CHAPTER I
Introduction

Small and medium-sized enterprises (SMEs) continue to make significant contributions globally. SMEs are a key source of economic growth and dynamism in all economies. Adaptability, resilience and the ability to manufacture goods and to provide services with a high degree of flexibility and cost effectiveness are hallmarks of the SME sector. Innovations based on proper marketing have been the unique and biggest strength of SMEs. Small businesses are particularly important for bringing innovative products and/or services to the market. A number of modern products, especially electronics and ICT products, owe their origin to the SME sector.2

In fact, SMEs are a “nursery” for nurturing entrepreneurial talent, in addition to creating employment and fostering industrial development in an economy. SMEs are alleviating poverty around the world as well as increasing the social and economic participation of women, youth and minorities. Some SMEs also have the potential to grow into large enterprises and even transnational corporations (TNCs) or multinational corporations over time, and make important contributions to national, regional and global economies. The Asia-Pacific region – where trade and FDI-driven development strategies with rich natural endowment are commonly undertaken – is also enjoying all of the above-mentioned benefits of SMEs.3

In most countries of the world, SMEs generally start as proprietorships, become small business enterprises and then grow into medium-sized enterprises.4 Indian statistics (Ministry of Science and Technology, 2011) reveal that 99.7 per cent of all enterprises in the world are SMEs while large enterprises only account for 0.3 per cent. On average, SMEs provide between 60-70 per cent of the jobs, especially within the Asia-Pacific context (Hall, 2002). In Asia and the Pacific, SMEs typically account for nearly 50 per cent of all value addition.

1 Having recognized their expected contribution to inclusive and sustainable industrialization in developing countries in Asia and the Pacific, this publication mainly focuses on the development of export-oriented SMEs as well as SMEs in supporting industries. Those SME segments are typically characterized by high technology adaptation and backward linkages, which are key success factors for their effective penetration into foreign markets. Other major SME segments, i.e., domestic market-oriented SMEs and cottage industries, which mainly serve domestic and local markets, are not discussed extensively in this publication (Uchikawa and Keola, 2009) although they may share some of the similar corporate characteristics to export-oriented and support industry SMEs. For a more detailed discussion, see section C. “Typology of SMEs”, in chapter II. Note that the statistics of SMEs in this publication are the aggregate data of all SME segments, including micro enterprises.

2 For example, Taiwan Province of China’s economic transformation is often viewed in this context.

3 The size of the SME sector in an economy does appear to be positively associated with gross domestic product (GDP) per capita growth in many countries. Strong SME sectors do not necessarily drive economic growth, but they are “characteristic of fast-growing economies” (ESCAP, 2009a).

4 Every SME does not go through this growth path, as the failure rate of new and small businesses is considerably high; such a rate differs by industry and country. See chapter II for more information.

The SME sector is highly dispersed and can even sustain itself with minimal transportation, power and communication infrastructures. Experience also shows that without such supporting infrastructure, advanced technology and modern methods of production, SMEs suffer from low quality and productivity (ESCAP, 2009a). SMEs also require basic support for steady growth in terms of adequate capital, market access, technology adaptation and a skilled workforce. In the SME sector, the paramount role of state policy should be that of a “facilitator”; policymakers must resist controlling and micro-managing entrepreneurs. Proper government policies, supporting infrastructure and development services are required to trigger the individual initiative of entrepreneurs and their resources in productive processes.

A. Objectives

This publication aims to provide comprehensive and practical guidelines for policy formulation for SME development in Asia and the Pacific, clearly outlining policy objectives to be undertaken. Special attention is paid to both the selection and the implementation of policy options in the real world. This guidebook offers feasible policies at the operational level. For this purpose, the publication covers six key areas: business environment, entrepreneurship, finance, business development services, innovation and technology, and market access. The guidelines must be general enough so that individual nations can adapt them to their own industries while reflecting the various stages of economic development within the Asia-Pacific region; hence, this guidebook does not cater to only one development stage. In addition, it provides some practical ideas on how to establish necessary institutional frameworks for the smooth implementation of the policy options. While the guidebook is designed for policymakers, it is also useful for entrepreneurs and trainers as well as business associations, such as chambers of commerce and federations of industry.

B. SME development prospects

The strategic importance of SMEs in overall economic development has been widely recognized in the past and has been even more evident in recent decades, both in developed and in developing nations. To foster the growth of SMEs, a number of cultural, behavioural and social factors need to be considered to obtain the desired outputs from development programmes and initiatives. The overall objectives of SME development are to: (a) create jobs and generate income; (b) improve SME performance and competitiveness; and (c) increase their participation in and contribution to the national economy.
There are a number of obstacles that need to be overcome to achieve these objectives. The following constraints for SME development in the Asia and the Pacific have been identified by AAMO (2007):

(a) Poor business environment (e.g., bureaucracy, taxation and unfavourable property rights enforcement);
(b) Poor infrastructure (e.g., transportation facilities, power plants, industrial estates and telecommunications);
(c) Inadequate access to finance (e.g., obtaining loans, securing collateral and third-party guarantees and a lack of alternative sources);
(d) Low technological capacities (e.g., rapid technological advancement in markets, locating sources of appropriate technology and acquiring technology to develop attractive products);
(e) Too few applications of ICT (e.g., business communications, marketing intelligence and customer development); and
(f) Intensified competition in domestic, regional and global markets (e.g., trade and investment liberalization, less protectionism, freer movement of goods and capital, lower import duties, cuts in subsidies and cost pressures).

The United States Small Business Administration (2008) outlined five major challenges governments face with regard to small businesses: (a) strengthening the overall economy; (b) regulating taxes; (c) overseeing cost and availability of health insurance; (d) attracting and retaining a quality workforce; and (e) managing global competition (Moutray, 2008). In the Asia-Pacific region, the UPS (2007) Asia Business Monitor identified the top three business concerns for SME owners as the quality of products and services, customer loyalty and the retention of a qualified workforce. The DP Information Group, in a 2011 survey of SME development in Singapore, highlighted several SME needs including internationalization for growth, increased productivity, investment in technology and innovation, and greater financial strength to weather economic downturns (DP Information Group, 2011). A survey by the SME Agency of Japan in 2010 suggested that the four biggest problems faced by SMEs in Japan are a lack of marketing intelligence; staffing (37 per cent), finding customers (55 per cent), and technical ability (37 per cent). The DP Information Group, in a 2011 survey of SME development in the Asia and the Pacific, suggested that the four biggest problems faced by SMEs in Japan are a lack of marketing intelligence; staffing (37 per cent), finding customers (55 per cent), and technical ability (37 per cent).

A troubled SME tends to show signs of financial weakness beginning with cash flow issues. In terms of proactive policy, emphasis should be placed on cash flow. Policy that puts cash in the hands of SME owners quickly is generally the best course of action, i.e., a front-end tax credit is preferable to a deferred tax benefit, with everything else being equal. This idea is revisited throughout this book, particularly in chapter V on financing SMEs.

Various agencies have designed and implemented SME development interventions in Asia and the Pacific, particularly in less developed economies. The strategic approaches of 13 major bilateral and multilateral development and donor agencies were reviewed to discover their areas of focus and modalities. It was found that their specific and detailed interventions to improve value additions in the SME sector, and strengthen their contributions to their respective economies, covered the following six key areas:

(a) Enabling environment, covering appropriate policy and regulatory framework, including effective institutional framework and pro-business fiscal policy, and supporting infrastructure development, such as power, transport, communication, water, etc.;
(b) Entrepreneurship development, including management skills and human resources;
(c) Financing a business;
(d) Fostering business development services;
(e) Technology transfer and adaptation; and
(f) Market access, including trade promotion.

The findings strongly indicate that a comprehensive SME development approach typically covers the interventions for some or all of the above-mentioned key areas. Tables I.1 and I.2 present the strategic approaches of all 13 development agencies and their typical interventions, followed by a brief discussion on each key area.

1. Business enabling environment

To provide a favourable environment for SMEs to flourish, governmental policy interventions and supporting infrastructure play vital roles (World Bank, 2011a). Transparent policies and regulatory frameworks facilitate enterprise establishment, operation, promulgation, access to resources and markets and the exit of failing firms.

Footnote: Because the respondents were able to list multiple obstacles, the total exceeds 100 per cent.
Table I.1. Development approaches for SMEs implemented by selected bilateral and multilateral agencies

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<td>✓ (Supply chains and clusters)</td>
<td>✓ (Sectoral development and CSR)</td>
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Sources: Authors’ compilation.
Note: CSR – corporate social responsibility.
### Table I.2. Typical interventions of the six key areas for SME development

| Business enabling environment | (a) Corporate registration  
| Policy and regulatory framework  
| (b) Corporate governance 
| (c) Fiscal incentives (tax exemptions, subsidies and grants)  
| (d) Labour laws  
| (e) Bankruptcy laws  
| (f) Administrative institutionalization  
| (g) Anti-corruption  
| Infrastructure for business | (a) Transportation  
| (b) Power and electricity  
| (c) Water  
| (d) Communications  
| (e) Business premises, industrial estates and incubation centres  
| Promotion of entrepreneurial culture | (a) Entrepreneurship training and education  
| (b) New business nurturing (incubation)  
| (c) Women and youth entrepreneurial programmes  
| (d) Raising public awareness  
| Financing the business | (a) Microfinance  
| (b) Commercial loans  
| (c) Public credit guarantees  
| (d) Specialized or development financial institutions  
| (e) Corporate bond market  
| (f) Leasing and factoring  
| (g) Venture capital and angel investment  
| Business development services | (a) Marketing, laws, accounting, taxation, finance, foreign trade and technology  
| (b) Business incubation  
| (c) Strengthening service providers, such as business associations and training institutes  
| (d) Certified professional services  
| Innovation and technology | (a) Product and service development through marketing  
| (b) Research and development  
| (c) Technology transfer  
| (d) Technology incubation and commercialization  
| (e) Higher education reform  
| (f) Quality standards and certificates  
| (g) Intellectual property rights  
| (h) E-commerce  
| Market access | (a) Information dissemination on trade and investment liberalization  
| (b) Market intelligence  
| (c) Trade fairs and missions  
| (d) Export promotion agency  
| (e) Product and quality certifications  
| (f) Regional and global supply chains  

**Source:** Authors' compilation.

Sustainability of the policies and regulation – such as enterprise registration, corporate governance, fiscal incentives (tax exemptions, subsidies, and grants), anti-corruption, labour laws and bankruptcy laws – rely heavily upon adequate judicial and efficient administrative frameworks. Policies and regulatory directives with a clear vision and mission as well as adequate implementation of operation modalities build confidence among SME entrepreneurs; such directives strengthen their capacity to improve linkages with other enterprises, both large and small. The availability of specialized and formal institutional resources for SME development is also a pillar for creating a level playing field and facilitating their access to finance, skills and knowledge.

Adequate and quality infrastructure enhances SME competitiveness. Infrastructure for businesses comprise basic physical and organizational structures that are needed for the operation of enterprises that include, among others, transportation, water supply and sewers, power grids, telecommunications and training and research facilities. Viewed functionally, infrastructure facilitates the production of goods and provision of services by enterprises. For example, roads enable the transportation of raw materials to factories and the distribution of finished products to markets. Power and water supplies are necessary for the operation of machinery and equipment. For entrepreneurs, access to infrastructure such as business incubators and industrial parks helps tremendously in reducing their entry and running
costs by providing lower than market rates for rent and shared supporting services. Almost all major bilateral and multilateral donors are supporting the Asia-Pacific developing countries in building such infrastructure; however, specific infrastructure aimed at SMEs is still lacking (AAMO, 2007). The provision of such infrastructure, such as SME parks, will enhance their productivities and improve their competitiveness in the markets.

2. Promotion of entrepreneurial culture

Entrepreneurial culture is defined here as the tendency of a society to promote or motivate its people to be an entrepreneur. This is an aspect that is highly sensitive to government policy. There are basic conditions that a government must furnish to encourage entrepreneurial activity, with a fair expectation of gain and risk. According to the Global Entrepreneurship Monitor (GEM) (2007), these conditions consist of macroeconomic stability, a strong regulatory and institutional framework, market openness, formal education, conducive cultural and social norms and technological readiness. The Asian Productivity Organization (APO) (2007) pointed out that government provisions that created a conducive environment for entrepreneurial culture might involve regulatory reform, entrepreneurial skill development, women and youth entrepreneurial programmes, business incubation and raising public awareness. Technical knowledge for potential entrepreneurs should also be an integral part of overall entrepreneurship-building. An extensive programme for entrepreneurial development, with concomitant support through small business consulting services, would result in higher levels of entrepreneurial activities and thus the strengthening of existing SMEs. Increased donor support for enhancing entrepreneurial culture would also pay big dividends.

3. Financing a business

Financing a business involves enhancing the degree to which financial services are available to all, through easy and affordable means. Well-functioning financial systems and markets are particularly important and critical in attracting private sector investment, and thereby fostering SME development. The ability of SMEs to grow and strengthen their competitiveness depends highly on their potential to invest in development, innovation, improvements and diversification over time. All of these investments need short- and long-term capital; therefore, access to finance is a central issue.

Against this background, SMEs consistently cite lack of access to finance as a severe handicap (ESCAP, 2009a). In attempting to gain access to financial services, SMEs continue to face constraints caused by many common factors, such as an ineffective financial sector, high interest rates, lack of information on capital availability, excessive red tape, lack of collateral, poor property rights laws, lack of proper financial products, missing credit rating agencies and poor human resources in the financial sector (ESCAP, 2009a). Government officials should address these factors in order to make financial resources accessible to entrepreneurs. Recommended policy interventions that would provide much assistance include microfinance supplies, affordable commercial loans, public credit guarantees, a credit-rating scheme and SME-specialized financial institutions. Donor assistance in the financing of SMEs, particularly through two-step loans, venture capital, business incubation arrangements and targeted financing for priority sectors, particularly in rural areas, would bring tangible results.9

4. Innovation and technology development and adaptation

One of the critical factors that influence the competitiveness of enterprises is the development and marketing of innovative products and services through effective marketing and enhanced technological capability (Drucker, 2008). Innovation is an essential process of change in order to maintain the development and growth of an SME. In times of rapid change, innovation has to be a priority ingrained into management for the firm’s survival. It should be integrated into the existing enterprise systems and implemented as entrepreneurial strategies outside the SME in the marketplace (Drucker, 2008). SMEs should construct a policy of systematic innovation, analyze changes within and outside organizations at regular intervals, and regularly identify whether there are opportunities for innovation.

Technology development and adaptation play an important role in innovation. Technology comprises both hardware, in terms of the physical assets, and software, in terms of know-how and skills. Technology development and adaptation encompass R&D, the dissemination of information and knowledge, the matching of technology with needs and the creative adaptation of technologies for new uses (ESCAP, 2007a). SMEs in developing countries often produce products and services of moderate quality, commonly due to outdated technologies. This has resulted in the rejection of their products in competitive markets at both the domestic and international levels. In recent years, their situation has worsened because they have had to survive under intensifying competition due to globalization, widening free trade regimes and the phasing out of tariff barriers under WTO mandates. The best use of technology enables SMEs to be more innovative, market new products and services, reduce costs of production, maintain consistency in quality and standardization, improve productivity and enhance their competitiveness.

To boost innovation, government assistance in technology policy and infrastructural build-up is crucial. However, donor assistance in technological capacity-building remains limited. This is particularly the case with regard to SMEs in the developing countries of Asia and the Pacific. The building of technology-related institutions and R&D facilities as well as increased assistance in widening skills development programmes would bring tangible gains in enhancing SMEs’ innovation.

9 It is useful to distinguish between microenterprises operating in the informal sector and small enterprises in the formal sector – particularly in the context of their access to finance. Micro-enterprises programmes often address the collateral-free credit needs of microenterprises in the informal sector, while small enterprises without an adequate collateral base are the ones suffering from limited access to collateral-free credit. Many of the programmes for facilitating access to credit by these small enterprises through commercial banks have been unsuccessful, mainly because of high operating costs. Current literature highlights the need for developing a mechanism for collateral free access to institutional credit (e.g., ADB, 2009; and DFID, 2008).
5. Business development services

Inadequate business development (and support) services or their relatively higher unit cost has hampered SMEs' efforts in improving their competitiveness. A lack of both information and accessibility to existing services by SMEs has also resulted in weak demand for such facilities. Obtaining information about the laws, taxation, customs regulations, market intelligence, business development, training opportunities and financing sources are generally expensive and time consuming, particularly in less developed countries. Thus, as has been pointed out by ADB (2006), most SMEs remain ignorant of the latest developments. Service providers, particularly lawyers, accountants, and marketing and technical consultants, often do not possess cost-effective management solutions that SMEs require most. It is incumbent upon governments to provide such critical SME development services jointly with commercial service providers as well as with business and industry associations, such as chambers of commerce and federations of industries. As noted by the Donor Committee for Enterprise Development (2011a), donors can also assist through financial assistance and the sharing of experiences in successful cases of business service provisions from other countries.

6. Market access

Given the fact that most domestic markets for SMEs in countries of Asia and the Pacific are saturated, there is a need to encourage those SMEs to seek greater access to international markets through international production networks or global supply chains. Orienting SMEs' efforts towards export markets by providing information about international markets and trade systems as well as incentives to promote linkages to global supply chains would prove beneficial. Traditional ways to facilitate local SME penetration of international markets involve various export promotion activities, such as participation in international trade fairs and exhibitions, organization of buyer-seller meetings, dispatching of trade missions and the establishment of national export promotion agencies. Trade promotion, by its nature, is intended to stimulate interest between foreign buyers and local suppliers, specifically to increase their business by exposing each other to new individuals and firms to conduct business with.

C. Policy development and implementation: Stakeholders and strategies

1. Policy development

Although there have been various national initiatives as well as a number of bilateral and multilateral agencies promoting SMEs in the Asia-Pacific developing countries, the need for SME development is urgent. Existing initiatives have not satisfied demand as of yet. Working with the active involvement of all stakeholders, particularly the SME associations and chambers of commerce, governments need to solicit large donor assistance for SMEs. Since different government agencies, such as those related to agriculture, industry, commerce, enterprise development, trade and finance, are involved in SME development, thorough inter-ministerial coordination and well-designed division of labour are essential. Stakeholders in SME development include:

(a) Governmental agencies, including apex SME development agencies;
(b) Financial institutions (both public and private);
(c) Education and training institutions;
(d) Research institutions;
(e) Business associations (e.g., chambers of commerce and federations of industries);
(f) Labour unions;
(g) Providers of BDS;
(h) Bilateral and multilateral development/donor agencies;
(i) Civil society organizations; and
(j) Individual enterprises and SMEs.

It has been observed that although governments and public-sector organizations play a central role in SME development, comprehensive facilitation requires the involvement of multiple actors (Baig, 2007). For example, governments implement policy reforms with the support of multilateral development institutions and in consultation with the private sector. The private sector embraces more productive and sustainable positions with support from governments or multilateral bodies (Baig, 2007). These interactions are captured in a common framework (see table i.3), which presents an overview of general actions that should inform policy development for different actors to facilitate SME development.

2. Policy implementation

Policymakers in Asia and the Pacific have been implementing SME development programmes in several fields, including: (a) policy advocacy (typically together with reforms in administrative framework); (b) infrastructure development; (c) institutional capacity-building both at the public and the private level; (d) human resource development for governments, business associations and enterprises; (e) reform in financial institutions and markets (developing new financial products); and (f) product-based trade and investment promotion.

In this connection, governments and development agencies share some common tactics to enhance the smooth implementation of policy, particularly in selecting the most effective tools and engaging the needed local organizations as the main counterparts for the projects. These tactics include:

(a) Establishment of a national steering committee of the project comprising of individuals from both the government and the private sector;
(b) Identification of a national focal-point office or a primary counterpart, typically among governmental agencies, including the establishment of a national SME development agency;
(c) Organization of multi-stakeholder consultations and dialogue;
(d) Support to and collaboration with business associations;
(e) Support to and collaboration with BDS providers;
In general, SMEs are still in a precarious condition in Asia-Pacific developing countries, and governments must take a leading role in supporting and facilitating their development. Their selection of a proper modality of policy development and implementation particularly affects the effectiveness of SME development in a country.

One trend in technical assistance for SME development in the region is the emergence of large-scale, cost-sharing programmes among development agencies, which typically promote an enabling business environment, access to finance and direct support to individual enterprises’ business development, e.g., Katalyst and the Bangladesh Investment Climate Fund (BICF). These joint programmes help the governments, producers’ associations, and individual enterprises via business development services and finance. Some of them also are adopting sectoral development and value chain approaches. Joint programmes also tend to establish an independent secretariat to manage their activities and funds; while this saves money, it has the disadvantage of isolating SME development projects from national stakeholders.

### D. Methodology

This policy guidebook addresses the policy frameworks, institutional arrangements, public-private sector cooperation mechanisms and technical support for SME development in Asia-Pacific countries. Developing such a manuscript is a daunting task when considering the variety of experiences as well as the varied policies and programmes of each country.

For this purpose, the book focuses on an analytical review of existing policy measures, acts, documents, studies and other secondary materials on SME financing mainly in Asia and the

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8 Policymakers must recognize the considerable costs involved in providing direct assistance to individual firms. Within this context, the role of business associations could be further promoted as providers of business development services. See chapter VI for further discussion of this issue.

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Table I.3. Common framework of actions for SME development

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<th>Sector</th>
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<th>Public-private partnership</th>
<th>Private</th>
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<tr>
<td>Drivers</td>
<td>Governments, public sector organizations, multilateral development agencies/donors</td>
<td>Government-local company, Government-academia Local company-donor Government-CCI/association</td>
<td>Local/multinational companies, academia, industry associations, chambers of commerce and industry, foundations, non-governmental organizations (NGOs)/civil society, financial institutions</td>
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<td>Actions</td>
<td>Reform policies, regulations, and legal framework for SMEs, Engage the private sector in policy process, Promote an entrepreneurial society and entrepreneurial culture, Monitor entrepreneur profile, entrepreneur activity and entrepreneurial business environment.</td>
<td>Entrepreneurship trainings and knowledge development, Strategic public-private partnerships for vital services, Broadening financing options.</td>
<td>Encouraging entrepreneurship, Developing linkages and strengthening networks to nurture small businesses, Fostering technological upgrading and new business opportunities, Promoting corporate governance and social responsibility.</td>
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Pacific, in line with grounded theory, a qualitative research methodology (Glaser and Strauss, 1967). Relevant materials were also taken from other regions. The grounded theory methodology can generate or build theory and is well suited for studying both objectives and subjective phenomena that can be derived from different experiences (cf. Locke, 2001). Specific policy implications and guidelines are documented, based on various countries’ strategies and practices in the context of financing of SMEs in Asia and the Pacific, apart from the experience and expertise of the contributors, researchers and authors of this volume.

The United Nations Secretariat and the Government of Japan established and financially supported a research team. ESCAP has invited academics and industry experts from inside and outside the region to contribute to the development of the guidebook. Following the first draft, two regional expert group meetings were held separately to review the manuscripts and to obtain additional data. The participants included SME development agencies, commercial banks, SME/exim banks, credit guarantee agencies, multilateral and bilateral development agencies, international financial institutions, business associations, industry experts and academics from the region. Their feedback and follow-up communications via phone and e-mail were also incorporated to the maximum extent possible in subsequent drafts.

E. Outline of the guidebook

This publication comprises nine chapters. Following this introductory chapter, chapter II provides the background and elaborates on the competitiveness and contribution of SMEs in the region. It discusses the underlying need for policy objectives and associated interventions together with specific challenges and constraints faced by policymakers. Chapter III highlights factors enabling a conducive business environment for SMEs’ steady growth. Chapter IV addresses issues concerning entrepreneurship development, while chapter V covers finance, which is typically seen as one of the most critical issues of SME development. Chapter VI underscores the crucial role of business development services while chapter VII discusses the importance of innovation and technology for SMEs to compete effectively. Chapter VIII emphasizes the need for greater market access. Chapter IX provides a comprehensive summary of policy guidelines, issues and challenges that need to be addressed for ongoing SME development, in addition to the framework of M&E exercises.