee, with request for examination and first registration fee included, related to patents, utility models and industrial designs. For micro enterprises, defined under “the Special Act for Supporting Individual or Micro Enterprise”, a 70% reduction of the above fees is provided under the Fee Regulation. “Micro enterprises” involved in an IPR-related dispute are also eligible for a 70% fee reduction when filing their trial request for identifying the scope of their right of patent, utility model and industrial design.

- The role of the Peruvian National Institute for the Defense of Competition and Intellectual Property (INDECOPI) in the promotion of the use of distinctive signs (especially collective marks and appellations of origin) by groups of SMEs through training and also by publicizing the various mechanisms for the registration and promotion of intellectual property.

Main Lessons Learned on Regulatory Reform

Institutions such as the JPO play an important role in the protection of SMEs' Intellectual Property Rights. SMEs take advantage of the differentiated treatment to apply for patents due to the incentives given such as the expansion of the eligibility of SMEs that can apply for patents and the elimination of burdensome paperwork. Furthermore, the regulatory changes implemented by the JPO shows that SMEs can save resources to apply for patents, as the reduction in cost is substantial. It seems that the JPO plays an important role promoting these schemes among SMEs, by offering advisory services and implementing training sessions for SMEs. The combination of institutional promotion and rule-based approaches has resulted in effective regulatory tiering in favor of SMEs in this important area.

China's Utility Model Patent System

The utility model patent system, the purpose of which is to protect small inventions and creations and supplement patents, plays a unique role in China's patent protection system. Though starting at a comparatively late stage in China, this system has experienced rapid development and remarkable achievements. It contributed to promoting not only the implementation of the patent system, but also the economic, scientific, and technological development of the economy.

While the utility patent model benefits the largest multinational companies (the top 10 foreign applicants for utility model patents in 2011 in China were all big and well known multinational enterprises, mainly from the United States and Japan), this regulatory reform was mainly designed with SMEs in mind. It is an example of de jure non-discriminatory regulation that de facto primarily benefits SMEs. Indeed, China has a large number of SMEs with little knowledge of the complicated patent system.

The utility model examination in China adopted a preliminary examination system, which simplified the examination procedures, shortened the examination period, and reduced the application expenses, and thus introduced the patent system to many SMEs. China has a lot of technology-oriented SMEs (e.g. Suzhou Touchstone, in the production of mid- and high-end surgical operating instruments, owns 297 utility model patents, and Haixin, devoted to research and production of anti-static products, owns over 50 utility model patents) that protect their technological innovations and strengthen their competitiveness with utility model patents. Utility model patents provide powerful protection for a company's innovation during its start-up phase, and pave the way for the SME's future development.

First introduced in 1985, the Chinese utility patent model has been revised and reinforced by subsequent Patent Laws in 1992, 2000, and 2008. It is now in conformity with the system of most other economies. This process of convergence with international practice has been an important element of developing the system, and making sure it responds to the needs of local SMEs. It also shows that the Chinese approach to regulatory reform in this area has learned from international best practice as appropriate. This finding is reminiscent of previous PSU work on regulatory reform and innovation, and in particular the case of Korea.

In 1997, China's utility model patent applications surpassed 50,000, ranking number one in the world for the first time; in 2011, its applications reached 585,000; by 2000, China's applications for utility model patent accounted for 42% of the world total and, with the sharp growth of China's utility model applications, it accounted for 83% of the world total by 2010; in 2011, SIPO granted in total 408,000 utility model patents, which represented 18.6% growth over the previous year; by the end of 2011, the valid utility model patents granted by SIPO were 1,121,000. Despite the rapid growth and the large quantity of China's utility model patent applications, the per capita number of utility model applications in China is not high. In 2011, China's utility model patent applications per 10,000 persons only reached 4.5, which was much lower than that of Germany, Japan, and Korea's historical peak.

Main Lessons Learned on Regulatory Reform

As a middle income economy, China is still developing its innovative capacity. Most indigenous technologies are the results of improvements or transplants of existing technologies or related technologies. The market life of those technologies is often short and their technology level is relatively low. Therefore, the utility model patent system is still an important IP system for encouraging invention-creations and promoting economic development in China. Applying for utility model patents has become an important means of implementing IP strategy and promoting indigenous innovations in SMEs. More and more SMEs in China are taking utility model patent application as an important approach to own their indigenous IP rights. Utility model patents are becoming their important intangible assets and a useful tool for SMEs to participate in market competition.

In the context of the increasing speed of the market life of technologies, it is important to keep flexibility in regulations. Since their introduction in 1985, Patent Laws have been revised in order to keep pace with technological changes, in line with good regulatory practice. Furthermore, the regulatory changes have been converging towards international practices (for example, standards), in order to facilitate companies expanding into global markets.

SME-FRIENDLY RIA

Regulation is often necessary to achieve a certain number of legitimate objectives, such as public health and safety, consumer or environment protection, etc. Such objectives should be achieved in the most cost-effective and efficient manner, without creating unnecessary burdens, e.g. to the operation of business or trade. This threshold could vary depending on the capacities (scale and resources) of the firms, however, and the uniform application of some regulations could impose unnecessary and disproportionately burdensome demands (including legal, accounting and consulting costs) upon SMEs with limited resources.

Regulatory Impact Assessment (RIA) is a key part of a government's toolbox when it comes to ensuring that regulations meet their objectives at minimum economic cost, including to SMEs. Economy-level practice on RIAs differs along a number of dimensions. RIA can be applied before as well as after reforms. In the former case, it is meant to help inform regulatory design, whereas in the latter case it is more about monitoring and evaluation, and possible re-design. Typically, a RIA includes a cost-benefit analysis of the regulation in question, and it is often quantified. In some cases, the RIA process not only provides information on the costs and benefits of a proposed or actual regulation, but suggests lower cost alternatives that are consistent with the same regulatory aims. RIAs are spreading

through the APEC region, and the practice is being picked up in different ways by some developing economies. The trend is definitely towards the adoption of RIAs on a relatively broad basis, although much work remains to be done in some economies to entrench the process, and ensure that all government departments are aware of the possible benefits it can bring in terms of supporting good regulatory practice.

This case study does not review RIA activity in general in APEC member economies, but instead focuses on examples of RIAs that deal specifically with issues relating to SMEs. For example, in calculating regulatory costs and benefits, it is possible to disaggregate results by firm size, so that differential cost impacts on SMEs as compared with large firms can be discerned. It is also possible to identify possible strategies, such as regulatory tiering, that can achieve a given regulatory objective while minimizing compliance and other costs for SMEs. Together, this report refers to this type of RIA as “SME-Friendly RIA”, to give the idea that the assessment deals specifically with issues of concern to SMEs and helps identify strategies to support them in dealing with regulatory burdens through the context of reform. Figure 8 sets out the examples used.

Figure 8: Case Study Four Examples.

Case Study Four: SME-Friendly RIA

- USA
- Canada
- Chinese Taipei

The first example for this case study is the US Regulatory Flexibility Act. Originally introduced in 1980, the Act requires government agencies to assess the impacts of their regulations and procedures on small businesses in appropriate cases. In addition, the Small Business Administration has an advocacy office, which intervenes on behalf of small businesses in the rule making process. The purpose behind such advocacy endeavors is to assist administrations in designing regulations that are both fit for purpose, and minimally disruptive to the growth and development of SMEs. The Act has been amended a number of times since its inception, and the advocacy role of the Small Business Administration has grown over time. This SME-friendly RIA approach is estimated to have saved small entities (and the economy as a whole) USD \$150-\$200 billion per year.

Canada also considers the needs of SMEs when analyzing its regulations. The government's focus has been on red tape burdens, which are known to disproportionately affect SMEs through their effect on compliance costs. Recognizing that measurement is an important part of efforts to reduce regulatory burdens on SMEs, Statistics Canada has undertaken two surveys of SMEs to estimate regulatory compliance costs, and assess the impacts of changes on the ground. Results are promising, with noticeable decreases in SME compliance costs between the two surveys. In the area of taxation, the Canada Revenue Agency has developed a performance monitoring framework that assesses regulatory compliance issues for SMEs using direct (time and cost) as well as indirect (proxy) metrics. The result is a regulatory reform framework that is specifically attuned to the needs and concerns of SMEs.

Chinese Taipei is included in the list of case study examples because it is selectively implementing various aspects of RIA even though it does not yet have a fully fledged RIA mechanism that is applied comprehensively to all, or most, regulations. Notwithstanding this, the Small and Medium Enterprise Administration conducts a de facto RIA annually when it presents its White Paper to the Legislative Yuan. The White Paper is a vehicle for putting SME concerns directly in front of legislators, and promoting reforms that save time and money for affected businesses. In addition to this annual activity, the Administration also takes part in ad hoc activities that have an SME-friendly RIA flavor. For example, it participated in work reviewing the economic implications of a trade deal with China, and effectively put forward the concerns of small businesses, which faced both opportunities and challenges as a result of the agreement.

Example 1: The US Regulatory Flexibility Act

The U.S. Small Business Administration (SBA) Office of Advocacy estimated SMEs spent USD \$12.7 billion annually on government paperwork alone. It also estimated that the average cost of regulation was \$2,979 per employee for large firms with 500 or more employees and \$5,532 per employee for small firms with fewer than 20 employees. As early as 1980, the U.S. therefore introduced the Regulatory Flexibility Act (RFA) that aimed “to establish as a principle of regulatory issuance that agencies shall endeavor, consistent with the objectives of the rule and of applicable statutes, to fit regulatory and informational requirements to the scale of the businesses, organizations, and governmental jurisdictions subject to regulation”.

According to Congressional Findings and Declaration of Purpose for the RFA:

- “the failure to recognize differences in the scale and resources of regulated entities has in numerous instances adversely affected competition in the marketplace, discouraged innovation and restricted improvements in productivity.
- unnecessary regulations create entry barriers in many industries and discourage potential entrepreneurs from introducing beneficial products and processes.
- the practice of treating all regulated businesses, organizations, and governmental jurisdictions as equivalent may lead to inefficient use of regulatory agency resources, enforcement problems and, in some cases, to actions inconsistent with the legislative intent of health, safety, environmental and economic welfare legislation.

- alternative regulatory approaches which do not conflict with the stated objectives of applicable statutes may be available which minimize the significant economic impact of rules on small businesses, small organizations, and small governmental jurisdictions.
- the process by which Federal regulations are developed and adopted should be reformed to require agencies to solicit the ideas and comments of small businesses, small organizations, and small governmental jurisdictions to examine the impact of proposed and existing rules on such entities, and to review the continued need for existing rules.”

Originally passed in 1980 (P.L. 96-354), the RFA was gradually strengthened, and amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (P.L. 104-121), the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203), and the Small Business Jobs Act of 2010 (P.L. 111-240). More recently, on February 5th, 2015, the House of Representatives passed the Small Business Regulatory Flexibility Improvements Act (H.R. 527) to revise and expand the rulemaking requirements and procedures of federal agencies that affect small entities. According to Small Business Committee Chairman Steve Chabot (R-OH), in his Introduction to H.R. 527, on 26 January 2015:

“The Small Business Regulatory Flexibility Improvements Act is about making the federal government stop and think about its impact on the millions of American families who operate or work for our small businesses. That’s the heart of good government. The one-size-fits-all approach to federal regulations has, for decades, hit small businesses, their owners, and their employees the hardest. Giving them the voice they deserve helps give our small businesses the freedom they need to provide the jobs and innovation that drive the American economy forward.”

The RFA requires federal government agencies to consider the impact of their proposed rules on SMEs. The threshold for review is that the proposed regulation must have a “significant” economic impact on a “substantial number” of small entities. In addition to considering the impact of their proposed rules, agencies are also required to consider alternative measures that achieve the same purpose but minimize the regulatory burden on SMEs. The process for seeking these less burdensome alternatives is three-fold. Agencies must:

- Solicit views of affected small entities.
- Consider the views of the SBA Office of Advocacy.
- Publish an initial regulatory flexibility analysis (IRFA) and/or a final regulatory flexibility analysis (FRFA) in the Federal Register, or provide a certification that the regulation will have no “significant impact”.

The U.S. SBA Office of Advocacy has been in charge of monitoring the implementation of the law, and its reports quickly made it clear that the law was not strong enough. In particular, until 1996, the courts did not have jurisdiction to review the administrations’ compliance with the law. In 2002, Executive Order 13272 imposed on federal agencies the requirement to establish written procedures and policies explaining how they measure the impact of their regulatory proposals on small entities and to vet those policies with the Office of Advocacy; to notify the Office of Advocacy before publishing draft rules expected to have a significant small business impact; and to consider the Office of Advocacy’s written comments on proposed rules and publish a response with the final rule. The scope of application of the law

was also progressively extended to include more agencies and more rules, and the enforcement powers of the SBA and the courts have been increased.

The SBA Office of Advocacy plays a key role in this framework by working with SMEs to identify proposed regulations that are of concern, and developing submissions to the relevant government agency under the RFA. In 2014, the Office of Advocacy filed 22 formal comment letters on specific regulatory proposals, focusing most frequently on the SME impacts of rules, and the consideration of SME-friendly alternatives. It also participated in three panels convened by the Environmental Protection Agency and one by the Consumer Financial Protection Bureau under the Small Business Regulatory Enforcement Fairness Act.

The Office of Advocacy has been effective in ensuring that the concerns of SMEs are heard within government, and acted upon. In 2014, 13 of the rules on which it provided SME input resulted in final versions that took account of SME input. The estimated cost savings for small business were USD \$4.8 billion.⁴⁴

The strengthening of the law was also criticized due to its implementation costs for the administration. Indeed, there is a right balance to strike between the burden of regulation for SMEs and the burden of differentiation for public agencies. For example, on the occasion of the consultations in the House about the latest Small Business Regulatory Flexibility Improvements Act (H.R. 527), the Executive Office of the President (Office of Management and Budget) asked for the President to veto the bill if he had an opportunity to do so, on the basis that the bill “would impose unneeded and costly analytical and procedural requirements on agencies that would prevent them from performing their statutory responsibilities. It would also create needless regulatory and legal uncertainty and costs for businesses and the American public”. In particular, according to the Executive Office, the new bill would impose unnecessary new procedures on agencies and invite “frivolous litigation” as a result of the extension of judicial review and remedy mechanisms. On the other hand, the Congressional Budget Office estimated the H.R. 527 implementation cost to be USD \$55 million over the period 2015-20, and suggested that the net increase in spending by agencies would not be significant.

Main Lessons Learned on Regulatory Reform

This example demonstrates the way in which RIA-like processes can be made to work specifically for SMEs. It is also a good demonstration of the ways in which transparency can promote good rule making, in line with good regulatory practice. This point is evidenced by the various amendments to the original law, and the procedures for advocacy and consideration that are now in place. Of course, incentives across different parts of government can be more or less aligned with these kinds of priorities, and it is important to ensure an appropriate degree of coordination between agencies and authorities. Finally, the transparency with which the RFA is implemented—including the advocacy role of the SBA—is a further example of the application of good regulatory practice in this context.

Example 2: The Canada Revenue Agency’s Performance Measurement Framework for Compliance Burden Reduction

The Government of Canada has taken important steps towards the reduction of administrative burden on business, and SMEs in particular (e.g., the dedicated website

⁴⁴ <https://www.sba.gov/sites/default/files/advocacy/FY2014%20RFA%20Report.pdf>.

www.reducingpaperburden.gc.ca). As noted in the Economic Action Plan 2013, the Government remains committed to eliminating unnecessary red tape from the federal regulatory system, while maintaining the economy's high standards for safety and protection (the Red Tape Reduction Action Plan was launched in October 2012). As early as 2007, the Government committed to reduce paperwork burden by 20 percent—and fulfilled this commitment within 2 years.

Interestingly, this policy was backed by innovative Regulatory Impact Assessment (RIA) mechanisms. For example, Statistics Canada launched a *Survey of SMEs Regulatory Compliance Costs* that had its last iterations in 2008 and 2011, with associated reports issued in 2010 and 2013. It helped the Government prioritize regulatory compliance cost reduction efforts in favor of SMEs. Beyond Canada, these statistics were widely used to inspire best practice among OECD economies. Another example is the development by the Canada Revenue Agency (CRA) of a “Performance Measurement Framework for Compliance Burden Reduction” based on the same Statistics Canada survey. In both cases, the idea is to prioritize regulatory reforms on the basis of the assessment of administrative burdens, and measure the impact of the reforms on SMEs.

The CRA Small Business Compliance Burden performance measurement framework identified two types of measures that were frequently used by other levels of government and economies. These measures relate to the time and money expended by small businesses in order to comply. The CRA then divided these measures into two categories:

- Direct measures: measures that have a direct impact on time and money expenditures by small business (Costs in Time; Costs in Money).
- Indirect or proxy measures: measures of factors that indirectly affect time and money expenditures (Complexity of the compliance process; Quantity and Quality of CRA services for taxpayers).

The CRA also acknowledged that there were many factors that could affect the compliance burden, but over which it had little influence or control (e.g., characteristics of individual taxpayers, tax law and policy, etc.). During the two iterations of reporting against the framework (2010 and 2013), the cost in compliance faced by small businesses steadily decreased.

RIA is not only useful to measure performance ex post, it could also be used ex ante to guide regulation. For example, the CRA is committed to cutting red tape for small and medium businesses by continually asking for feedback on its services on an ongoing basis. In 2011, as part of the Government of Canada Red Tape Reduction Commission consultations with small and medium businesses, the CRA developed action plans to address over 1,100 identified irritants related to the Canadian tax system. Additional consultations were held with small business, representatives, and bookkeepers in 2012 to refine the action plans to ensure the key commitments focused on the priorities of small and medium businesses. In the fall of 2014, the CRA launched a second round of red tape reduction consultations with small and medium businesses, bookkeepers, accountants, and stakeholder associations through in-person roundtables, online surveys, and written responses. There was a tremendous level of engagement from participants during the consultations. Discussions were very constructive—many participants acknowledged CRA's progress on reducing red tape and provided helpful feedback on what they felt should be the new priorities.

Top recommendations from the business community (what was heard - 2014 consultations) included:

- Improve telephone client services.
- Help businesses get it right from the start.
- Provide information in language business can understand.
- Make it easier to find information and services on the web.
- Make more online services and tools available.
- Better explain the audit process.

From the 2014 consultations, the CRA developed an action plan for its red tape reduction commitments for fiscal years 2015-2016 and 2016-2017.

Table 9: 2015-2017 Red tape reduction action plan highlights.

Telephone service improvements	<ul style="list-style-type: none"> > Develop new tools and streamline procedures for telephone service agents. > Work closely with key stakeholders to look at the merits of piloting a dedicated telephone service for registered tax preparers. > Be ready to implement the new Government of Canada telephony platform.
Accessible, clear, and understandable tax information	<ul style="list-style-type: none"> > Help small business owners get it right from the start by establishing the Liaison Officer Initiative as a permanent program. > Engage stakeholder associations to identify the guides and forms that need to be simplified and clarified. > Create a dedicated webpage for small and medium businesses to meet their needs. > Expand outreach through public-private sector partnerships.
Filing requirements and frequency	<ul style="list-style-type: none"> > Reduce the frequency of remittances for small new employers. > Expand the My Business Account (<i>on-line portal</i>) Submit document service to allow businesses to request CRA search for payments made and to submit cashed checks as proof of payment. > Explore sending messages to businesses through My Business Account and email reminders for filing and payment obligations.
Online service	<ul style="list-style-type: none"> > Expand My Business Account (<i>on-line portal</i>) to: <ul style="list-style-type: none"> - Include statements of capital gains and losses. - Accept supporting documentation with notices of objection. - Allow the submission of supporting documents online for additional business programs. > Explore opportunities for: <ul style="list-style-type: none"> - Providing more convenient options for communicating between the CRA and businesses. - Developing new or improving existing mobile apps.
Sharing information within government	<ul style="list-style-type: none"> > Work with all levels of government to: <ul style="list-style-type: none"> - Encourage them to adopt the Business Number as a

	<p>common business identifier.</p> <ul style="list-style-type: none"> - Explore options to improve federal electronic information sharing.
Audit experience	<ul style="list-style-type: none"> > Develop a My Audit tab in My Business Account (<i>on-line portal</i>) to allow electronic communications. > Develop training products (videos, workshops, job aids) and support tools for auditors. > Develop new educational campaigns to promote voluntary compliance. > Continue to focus audit efforts on businesses at the highest risk of non-compliance.

Main Lessons Learned on Regulatory Reform

The Canadian example shows the positive impacts of cost-benefit analysis and stakeholder consultations can have when applied to regulations and services that affect SMEs. Cost savings and burden reduction thanks to broad sense regulatory reform have been substantial, and have been achieved without compromising underlying regulatory objectives, including in as important an area as tax compliance.

Example 3: The Legal, Procedural, and Administrative Architecture for Regulatory Cost-Benefit Analysis in Chinese Taipei

Chinese Taipei has not implemented a formal RIA regime, but has studied OECD best practices on the topic in detail with a view towards future domestic implementation. The government has in this light conducted “simulation” RIAs to understand how they function in practice and to assess their feasibility for implementation as standard practice.⁴⁵

With respect to SMEs, the regulatory feasibility assessment (RFA) section of the RIA simulations explicitly required: “If SMEs are involved, it is to conduct the Regulatory Feasibility Assessment for them.”⁴⁶ This is no surprise as sensitivity to the particular difficulties SMEs face in meeting regulatory requirements is clear in the legal, administrative, and procedural framework of support for SMEs in Chinese Taipei.

Indeed, Article 12-1 of the *Act on Small and Medium Enterprises* (the Act) categorically requires the Ministry of Economic Affairs (MOEA) to “periodically review the acts related to small and medium enterprises” and report the results of such reviews to the Legislative Yuan on an annual basis. The Small and Medium Enterprise Administration (SMEA) under the MOEA handles the day-to-day administration of policies on SMEs. As part of its duties, the SMEA produces an annual White Paper reviewing not only acts related to SMEs, but also trends in the economic environment, financial conditions and human resource situation from the SME perspective. A de facto RIA, the White Paper seeks to assess the performance of policies and programs in place to support SMEs in light of the changing environment with a view towards formulating improvements to existing programs and regulations to better support SMEs. The MOEA via the SMEA also employs the White Paper as a vehicle to

⁴⁵ Huang, Yang-Yu (2008), “The Experience of the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu in Promoting Regulatory Impact Assessment (RIA)”, WTO TBT Committee, Workshop on Good Regulatory Practice, March 18 – 19, Geneva, www.wto.org/english/tratop_e/tbt_e/wkshop_march08_e/session3_e/huang_e.ppt.

⁴⁶ Huang (2008), slide 11.

propose new programs and regulations to the Legislative Yuan for consideration and possible legislative action.

In Chinese Taipei, the process of creating new legislation and regulations is generally governed by the *Administrative Procedure Law* of 1999 which “*expects* government agencies to conduct hearings *before* the administrative regulations delegated by any legislation having an effect on the rights and obligations of people are issued or amended.”⁴⁷ (Emphases added) With respect to SMEs in particular, the SMEA is not only active in consulting with SMEs at the development stage of new laws and regulations, but also in providing analysis of their potential impact on SMEs, and as an integral component of the rulemaking process itself.

Nowhere was the role of SMEA as a provider of RIAs and recommendations more clear than in the case of the Economic Cooperation and Framework Agreement (ECFA) between Chinese Taipei and China. An entire chapter of the SMEA 2010 White Paper was devoted to analyzing the substantial and multifaceted impact ECFA would have across Chinese Taipei’s diverse SMEs. The SMEA articulated that ECFA is a “transitional agreement” designed as a first step towards an eventual free trade area between China and Chinese Taipei. It underscored three objectives of the negotiations for ECFA including 1) negotiating an “early harvest” list of products and services for initial liberalization, 2) maintaining a “dual-track” approach whereby some products would continue to receive protection, and 3) developing “risk control mechanisms” to monitor Chinese imports for unsafe products.⁴⁸

Economic analysis cited in the chapter indicated that ECFA would likely contribute more than 1.65 percent to domestic GDP growth and identified sectors of the domestic economy expected to receive positive, as well as those expected to receive negative, impacts from ECFA liberalizations.⁴⁹ The SMEA analyzed ECFA’s importance to the long-term competitiveness of domestic enterprises based in relation to international developments such as the ASEAN+1 and ASEAN3” free trade agreements. In the absence of ECFA, producers in Chinese Taipei would continue to face import duties of 5 to 10 percent on products exported to China—which then constituted 40 percent of total exports—that producers in the ASEAN+ agreements would eventually not. Analysis provided similarly highlighted that enterprises in the domestic services sector would face increased competition from Chinese counterparts that tended to be better financed. However, increased access to China’s services sector would also provide opportunities for domestic service sector enterprises to achieve economies of scale that would not be possible based on the domestic economy alone.⁵⁰

Underscoring the favorable asymmetric profile of ECFA’s Early Harvest List, the chapter concludes with a review of measures in place and those that would be implemented to support SMEs and workers facing negative impacts from ECFA liberalizations. Although the

⁴⁷ Lo, Changfa, (2002-4), “RIA as a Tool from Chinese Taipei’s Perspective”, National Taiwan University, Taipei, www.apeccp.org.tw/doc/APEC-OECD/2002-4/007.pdf.

⁴⁸ SMEA (2010), 2010 White Paper, SMEA, Taipei, p. 152, http://book.moeasmea.gov.tw/book/doc_detail.jsp?pub_SerialNo=2010A01017&click=2010A01017.

⁴⁹ *Ibid.* “ECFA will have a *positive impact* on production in the machinery industry, the chemical industry, the rubber and plastics industry, the textile industry, the iron and steel industry, and the petroleum products industry. However, it cannot be denied that ECFA will have a *negative impact* on the electromechanical and electronic products industries, the transportation vehicle industry, the timber products industry, etc.” (Emphasis added)

⁵⁰ *Ibid.*, p. 154.

539 products that China liberalized under the Early Harvest List represented nearly double that of Chinese Taipei's 267, the economic value of the former was far higher. Chinese liberalizations represented 16.1 percent of Chinese Taipei's total exports, valued at USD \$13.8 billion. China's Early Harvest List liberalizations represented well over four fold the value of Chinese Taipei's import liberalizations vis-à-vis China.⁵¹

To support adjustment by SMEs and employees negatively impacted by ECFA liberalizations, the MOEA and the Council of Labor Affairs (CLA) had implemented separate but complementary policy regimes. Administrated by the MOEA, the Plan for Supporting Structural Adjustment in Response to Trade Liberalization (the Plan) had a budget of NTD 95 billion (USD \$3 billion) and has a ten-year implementation time frame. The Plan divided negatively impacted enterprises into three categories including those in need of "revitalization guidance", "structural adjustment", and "injury relief." Each category of enterprise would receive varying combinations of "guidance" accompanied by credit guarantees and low-interest loans to upgrade technology, improve efficiency, develop new areas of business, and/or to shift into completely new sectors of economic activity. Also based on a ten-year implementation time frame, the CLA Plan for the Provision of Support for Job Creation in Response to Trade Liberalization adopted a two-pronged approach of first providing wage subsidies, supporting re-designing of jobs and training to help protect existing jobs. The second prong focused on helping redundant workers find new employment and encompassed re-employment assistance, new skill development, support for start-ups, as well as subsidies to support transportation, housing, re-location, and unemployment benefits during transition periods.

Perhaps the most noteworthy portion of the ECFA RIA chapter was the recommendations forwarded for possible legislative and executive action. Among them was a call to accelerate the lifting of restrictions on independent travel by Chinese citizens to Chinese Taipei, thus allowing small-scale service providers to benefit directly from increased tourism. Emphasis was also placed on supporting "demand-oriented guidance subsidies", whereby owners and workers from negatively impacted enterprises are invited to propose policy concepts during the course of conferences, presentations, and seminars for consideration and study by officials for possible implementation. Also forwarded was a recommendation to support the expansion of transshipment activities within the ECFA framework. The objective would be to strengthen the domestic logistics industry and to revitalize port infrastructure in Chinese Taipei's three major port cities. In short, the contours and specific nature of the recommendations not only appeared informed by the findings of the RIA, but also by meaningful dialogue between SMEs and the policy administration supporting them.

Main Lessons Learned on Regulatory Reform

Chinese Taipei's experience is important because it highlights the ways in which regulatory cost-benefit analysis can be undertaken even in the absence of a fully-fledged RIA framework, even if development of such a framework appears likely in the future. In this case, cost-benefit analysis not only informed the development of policies to support SME activity, but also frankly identified businesses and workers who could lose from policy reforms. This example shows that RIA can work to help identify areas in which the reinforcement of safety nets is required if reforms are to be politically feasible and yield maximum economic return.

⁵¹ *Ibid*, p. 155.

5. CONCLUSION AND POLICY IMPLICATIONS

Regulatory reform is an issue that looms large for SMEs around the APEC region. This report has shown that small businesses are concerned about a variety of regulatory issues, and the burdens that can sometimes be imposed by compliance costs and other issues relating to regulation that pursues valid public policy objectives. The underlying proposition of this report is that it is possible to achieve those objectives at the same time as minimizing time and cost burdens for SMEs, which are often subject to disproportionate costs in relative terms due to the fixed nature of some compliance costs, and their inability to outsource compliance functions to external providers.

Against this background, this report has presented four case studies of regulatory reform that can help improve the business environment for SMEs. Each case study relates to an issue area referenced in the project TORs. The report's methodology has been to present the case study as a summary of the various challenges and opportunities arising in a particular case, and to back up the analysis with a selection of examples from developed and developing economies across the region. As the case studies make clear, numerous APEC economies have been successful in implementing regulatory reform programs of various types with the objective of improving the business environment for SMEs. In those cases where performance has been tracked over time, there is evidence of significant cost savings for SMEs, as well as substantial improvements in firms' ability to grow, develop, and internationalize.

Concretely, the case studies and examples presented in this report have covered the following cases:

1. Dedicated agencies to support SME growth, development, compliance, and internationalization.
2. Agencies and institutions that support SME financing.
3. Regulatory tiering, i.e. varying regulatory requirements according to firm size.
4. SME-friendly RIA.

In general terms, more examples have been in evidence for the first two areas than for the second two. APEC economies therefore widely recognize the need to support SMEs in their growth, development, and internationalization, and to take steps to improve their access to finance. Indeed, when firms are surveyed, SMEs highlight access to finance as a key constraint more often than do large firms. The examples for the first two case studies cover developing and developed economies from all around the region, and highlight the various ways in which governments can—within their own institutional and developmental settings—put in place regulatory reforms to benefit SMEs.

Although there are fewer examples in evidence for the second two case studies, there is still a substantial body of best practice within the region that other economies can draw upon in accordance with their needs and priorities. Regulatory tiering is a solution that can be adapted to a variety of circumstances. Moreover, as the example of Chinese Taipei shows, even as

complex an undertaking as RIA does not need to be formalized for all the economy at one time, but techniques can be applied as needed to SME issues to inform policymaking.

The examples for all four case studies indicate that SME issues affect developing and developed economies alike. SMEs account for the bulk of firms by number in both cases, and typically also account for the majority of employment. As a result, efforts to boost SME performance and facilitate growth can have particular benefits in terms of creating good jobs, and fostering sustainable and inclusive growth. The case study examples presented in this report are intended to represent a selective repository of regional best practice that economies can draw upon in their own efforts to implement pro-SME regulatory reforms. The subjects covered are not exhaustive in terms of the business obstacles encountered by SMEs, but they represent four of the most important areas that are susceptible to action by regulatory authorities.

In terms of lessons learned, and policy implications that can be drawn, the case studies make it possible to highlight a number of areas. Again, the list is not intended to be exhaustive, but is presented as a convenient summary of the key points to emerge from the work undertaken for this project.

1. Regulatory reform to improve the business environment for SMEs should include aspects of rule making and institution design, including as appropriate the putting in place of specialized agencies. Many APEC economies have dedicated agencies to support SME growth and development, and continued work in areas such as incubators could prove fruitful. Similarly, measures and agencies to promote SME access to finance can help alleviate a serious business constraint, for example through the provision of market-friendly guarantees, or facilitation of information exchange among private actors through appropriate regulatory frameworks.
2. SMEs need to be included in the reform process, and given a voice. Transparency is important in the process. Consultation with the private sector, including SMEs, is key to a better understanding of the business constraints SMEs face, as well as the measures they see as most needed for overcoming those constraints. A peak body for SMEs can be one way of effectively channeling their views to the government, but other means of consultation can also be effective.
3. The public and private sectors need to work together to promote regulatory reforms that improve the business environment for SMEs. This observation is not limited to SMEs themselves. In terms of internationalization, for example, most SMEs will need to link to larger firms in order to become embedded in GVCs. It is therefore important that governments adopt incentive-compatible regulations that promote linkages between SMEs and lead firms, both domestic and international.
4. Regulatory compliance, and compliance with voluntary standards, can be a major obstacle for SMEs. There is much that governments can do to ease the burden. On the one hand, regulatory tiering can offer SMEs more flexible schedules or structures for dealing with regulatory obligations. For voluntary standards, capacity building exercises that include the private sector can help develop the ability of SMEs to satisfy relevant standards, which in turn facilitates their access to GVCs.

5. Regulatory reform to improve the business environment for SMEs is a process, not a one off event. As such, instruments such as RIA—whether formalized or not—are crucial in helping sustain the momentum behind reforms. Similarly, tracking performance and implementation on the ground is an important element in continuously improving policies that affect SMEs. Measurement and data are key elements both of RIA and of performance monitoring and evaluation. Economies can benefit from increased attention to data collection and publication in relation to SMEs and the regulatory burdens they face. As new issues appear, it is important to have some flexibility to fine-tune the existing regulation to adapt it to new scenarios. This can help SMEs to adjust and be ready to face a new business environment.

As seen, many of these lessons show the relevance of good regulatory practices, such as the need to emphasize inter-institutional coordination, the utilization of cost-benefit analysis, the incorporation of transparency in the process of implementing reforms, and the inclusion of flexibility to fine-tune regulation and adapt it to new circumstances. These practices are part of the APEC Good Regulatory Practices criteria.

This report has shown that APEC economies have been proactive in identifying ways in which SMEs need support in their efforts to grow, develop, and internationalize. This statement is true of developing and developed member economies alike. Although the instruments adopted differ considerably across economies, there is general evidence of an awareness of the need to conduct regulatory reform in a way that both achieves important public policy objectives, and limits the time and cost burden on small businesses. As the SME sector receives greater attention internationally and domestically, APEC member economies can draw on the examples collected in this report to refresh and enhance their existing programs, and thereby give SMEs throughout the region an important boost that can translate into improved economic and social outcomes.

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