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## THE PRODUCTIVITY CHALLENGE IN FINANCING INCLUSIVE AND SUSTAINABLE GROWTH

SUPPORTED BY:



## ACKNOWLEDGEMENTS

This report is authored by **Gianluca Riccio**, CFA, who assumed the Chair of the *Business at OECD*-B20 event, held on 28 May 2018.<sup>1</sup> Gianluca is Vice-Chair of the *Business at OECD* Finance Task Force and a member of the B20 Argentina Financing Growth & Infrastructure Task Force.

The publication benefited from the contribution, guidance and support of (in alphabetical order):

**Mr Kent Andrews**, Senior Vice President, **TD Bank**, Canada; and Chair, *Business at OECD* Finance Task Force

**Mr Sergio Arzeni**, President, International Network for SMEs (**INSME**)

**Ms Antonella Baldino**, Chief Business Officer, **Cassa Depositi e Prestiti** (CDP), Italy

**Mr Mariano Bosch**, Chief Executive and Co-Founder, **Adecoagro**, Argentina

**Mr Vieri Ceriani**, Chief Executive, Soluzioni per il Sistema Economico Spa (**SOSE**), Italy

**Mr Fayezul Choudhury**, Chief Executive Officer, International Federation of Accountants (**IFAC**)

**Mr Matthew Gamser**, Chief Executive Officer, **SME Finance Forum**

**Mr José Manuel González-Páramo**, Executive Member of the Board, Head of Global Economics, Regulation and Public Affairs, **BBVA**, Spain

**Ms Flora Hamilton**, Head of Financial Services, Confederation of British Industry (**CBI**), United Kingdom

**Mr John Hannagan**, Chairman, **RUSAL**, Australia

**Ms Burcak Inel Martenczuk**, Head of Financing Growth, European Banking Federation, European Union

**Mr Charles R. Johnston**, Managing Director Global Government Affairs, Citigroup, United States; and Vice Chair, “Business at OECD” Executive Board

**Mr Erol Kiresepi**, President, International Organisation of Employers (**IOE**); and Chief Executive and Chairman of Santa Farma Pharmaceuticals, Turkey

**Ms Miriam Koreen**, Deputy Director, Centre for Entrepreneurship, SMEs, Local Development and Tourism, **OECD**

**Mr Korkmaz Ilkorur**, Independent Member of the Supervisory Board, **Kredyt Euro Bank NV**, Netherlands

**Mr Alexander R. Malaket**, President, **OPUS Advisory** Services International Inc. United States

**Dr Stormy-Annika Mildner**, Head of the Department External Economic Policy of the Federation of German Industries (**BDI**), Germany; and B20 Germany Sherpa

**Ms Laurence Morvan**, Managing Director, Office of the Chief Executive Officer, **Accenture**

**Mr Phil O’Reilly**, Managing Director, Iron Duke Partners, and Chairman, *Business at OECD* Executive Board

**Ms Veronique Ormezzano**, Head of Group Prudential Affairs, **BNP Paribas**, France

**Mr Jeffrey Owens**, Director of Global Tax Policy Centre, **Vienna University** of Economics & Business, Austria

**Ms Lida Preyma**, Director, Global AML Risk Management, **BMO Capital Markets**, Canada

**Mr Andrés Portilla**, Managing Director of Regulatory Affairs, **International Institute of Finance** (IIF)

**Mr Matthew Reed**, Chief Operating Officer, **Business Growth Fund** (BGF), United Kingdom

**Capt. Samuel Salloum**, Co-Chairman of **GCEL**, Switzerland

**Mr Stephen Shelley**, Group Chief Risk Officer, **Lloyds Banking Group**, United Kingdom

**Dr Alexander Shokhin**, President, **Russian Union of Industrialists and Entrepreneurs**, Russia

**Mr Che Sidanius**, Global Head of Regulation and Industry Affairs, **Thomson Reuters**, Canada

**Ms Ghada Teima**, Lead Financial Sector Specialist, **World Bank Group**

**Mr Tunç Uyanık**, Chief Executive, **World SME Forum**

**Prof Salvatore Zecchini**, **University of Rome** “Tor Vergata”, Italy; Former Chair of OECD Working Party on SMEs and Entrepreneurship

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## FOREWORD

Achieving sustainable growth is at the forefront of G20 efforts. *Businesses at OECD*, and the B20, are proud to support this important multilateral process as we seek to strengthen the resilience and competitiveness of our economies. The annual Roundtable on SMEs Access to Global Value Chains, now in its fourth edition, makes an important contribution here. In convening experts from the OECD, B20 and *Business at OECD* communities, the Roundtable fosters collaboration in the development of policies to support the financing of small and medium-sized enterprises (SMEs) in Global Value Chains.

This remains crucial today, as important parts of the global economy continue to perform below their potential. Poor policy coordination creates costly fragmentation and too many policy initiatives are run in silos. This generates unneeded dispersion of effort and frequently negative unintended consequences. Accordingly the crosscutting nature of the Roundtable, in enabling added value across all relevant B20 Task Forces is especially relevant these days.

This year, in cooperation with B20 Argentina, we focus on the productivity aspect of financing SMEs. As a crucial engine of growth in our economies, understanding the key drivers of productivity, and the role of SMEs in this, is critical. To support our effort, this publication leverages the insights of previous editions and covers topics including digitalization, cyber security, innovation, financial inclusion, green finance and financial regulation. Coordinated G20 action in these areas is essential to better support the financing of SMEs in global markets.



Russel Mills  
Secretary General, Business at OECD



Daniel Funes de Rioja  
B20 Chair

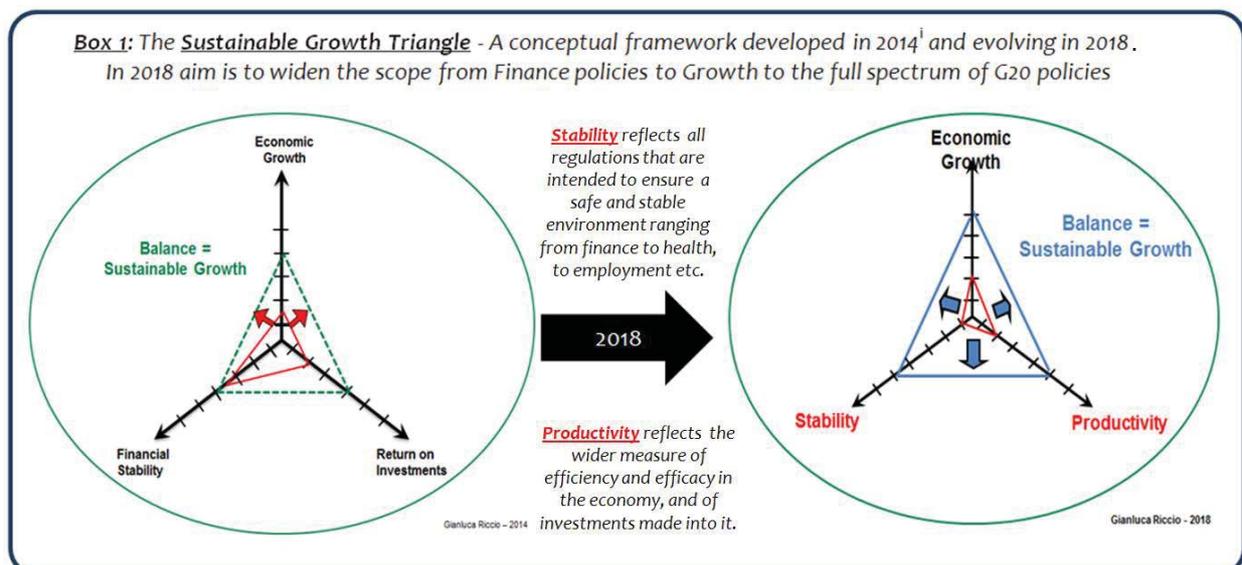
## TACKLING THE SUSTAINABLE GROWTH CHALLENGE: A LONG-TERM JOURNEY

Sustainable growth has several definitions. To the OECD it is growth that balances economic, social, and environmental considerations with a long-term, global perspective. Generally, it refers to development that meets the needs of the present without compromising the ability of future generations to meet their own needs. This in itself leads to various interpretations as to which approaches work. Policies can range from active government intervention, to minimizing the role of the state.

Growth is not only important in itself, the type and quality of growth matters. Good quality economic growth is achieved through longer-term investments (e.g. in digital, infrastructure, health, climate and energy) which can only be obtained by ensuring proportionate productivity and returns.

The OECD addresses a range of sustainable growth concerns across its work. By providing a unique forum to exchange experience and best practice the OECD supports governments in developing practical approaches to achieve sustainable development. As part of this effort, *Business at OECD* has worked to highlight the importance of addressing the unintended consequences of regulation (BIAC, March 2014; BIAC, July 2014). In 2015, *Business at OECD* together with B20 Turkey gathered representatives from SME associations, governments, financial institutions, large corporates, and international organizations for a BIAC-B20 Turkey special event at the OECD Headquarters in Paris (BIAC-B20, June 2015). The aim was to identify G20 priorities that would lead to viable solutions to foster sustainable growth. The key questions participants addressed included, are objectives for financial stability, economic growth, and productivity, sufficiently aligned in order to support our sustainability in our economies and societies? What are the recommendations needed to achieve a sustainable balance?

The work led to the creation of a stylized framework; see **Box 1** below, which is meant to offer a conceptual platform to evaluate a policy's support for sustainable growth.<sup>1</sup> Imagining that the global economy sits atop a three-legged stool, the legs represent three pillars of the economic system: [1] Stability; [2] Economic Growth; and [3] Productivity. The global economy can only sit sustainably atop the stool if the three legs are balanced in relation to the ground they stand on. To address any one aspect in this 'sustainable growth triangle', a coordinated and comprehensive approach involving all actors is needed. It doesn't matter what the policy is (it can range from financial, to economic but also be environmentally and socially sustainable), the question is always whether it is offering a balance with other policies or generating unintended consequences, like off-setting other policies. Only a balanced approach can offer sustainability.



From Turkey in 2015, the work progressed in 2016 and 2017 under the Chinese and German G20 Presidencies with annual iterations of the *Business at OECD-B20* roundtable.

In each, the purpose was to “join the dots” across all recommendations and transverse all B20 taskforces. This is because the issues highlighted above are not caused by a lack of policies, or a scarcity of effort, but because often policies are run in silos. In a globalised world, this generates at best the dispersion of effort and at worst, unintended consequences.

Each year since 2015, the conclusions of the roundtable helped to pave the way for action by G20 leaders. In 2017, the three overarching recommendations to G20 Leaders were:

- 1. Focus on coordination and consultation in implementation, supported by independent impact assessments, in order to minimize cross-border and cross-policy inconsistencies (also ensuring alignment between regulation 1.0 and 2.0) and thereby minimize direct and indirect compliance costs for SMEs.*
- 2. Raise SME access to finance and skills through an integrated financing approach, fostering timely payments, better leveraging on opportunities offered by digital, trade finance and green finance.*
- 3. Maximize access to data and sharing of information through digital platforms for a coordinated response to global challenges, including cyber security.*

Common to each of these is the need, in the current economic climate, for governments to balance their actions. They **must not only be guardians of stability, but also enablers of growth and investment**. In turn, the private sector should take more ownership of actions.

## THE NEED TO FOCUS ON PRODUCTIVITY

Our 2017 recommendations remain highly valid today. Political shocks or protectionist pressures in some G20 countries, and backlashes against globalisation, technological change and migration in others, increase uncertainty and contribute to downside risks.

Ten years ago, OECD economies faced a moment of maximum peril – and the Eurozone economies went through an acute round of crises in the years that followed. Output plummeted and unemployment soared. Since the 2008-09 global economic and financial crisis, governments and regulators have taken decisive actions to prevent a similar crisis from occurring in the future.

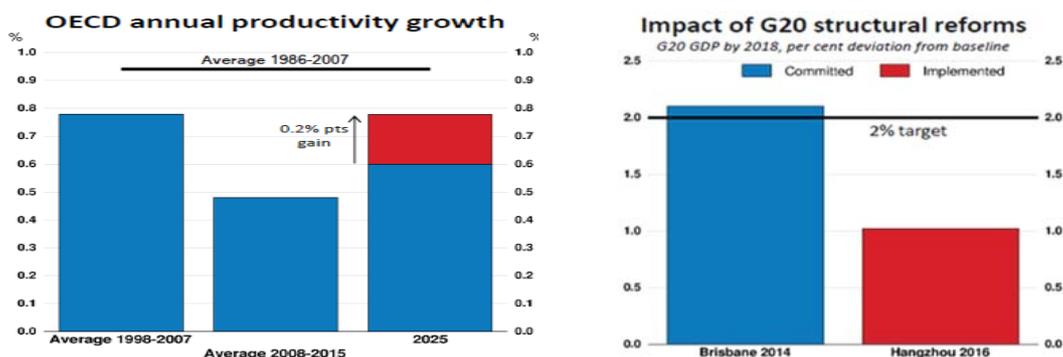
Positively, the March 2018 OECD Interim Economic Outlook revealed a brighter mood. Industrial production confidence indicators, headline measures of employment, and cross-border trade flows were all improving in most economies. This return to growth, and the avoidance of deflation, has benefited from the decisive and unprecedented monetary policy stimulus implemented by central banks in major OECD countries.

However, growth remains at, or below, pre-crisis norms in many advanced economies. Slow productivity growth and demographics are having a significant impact. They have also been supported by a monetary stance that cannot be maintained indefinitely: provision of cheap liquidity is frozen in bank balance-sheets given the need to accumulate high-quality liquidity buffers to comply with the Leverage Coverage Ratio (Euro 2.7 trillion in the EU), or asset purchase programs that appear to have created an increase in financial assets' values not reflected by a commensurate increase in value in the real economy (i.e. productivity).

In many emerging economies, growth has slowed, especially for commodity exporters, where permanently lower export prices call for new growth models. Essentially, growth, productivity and investments, still show modest cyclical expansion, but not yet robust enough to yield a durable improvement in potential output or to reduce persistent inequalities.

Importantly, appreciation has started to grow in the G20 that reforms must “ensure their consistency with overall objectives including by addressing any material unintended consequences” (G20-China Leaders' Summit Communique). However, the attention to unintended consequences has focused mostly on the balance between Stability and Economic Growth, only two of the three axes of the “**Sustainable Growth triangle**” in Box 1. The third axis is equally important: productivity. Only when productivity, described by the OECD as the “ultimate engine of growth in the global economy” [OECD, 2015], is part of the equation can a policy be evaluated in 360 degrees.

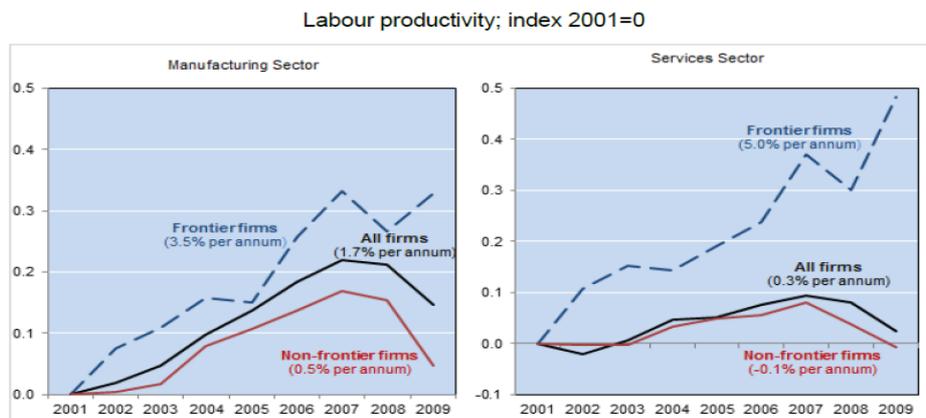
Productivity reflects the ability to produce more output by better combining inputs, through fostering new ideas, technological innovations and enhanced business models. It is about “working smarter”, rather than “working harder”. All OECD economic analyses show the lag in productivity, in an increasingly interconnected world, requires stability (not just financial) of the affected markets, as impacts go beyond the investments' immediate boundaries.<sup>ii</sup>



OECD economies face the twin structural challenges of low productivity growth and rising inequality.

- **Productivity growth** slowed in many countries even before the crisis, which amplified the downturn, and it is projected to remain lower than it was prior to the financial crisis. This productivity shortfall has resulted in output growth rates being consistently below OECD (and others) projections. Even in the relatively strong performer United States, it remains slow, continuing a long-term trend that pre-dates the crisis.<sup>iii</sup>
- **Inequality**, evident from both a productivity growth and from a social perspective (the two are inextricably linked, but frequently addressed separately), is best represented by looking at the growth and efficiency differentiation between (i) the globally most productive (i.e. global frontier firms), (ii) the most advanced firms nationally and (iii) laggard firms. Firms at the global productivity frontier are on average 4-5 times more productive than non-frontier firms in terms of efficiency with which inputs are used, multi-factor productivity (MFP)<sup>iv</sup>. The difference is even more acute with respect to labour productivity.

Against this backdrop, there has been unbalanced wealth distribution, which may contribute to keeping productivity low, fuelling a backlash against globalisation, or “**low productivity trap.**”



Notes: “Frontier firms” corresponds to the average labour productivity of the 100 globally most productive firms in each 2-digit sector in ORBIS. “Non-frontier firms” is the average of all other firms. “All firms” is the sector total from the OECD STAN database. The average annual growth rate in labour productivity over the period 2001-2009 for each grouping of firms is shown in parentheses. The broad patterns depicted in this figure are robust to: i) using different measures of productivity (e.g. MFP); ii) following a fixed group of frontier firms over time; and iii) excluding firms that are part of a multi-national group (i.e. headquarters or subsidiaries) where profit-shifting activity may be relevant.

Source: Andrews, Criscuolo and Gal (2015).

Further evidence of a low productivity trap can be seen in a by recent OECD analysis<sup>v</sup> that indicate the support of Global Value Chains (GVCs) to world trade has stalled. Likewise, such diverging trends have emerged also between large enterprises and SMEs. In most countries, before 2007 labour productivity grew at a comparable rate in both SMEs and large firms but in the post-crisis period, growth in SMEs has been weaker.<sup>vi</sup> While for small and medium-sized enterprises there has been a reversal in this trend during the recovery, the larger gap has become more persistent for micro-firms, especially in manufacturing<sup>vii</sup>. At the third OECD Ministerial Conference on “Strengthening SMEs and Entrepreneurship for Productivity and Inclusive Growth”, held on 22-23 February 2018 in Mexico, Ministers highlighted the necessity to enable SMEs to contribute more fully to productivity and inclusive growth, by supporting innovation and scaling up, fostering access to diversified financing instruments and participation in a globally integrated and digital economy<sup>viii</sup>. The rising gap in productivity growth between firms at the global frontier and other firms suggests that the capacity of the latter to learn from the frontier may have diminished. Only deeper trade integration through GVCs creates new markets and raises productivity, with a strongly needed revival of investment-intensive GVCs, and knock-on benefits to domestic demand.

The OECD conducted a thorough review of the current gap in productivity in their 2015, *The Future of Productivity*.<sup>ix</sup>

The report demonstrates much scope to boost productivity and reduce inequality by:

- More effectively allocating human talent to jobs. Yet, the research suggests that approximately 25% of workers report a mismatch between their skills and those required to do their job. A better use of talent could translate into significant labour productivity gains in many OECD economies.
- Aggregating benefits of diffusion by a market environment that fosters growth of most productive firms.
- A more robust approach to competition policy.

This suggests that there is much to be gained by reforms that make it easier for productive firms to attract the resources required to underpin their growth. More specifically, *The Future of Productivity* highlights three policy areas to be of key importance to sustain productivity growth:

- i) **foster innovation** at the global frontier and facilitate the diffusion of new technologies to firms at the national frontier;
- ii) **create a market environment** where the most productive firms are allowed to thrive, thereby facilitating the more widespread penetration of available technologies; and
- iii) **reduce resource misallocation**, particularly skill mismatches.

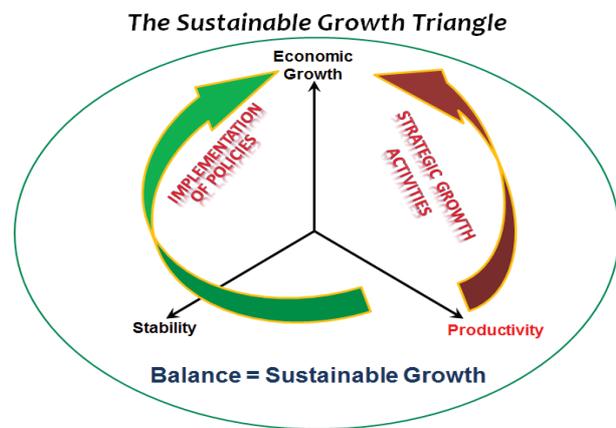
Reviving diffusion and improving resource allocation has the potential to not only accelerate productivity growth, and therefore break out of the “low productivity trap,” but also to make growth more inclusive, by allowing more firms and workers to seize the benefits of the knowledge economy. Diffusion of innovation at the global frontier to national frontier firms is facilitated by trade openness, participation in GVCs and the international mobility of skilled workers. Rising GVC participation magnifies the benefits from lifting barriers to international trade and from easing services regulation.

## THE CRITICAL IMPORTANCE IN JOINING THE DOTS

*Business at OECD-B20* work has focused on examining the links and common denominators across the B20 recommendations. This spans trade, investment, employment, entrepreneurship, financing, among others, to develop a truly holistic understanding of the financing of SMEs and the markets in which they compete. Put simply, participants took a step to “join the dots”, as it is our belief that the issues highlighted above are not caused by a lack of policies or scarcity of ideas or efforts, but to the fact that they are far too frequently run in silos. In today’s world, this leads to dispersion of efforts and unintended consequences, overshadowing the benefits of individual policy reform and contributing to the “low growth trap”.

At the macroeconomic level this can be tackled by policies that fall within the areas highlighted above by the OECD’s *The Future of Productivity*. It is critical however, that they be harmonised with policies aimed at Economic Growth and regulations aimed at Stability. Such harmonisation occurs through an integrated approach in two directions:

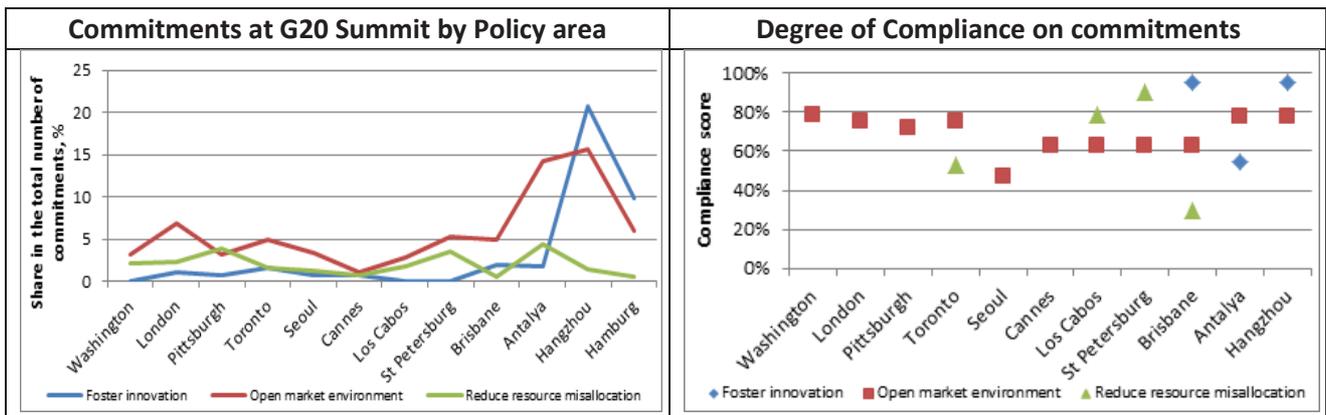
- a) **Strategic growth activities** – owned not only by the Governments, but also by the business community, who should own and aim towards a longer-term strategic vision.
- b) **Implementation of such policies** – the typical example of failing implementation is given by the cumulative burden caused to the ultimate receiver. Only through a proper implementation review, can unintended consequences be minimised.



Policies areas for productivity	Strategic growth activities	Implementation of regulations
<b>Foster innovation</b>	<ul style="list-style-type: none"> <li>Facilitate the access and diffusion of new technologies to firms and digital skills.</li> <li>Reinforce and Leverage GVCs.</li> <li>Helping SMEs (or firms in general) to develop and use their internal strategic resources effectively</li> </ul>	<ul style="list-style-type: none"> <li>Adapt the regulatory environment to facilitate the more widespread penetration of available and future technologies.</li> <li>Tackle cyber risk.</li> </ul>
<b>Open market environment</b>	<ul style="list-style-type: none"> <li>Sustain more inclusive productivity growth including sustainability and Environmental, Social and Governance concerns throughout the GVC.</li> <li>Diffuse innovation from leading firms to up-and-comers.</li> </ul>	<ul style="list-style-type: none"> <li>Support Trade by improving cross-border consistency in regulation.</li> <li>Foster a Legal system that allows easy entry for new firms and quick exits for inefficient and ensure the level-playing field with players</li> </ul>
<b>Reduce resource misallocation</b>	<ul style="list-style-type: none"> <li>Tackle skill mismatches, building a skills base for the next generation, including financial literacy as a key focus</li> <li>Investment in Research and Development (R&amp;D) that can be leveraged by all firms</li> <li>Removing tax distortions</li> </ul>	<ul style="list-style-type: none"> <li>Identify and tackle Regulation’s unintended consequences and inefficiencies</li> <li>Ensure no regulatory barriers exist for the free flow of resources, incl. worker mobility</li> <li>Growth enhancing tax reforms</li> </ul>
<b>Infrastructure Finance</b>	<ul style="list-style-type: none"> <li>Investing in infrastructure to support business and communities</li> <li>Appropriate design of Public-Private Partnerships (PPP).</li> </ul>	<ul style="list-style-type: none"> <li>Better understanding of rules settings’ consequences on long-term investments</li> <li>Financial instruments permitted to Banks and MDBs to transfer risks</li> </ul>

The G20 has made commitments in policy areas related to sustained productivity since the first Leaders' Summit in 2008 in Washington. The share of commitments fostering innovation has been low, only rising in the last two summits. The share of commitments on open markets has been relatively stable. However, resource misallocation has not been adequately addressed, with a share of commitments ranging from 0.5% in Brisbane (2014) to 4.4% in Antalya (2015). In 2018, the G20 should consolidate their resolve to reduce resource misallocation. As an example, one of the ways that this can be achieved is by building legal systems (bankruptcy policies) that allow quick exits for inefficient firms.

At the same time compliance has been a challenge. Though G20 members have delivered well on facilitating the diffusion of new technologies, more efforts are needed to strengthen implementation of measures addressing the digital divide and supporting free trade.



Source: OECD

The 2018 G20 Leaders' Summit Communiqué should recognize that only an integrated approach, coordinating efforts of businesses and governments, can offer an adequate response to global challenges. Isolated national initiatives and layers of uncoordinated rules are likely to fail, intensifying risks and regulatory arbitrage.

## A COMPREHENSIVE VISION

Sustainable growth can only be achieved by first developing a strategic vision. This must set the ambition to build a competitive economy that underpins an open, innovative and inclusive society. The vision affects the structure of the economy as the whole, and is based on advanced skills, innovation, supporting institutions, ecological ambition and an activating social policy. Therefore it could not, and should not, be created solely by government. It must be created and owned by business, government and society together. It must be:

- **Systemic** – working in alignment with other policy strands and supporting social and environmental goals
- **Practical** – delivery focused and with clear actions assigned to both business and government.

The strategy should have a realistic timeframe against which to measure its objectives, and should be backed by key performance indicators (KPIs) that underpin them. Short-term actions, such as protectionist measures, and protecting employment in unviable companies, are counterproductive.

Looking at global growth, it appears [Aiginger, 2014] that in the U.S. spending on innovation – and resulting productivity – is high, although this has not led to balanced trade. In contrast, Europe has a balanced trade position, with low dynamics and a persistent productivity deficit compared to the frontier economy. At the same time, emerging countries are gaining market share in both regions.

National, regional and global strategies need to incorporate the aforementioned policy objectives of fostering innovation, creating an open market environment and reducing resource misallocation, while at the same time linking to other social strategies in areas such as climate, infrastructure, education and skills development, diversity, etc.

### Foster Innovation

Innovation must be at the heart of any new strategy. Innovation drives improvements in productivity and sustainable economic growth; it raises living standards. Digital technologies (cloud, blockchain and crypto-assets, big data analytics and artificial intelligence, internet of things, etc.) and their impact on how data as a new strategic asset is managed represents a huge opportunity for productivity and growth but also a challenge to the modern workplace and the relationship between government, society and business.

### Data:

Data is diverse and the amount produced is growing exponentially, 90% of the world's data has been created in the last 24 months<sup>x</sup>, with no borders by definition<sup>xi</sup>. The ever-increasing possibilities on data storage and usage (e.g. profiling, identifying patterns of consumption and making targeted offers) are revolutionizing the way customers are served and businesses operate [EBF, 2016]. The use of data analytics is no longer just an opportunity, but a “requirement” in today's world and we must turn the digital divide into a digital dividend. The results can be a massive expansion of the electronic footprint of individuals and SMEs. In particular, data analytics may give SMEs a competitive edge and increase their productivity, including reducing costs, enhancing marketing, and strengthening ability to identify or foresee trends<sup>xii</sup>.

Customers expect data to be protected, but at the same time would be willing to accept the sharing of data in order to have access to tailor-made products and services, providing benefits such as faster access, lower insurance premiums and purchase discounts. The latest events in March 2018 relating to the improper use of Facebook customers' data have brought the issue at the centre of the agenda.

Box 2 below show how the use of data combined with a cooperative process between authorities and Business representatives can turn repressing policies into incentives. These are the kind of initiatives that G20 Leaders should encourage and strongly support.

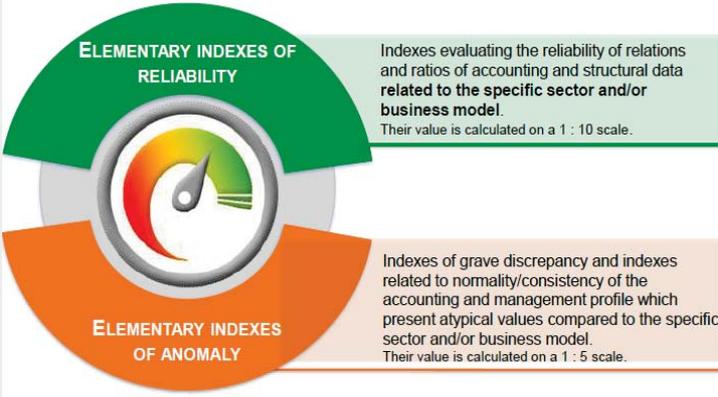
Digital data management involves a number of technologies related to how data is captured, stored and mined; these technologies act in two main different layers, one of them being pure infrastructure (cloud, blockchain, sensors in the internet of things, simple robotics) and the other being applications (big data analytics, artificial intelligence, advanced robotics, applications of the internet of things).

**Box 2: Italy's *Synthetic Reliability Index* -- from repressing to incentive policies, leveraging on digital**

**The Italian Tax Challenge with Micro Enterprises** – In Italy there are over 3.7 million enterprises, 95% of which employ between 1 and 9 workers. In terms of controls to reduce tax evasion, this represents an important issue, since it is nearly impossible to investigate adequately such a high number of small companies. The Italian Tax Administration (ITA) has continuously developed tools to facilitate the detection of possible areas of tax evasion with the goal of promoting compliance by the taxpayers.

**The old method** – Methods to date have been based on audit tools built on “Parameters” and complex elaborations in order to define specific “presumptive” revenues for each taxpayer. If the firm’s declared revenues are lower than the estimates, the firm can decide to comply to the estimates, i.e. raising its declared revenues or undergo Fiscal review. The challenge was to weight even more on firms in financial difficulties, whose revenues were genuinely below estimates, a “double-whip” effect.

**A new approach** has been created through a cooperative process with the representatives of the entrepreneurial and professional organizations, based on the utilization of data gathering from firms and Digital tools to cross-check data across a large variety of databases, which enable the taxpayers to do a real time evaluation of the economic and financial results of their activity in order to identify possible deviations and make the necessary adjustments before the due dates for tax declarations. The new system allows the most reliable taxpayers to **access a reward system**, which implies several advantages such as shorter deadlines for controls, exclusion from some tax controls and faster procedures for VAT reimbursements.



The diagram illustrates the Synthetic Reliability Index as a circular gauge with two main segments. The top segment is green and labeled 'ELEMENTARY INDEXES OF RELIABILITY'. It is described as 'Indexes evaluating the reliability of relations and ratios of accounting and structural data related to the specific sector and/or business model. Their value is calculated on a 1 : 10 scale.' The bottom segment is orange and labeled 'ELEMENTARY INDEXES OF ANOMALY'. It is described as 'Indexes of grave discrepancy and indexes related to normality/consistency of the accounting and management profile which present atypical values compared to the specific sector and/or business model. Their value is calculated on a 1 : 5 scale.' In the center of the gauge is a needle pointing towards the right, indicating a score.

*Data needed to elaborate and apply the different indexes will be acquired from the databases of the ITA and of other institutions and will be communicated to taxpayers. The synthetic indexes of reliability promotes compliance of the most virtuous taxpayers and will enable a better fight against those non-virtuous behaviours that distort the rules of competition and markets, while improving economic efficiency and tax system’s neutrality in accordance with the recommendations of the main international Institutions (OECD, IMF).*

**Cloud:**

The current use of private cloud is giving way to an increased use of public cloud supported by a short but reliable group of big cloud services providers. Although critical processes are not being migrated to the public cloud yet, the flexibility that these schemes provide in terms of adjustment of needed IT capabilities for companies has a direct consequence on productivity of businesses. There is a need to bring agility to the cloud adoption process, reducing time to market to increase competitiveness.

**Distributed Ledger Technologies (DLTs) and Blockchain:**

DLTs, including blockchain, are increasingly getting significant interest from established industries. The interest is especially strong among financial services firms, which are starting to see DLTs as a potential driver of huge savings in infrastructure and back-office processes. Blockchains are built on a series of

innovations in organising and sharing data. The objective is to create a single trusted source of information (a single version of the truth), used by all participants, containing a much richer dataset than exists in any one system today. Distributed ledger technology may have the potential to introduce a range of benefits for participants. Primarily, distributed ledgers may provide efficiencies in reconciling records both within organizations and across firms. However, wider benefits of distributed ledgers may also be leveraged through the integrity of the data that is stored on the distributed ledger and how it is shared and accessed by participants and regulators, as well as through the development of applications that interface with distributed ledgers such as digital currency or smart contracts. Crucially, verification of a transaction is achieved by relevant users in the Blockchain agreeing to the transaction.

### **Crypto-assets:**

Associated to certain types of blockchain, and specifically the public ones, are crypto-assets, which are issued either as tokens that gives the capability of using the blockchain as infrastructure or accessing applications built on the blockchain. In March 2018, the G20 Finance Ministers & Central Bank Governors (FM&CBG) have addressed the advantages and challenges of crypto-assets. Such assets can indeed improve the efficiency and inclusiveness of the financial system and the economy more broadly. However, we concur with the FM&CBG conclusion that currently crypto-assets lack of key attributes of sovereign currencies, and therefore issues have arisen with respect to consumer and investor protection, market integrity, tax evasion, money laundering and terrorist financing. At some point they could have financial stability implications.

### **Artificial Intelligence (AI) and robotics:**

The evolution of big data analytical capabilities and machine learning is boosting artificial intelligence towards real world applications in the financial services industry. As a means of leveraging the intrinsic power of data to provide more personalized services to consumers and to improve their experience when relating to financial institutions, AI could result in significant benefits for both industry and consumers such as enabling greater financial inclusion, improving customer's protection and privacy, enhancing customer experience, cybersecurity, ensuring sound risk management, and reducing the cost of regulatory compliance (e.g. fraud and anti-money laundering prevention). Robotics can be more or less AI-powered, but anyway have already changed the way many industries work and therefore have had an impact on financial services yet.

### **Internet of Things:**

The trend towards ubiquitous connectivity is now supported by technologies (5G, optic fibre, connected sensors) that facilitate the configuration of a real "Internet of Things". A "sensorised" world is an inexhaustible source of information about consumers' behaviours, and is going to multiply the volume of captured data by several magnitudes. Exploitation of this data through big data analytics and the use of AI will drive to extreme personalization, perfectly matching the effort required to provide accurate solutions to target consumers.

### **Cybersecurity:**

The spread of digital technologies means cyber security related risks are a top priority [Chapter 19 - BIAC-B20 (2016)]. There are challenges touching upon the borderless interconnectedness of financial systems and arising from the misuse of data, information asymmetries and data security. The malicious use of information and communication technologies have the power to disrupt financial services crucial to both national and international financial systems, undermine security and confidence and endanger financial stability. Such concerns are a top priority in the banking industry, as trust and integrity are core assets, and are intrinsically linked to bank's reputation.

"Cyber Essentials" is a good example: a scheme launched by the UK Government in 2014 for all UK firms of all sizes, and in all sectors with the aim of reducing cyber risk across organizations by following basic

cyber hygiene. From October 2014, the UK Government requires suppliers bidding for certain sensitive and personal information handling contracts to certify against the scheme. Large businesses need to work with their suppliers sharing best practices and mandating the scheme for all SMEs in their supply chain.

In October 2017 the Financial Stability Board (FSB) presented its conclusions on cybersecurity regulations, guidance and supervisory practices [FSB 2017]<sup>xiii</sup>, showing that regulations and guidance addressing cybersecurity for the financial sector vary widely across jurisdictions. The importance of regulatory harmonization and a globally consistent approach is paramount, and better coordination between the relevant administrations is an absolute necessity. Multiple, potentially conflicting regulatory schemes impose costs and divert resources from operational cybersecurity in financial institutions, and more importantly create gaps and arbitrage opportunity that are at the very base of cyber-attack opportunities. We welcome the progress the FSB is making<sup>xiv</sup> in the creation of a common lexicon of terms that, as a first step, would enable a stock-take of existing relevant regulations and supervisory practices, as well as to identify existing effective practices in G20 jurisdictions. In particular it is important to focus on cross-sector common understanding of relevant cyber security and cyber resilience terminology and work to assess and monitor financial stability risks of cyber risk scenarios.

### **Open market environment**

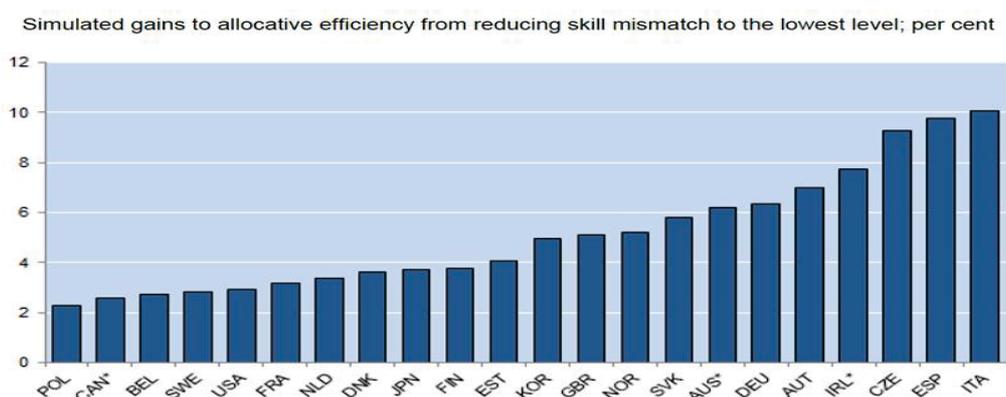
Over the next 5 years, artificial intelligence holds the top spot as the technology set to impact companies across all sectors. The key evolution from a productivity perspective is the shift of artificial intelligence from consumer to producer perspective: robotics as a technology is becoming engrained within business products and services.

However, country industrial strategies and policies remain most frequently at a national level. More than 315 million Europeans use the internet every day, yet less than 4% of online services are offered across national borders. The Confederation of British Industries' (CBI) research in 2017<sup>xv</sup> shows that there are clear barriers that can slow down uptake in businesses. Barriers are not uniform, rather that they can shift depending on a business' approach to innovation and their comfort in taking on new technology. Such barriers go in three directions: Shortage of specialist skills, security and privacy requirements, and raising investment capital.

### **Reduce resource and skill misallocation**

People are at the heart of any industrial strategy, without a long term skills strategy there is a risk of layering change on change. Changes driven by technological innovation, demographics, shifting business models and nature of work are significantly altering the skills demanded by the labour market. International mobility of skilled labour is a critical factor for fostering the participation in GVCs. Nonetheless, sustainability and ESG concerns should be taken into account throughout the whole economic and financial landscape, to ensure that the changes are framed in an environmentally-friendly ecosystem.

In order to mitigate this unfavourable combination of slowing growth and rising inequality, it has become increasingly important to allocate skills efficiently. The increasing economic importance of knowledge is projected to raise the returns to skills, thus underpinning further increases in wage inequality within countries (Braconier et al., 2014). The OECD shows potential gains to labour productivity from reducing skill mismatch in each country to the lowest cross-country level in each industry. Reducing skill mismatch in countries such as Italy and Spain to the lowest level would be associated with an increase in allocative efficiency of around 10%. Skill mismatch can potentially account for a non-trivial share of cross-country labour productivity gaps, thus motivating an analysis of the link between policies and mismatch.



Note: The chart shows the difference between the actual allocative efficiency and a counterfactual allocative efficiency based on lowering the skill mismatch in each country to the best practice level of mismatch, which implies a productivity gain of around 10% in Italy and 3% in the United States. 1-digit industry level mismatch indicators are aggregated using a common set of weights based on the industry employment shares for the United States. The estimated coefficient of impact of mismatch on productivity is based on a sample of 19 countries for which both firm level productivity and mismatch data are available. While mismatch indicators are available for AUS, CAN and IRL, the estimates for these three countries should be interpreted with caution to the extent that they are not included in the econometric analysis due to insufficient productivity data.

Source: Adalet McGowan and Andrews (2015a)

The persistence of skills gaps around the world are marks our inability to efficiently allocate investments in learning systems. Moreover, skill demand is evolving at ever-faster rates. The World Economic Forum finds that 35% of skills demanded today will change by 2020<sup>xvi</sup>. In order to make informed investment decisions, there is a need for far greater understanding of the dynamics behind this evolution. **Box 3** provides an analysis showing how critical is to measure the evolving skills gap in order to tackle it with strategic policies.

### Box 3: Interpreting and investing in tomorrow's skills – the skills' gap and the importance of good data

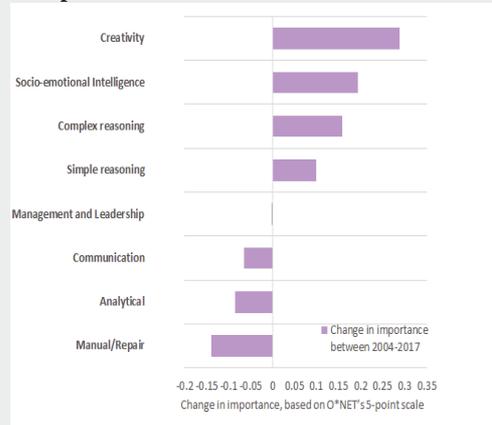
**The data challenge** – It is rare to find comprehensive and consistent data sources on skills around the world. Where data are available and reliable. It can offer a powerful source of insights to underpin investment decisions.

**The skills' gap challenge** – Accenture has performed a thorough analysis of data on US workers between 2004 and 2017 finding that the **skills composition demanded by different roles has changed substantially** over this period. Critically, it found that workers are required to utilise a broader range of skills in their work today, compared to 2004. For example, workers in analytical roles (chart below) are now expected to possess more social and creative skills. Rather than crunching numbers alone, these workers are now also typically expected to present and explain their analysis to different audiences. Similarly, creative roles now require a degree of analytical aptitude, such as interpreting data, which was not expected before. The implication is that our future workers need to be trained to possess more diverse groups of skills.

**Adapting education to meet skill demand** – Current skilling targets usually relate to the output of teaching institutions, in terms of people certified with specific skills or knowledge, (e.g. we need X million Engineers, or a Y% increase in Arts graduates). Instead, strategic planning can centre on the desired skills compositions of the learner, targeting the skills clusters that are most relevant and valuable to different roles or jobs. This research opens the door to data analysis that can help policymakers, businesses and educators understand the groupings of skills that will be most relevant to different types of jobs, allowing us to gear training investments accordingly across relevant sectors and regions.

There is an urgency here: education and training systems are slow to change with many of today's skills gaps still relating to the "knowledge economy" that came with the Internet, (e.g. technical skills and STEM skills). With the advent of intelligent systems, a further transformation in mass skill-demand dynamics is already in train, as workers will be interacting more frequently and intimately with smart machines. Now is the time to invest in strategic and targeted plans that can effectively support such transformation.

#### Workers in analytical roles have seen increasing importance of their creative and social skills



Source: Accenture analysis of data from The Occupational Information Network (O\*NET) of the US Department of Labour

Europe is unable to eliminate the gap in per-capita income and labour productivity compared to the U.S. (which is larger in per-capita terms and smaller per hour [Aiginger, Bärentaler-Sieber, Vogel, 2013]). The reason for this is that Research & Development are essential, but their expenditure by companies is lower in Europe, and Europe lags behind in top rated universities.

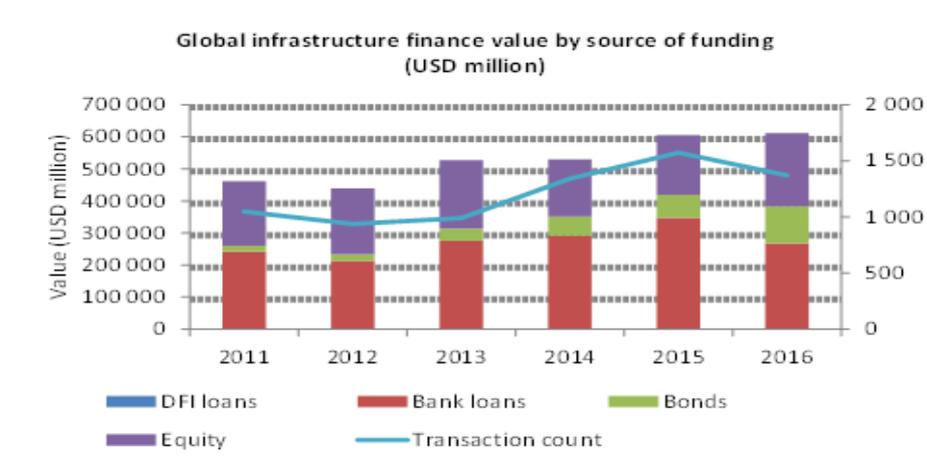
### Infrastructure Finance

As financial market can support infrastructures in various ways, the challenge of mobilizing greater private sector financing for infrastructure implies a better understanding of the relationship between the participants in infrastructure financing. The G20 should ensure that both Multilateral Development Banks and banks have a broader range of financial instruments available to **transfer some of those risks**, after completion, to investors, and make room in their balance sheets for new projects. These instruments should in particular include risk sharing through funds, as well as securitization, in order to provide institutional investors with desired geographic and sectorial diversification, as well as an appropriate alignment of interest. In this sense, an appropriate design of Public-Private Partnerships (PPP) is a key element for success.

Infrastructure projects are normally financed mostly by debt, which in the past has been provided mainly by banks. However, there is a growing opportunity for institutional investors (e.g. Insurance Companies and Pension Funds) to access this market due to the reduced lending capacity of the banking sector. In the first half of 2017, the worldwide Project Finance market was valued at USD 135bn, of which USD 112bn were loans and only USD 22bn were bonds, which was stable from 2016. 75% of bonds were issued in Developed markets, leaving Developing countries utilizing mainly only the banking channel.

The increasing demand for project bonds (5 years) has been supported by low interest rates, encouraging investors to search for yield. In a rising interest rates scenario demand would likely be lower.

Strategic initiatives like the Juncker Plan (in Europe) have advanced transparency of pipelines, but on the other hand regulations like IFRS9 hamper Infrastructure finance significantly. This is yet another example of policies that risk nulling each other. Any additional regulatory constraint that would trigger a new wave of bank deleveraging would therefore materially hinder the market, with Emerging and Developing countries the first to be impacted by bank risk aversion.



## IMPLEMENTING POLICIES – THE CUMULATIVE REGULATORY BURDEN

The financial crisis, and recent environmental disasters, severely tested the effectiveness of regulatory policy. Regulations have increased significantly as a result, delivering higher stability, but also generating material unintended consequences. These in turn have either required off-setting economic and monetary policies, or have hampered economic growth damaging the level playing field in the financial sector.

Productivity cannot be improved, or at least cannot deliver, on its full potential, if unintended regulatory obstacles are not overcome. Ultimately, a stable, consistent, and competitive Regulatory environment is needed. Businesses and citizens continue to suffer from unnecessary regulation, which holds back competitiveness and consumes the time of ordinary people. Public services are also affected, when there is unnecessary regulation inside government. In many countries, regulatory inflation continues to undermine the clarity of the law. Challenges with unintended consequences of regulation have been highlighted by Business at OECD and the B20 for several years. The OECD Declaration on Strengthening SMEs and Entrepreneurship for Productivity and Inclusive Growth recognises that an effective regulatory environment, effective contract enforcement and civil justice systems, and transparency and integrity in the public sector are critical to enable SMEs and entrepreneurs to thrive, scale up, and contribute to an open, digitalised and inclusive economy.<sup>xvii</sup>

OECD member countries collectively adopted a set of principles for effective regulatory management in 2005<sup>xviii</sup>. However, adoption is different from full implementation. Reflecting the core principle of continuity, the G20 Leaders' Summit Communiqué should recognize the need for **broader and independent economic impact assessments on the cumulative effects** of policies and regulatory initiatives. This must be done both domestically and across borders, and both ex-ante and ex-post within the nexus of further reinforcing financial stability, economic growth, and productivity. This is essential for building a competitive environment where companies of all sizes can conduct business across a global level playing field.

### Cross-policy and cross-border consistency supported by comprehensive pre- and post-implementation impact analysis

It is critical to ensure that implementation of the regulatory framework<sup>xix</sup> allows banks to continue to support the economic growth. The G20 Hamburg Communiqué restated the objective "to finalize the Basel III framework without further significantly increasing overall capital requirements across the banking sector, while promoting a level playing field". However, the recently published Basel reform package, while providing additional regulatory certainty for the global industry, fails the G20 mandate, as:

- It creates further unintended consequences, as highlighted by the section above on infrastructure finance and by the example in Box 4.
- The capital and liquidity frameworks are applied differently across jurisdictions.<sup>xx</sup>

The IFC in October 2017 expressed concerns that the impact may differ across countries, particularly "that some aspects of the Committee's recent proposals put both maintenance and progress with emerging market development at great risk. This can harm economic and financial sector stability." Spill-over impacts demand stronger home-host coordination, and require a stronger role for the international community to monitor and evaluate the impacts.

- The need for regulatory consistency within and between jurisdictions to ensure a level playing field.
- Pillar 2 approach and calibration need to be harmonized, while taking into account national specificities. Notably stress tests which are increasingly used to set banks capital requirements

- Given that much has changed since the initial Basel quantitative impact study regarding the design and calibration of the new standards, there is still need for additional comprehensive and rigorous impact assessment of the finalized package.

The World Trade Organization (WTO) research shows that, because of the fixed costs involved (inclusive of dealing with standards, costly border procedures or other non-tariff barriers), SMEs struggle to access trade finance. In fact, globally, 58% of trade finance requests by SMEs are rejected, versus just 10% for multinational companies.

Additionally, the US has announced its intention to recalibrate post-crisis regulation in banking, capital markets and asset management, while part of Europe and the rest of the world continue to be under pressure to further de-risk. This creates a major un-level playing field for the financial sector and for the financing of the economy; one of the factors that leads to regulatory fragmentation. Therefore there is an urgent need to address the risk of divergence in regulatory agenda.

#### **Box 4: The UK Business Growth Fund – unintended consequences of Financial Regulation in action**

**The Business Growth Fund (BGF)** – BGF was founded in 2011 by Barclays, HSBC, Lloyds Bank, Royal Bank of Scotland and Standard Chartered, to provide long-term growth capital for ambitious SMEs which were otherwise under-served by the traditional set of finance and private equity firms. The GBP 2.5bn fund targets companies across every region and sector of the UK economy, barring financial services. Last year, Canada announced plans for its own Business Growth Fund, and Australia and Mexico, also have proposals under consideration.

BGF takes a minority, non-controlling stake in the companies it supports, making venture capital and growth capital investments in tranches of up to £10m in companies across the UK and Ireland. Today, BGF has a portfolio over 225 companies in which it has invested in the region of £1.5bn. It is the leading provider of growth capital in the UK and the second most active investor in Europe. Companies in which BGF is an investor now employ almost 50,000 people.

**Current Regulation** – banks investing in equities through a collective investment undertaking (such as BGF), if the portfolio is sufficiently diversified, the shareholding is risk-weighted at 150% - 190% under the EU Capital Requirement Regulation (CRR). This has enabled banks investing in BGF to take a long-term view on returns and build a broad-based, patient capital business.

**Unintended Consequences of new Regulation** – under the Basel 3 reforms, the risk-weight for most equity investments is set at 250% - already a material increase on the current CRR - but this is increased further to 400% for venture capital investments. The **definition** of venture capital is unclear, and the Basel guidelines do not follow the European model in providing lower risk-weightings for diversified portfolios, despite strong academic research and practical experience confirming that this is the case.

No research or evidence has yet suggested that these changes are necessary, and yet their impact is already being felt, with plans for at least one new Pan-European fund having been abandoned since the new guidelines were published.

To be able to fund modern businesses which often have few assets to underpin lending, banks need to broaden their tools into non-lending instruments (such as equities) which offer a return commensurate with the additional risks which they are taking. Unlike the current EU rules, the Basel 3 guidelines discourage banks from making such investments as part of well-diversified portfolios and/or collective investment schemes. If the new Basel 3 guidelines are implemented without adjustment, it could well have a material impact on the financing of growth, at a time when access to equity investment for small companies has become more important to support innovation and growth.

Bank-led, large scale collective investment schemes are powerful alternative mechanism for attracting additional bank and non-bank capital into equity investment. The Basel III guidelines question the commercial rationale for banks providing SMEs with any form of equity, even if through a small stake in an independent investor with an extensive and broad range of investments, such as BGF. The adverse effect of the new regulation on the financing of the real economy has been also recently recognised by the UK Government in its response to the European Commission's consultation on Basel III implementation (point 1.22.2).<sup>xx</sup>

As emphasised in 2017 and previous years' recommendations, cross-policy, quantitative and qualitative, impact assessments (ex-ante and ex-post) are critical and need to be independent by those bodies setting the policies are. The G20 in Hamburg 2017 endorsed the FSB's work to analyse the effects of financial regulatory reforms and the structured framework for post-implementation evaluation, however it is key:

- The need to extend the framework to pre-implementation analysis of the future possible impacts, as post-implementation is too late to prevent unintended consequences;
- The importance of detailing general policy goals into clearly measurable Key Performance Indicators.

The B20 have suggested that an *international principles-based implementation process for financial regulation* should be introduced, possibly based on a Multi-Party Implementation Agreements (MPIA) model for regulatory cooperation. This also provides opportunities for cross-border consultation and mutual recognition. Consistent policy implementation plays an essential role in mitigating any unintended consequences of policies and regulations. A new dialogue system should formalize the current *ad hoc* approach to consultation and discussion and seek to address upfront any possible unintended consequences from conflicting regulatory objectives.

### **Regulation 2.0 and shadow banking – bringing regulation up to speed**

The post-crisis banking regulation action plan led to a new norm where less risk is carried by banks, but more by market participants; the Governor of Banque de France commented that the main issue now is no longer the solvency of banks, but the liquidity of non-banks.

The Group of Thirty notes In its "Shadow Banking and Capital Markets: Risks and opportunities" report (November 2016), that despite broadly favourable trends within the financial system itself, overall risks to stability are likely now to be as great as ever. Shadow banking has risen from \$73 trillion of assets in 2007 to \$92 trillion in 2015 – i.e. 150% of total GDP in the jurisdictions monitored by the FSB. This reflects the combination of rising leverage across the global economy together with some concerning developments in the specific ways in which credit is being extended in particular markets and countries. Likewise, new amplifying mechanisms particularly in illiquid markets, such as the rise in assets held in certain investment funds increases the risks from liquidity transformation. It is thus of key importance that authorities develop and use system-wide liquidity stress-testing tools, in order to address the risks of a "funds-run" in adverse market conditions, and to employ consistent and effective implementation of agreed policies, in particular those that address structural vulnerabilities in asset management activities.

As FinTech regulation evolves it is critical to ensure alignment between regulation 1.0 and 2.0. Inconsistency will fuel the potential for regulatory arbitrage and illicit financing. In the financial sector, the change in expectations and behaviour of customers and the uptake of online and mobile services represent a new challenge; measures set to tackle shadow banking must not affect genuine actives of the real economy, such as risk hedging via derivatives.

### **Regulatory Burden**

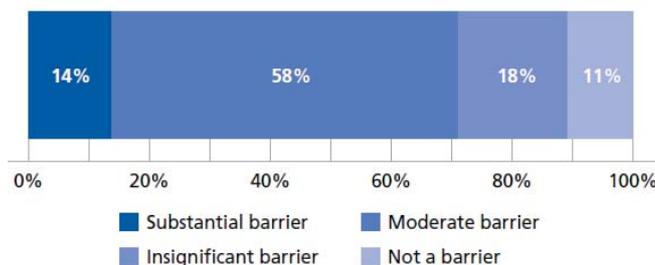
Nearly all OECD member countries (as well as several non-OECD countries) have established programmes to reduce administrative burdens on business. Governments can improve the regulatory environment by designing administrative rules that are fairer, predictable, enforceable and efficient. Such rules need to provide for more consistent responses to policy challenges, changing societies and the need to limit regulatory burdens. Innovation has to be at the heart of any new strategy, driving for improvements in productivity and sustainable economic growth. There are a number of options for strengthening co-

operation and exchanging best practices. These might include the establishment of regional to cross-border fora across GVCs.

BIAC together with the International Federation of Accountants (IFAC) have recently conducted a joint study on the **costs and impacts of regulatory divergence** [BIAC-IFAC, 2018]<sup>xxii</sup>. The findings show that regulatory divergence costs financial institutions 5-10% of their annual turnover (on average). This consumes scarce senior management time, as well as capital, that could otherwise be focused on identifying emerging risks in the financial system. Ultimately, these costs are a barrier to growth: more than US\$ 780 billion annually in costs to the global economy are conservatively inferred by the findings. The weight increase even further on the production line, particularly on SMEs, who not only have the regulatory burden weight, but also the increased cost of more expensive products.

76% of respondents indicated the inconsistencies in supervisory interpretations and practices, fundamentally different regulatory frameworks, and different regulatory or data definitions are the most significant inconsistencies.

**BIAC-IFAC survey - To what extent regulatory divergence has been a barrier to extending operations to regions in which it does not presently operate?**



Source BIAC-IFAC (2018)

Therefore, once again, crucial is increasing overall alignment in rules, regulations and standards; and increasing adherence to global standards starting from enhancing transparency by international organisations in developing new rules and regulations thinking about the ultimate weight on the final user.

### **Need to move from “regulation of actors” to “regulation of activities”**

Such structural vulnerabilities from asset management activities, shadow banking, digital and cybercrime call for a need to refocus the banking regulation to foster the financing of the economy, while addressing new sources of financial instability: same activity, same risks, same regulation. This is a crucial step, as regulation today is still tackling the weaknesses of the last financial crisis, rather than getting ready to address the systemic vulnerabilities of the next one. The risk is that “Generals may be preparing to fight the previous war”.

Under the G20 German Presidency, the conversation in this direction was started, but had limited progress. It is key to refocus regulation from regulating the players towards regulating the activities, the risks. Not doing so creates the single biggest vulnerability in Markets’ and overall systemic stability. More than ever, we need governments and regulators to shift from being gatekeepers of stability towards being enablers of growth and investment.



## FROM THEORY TO PRACTICE: SME HUB AND GVC PASSPORT

The importance of SMEs contribution to economic growth, innovation, job creation and social cohesion should not be underestimated. Across OECD countries, SMEs typically account for more than half of business sector activity and around two-thirds of employment. In emerging economies, SMEs deliver on average more than 40% of GDP and 50% of employment. Young, small firms, in particular, contribute significantly to creating jobs. Considering this important role, it is imperative to ensure that viable SMEs around the world have access to the credit they need to expand. Strengthening SMEs in global value chains (GVCs) was highlighted as a G20 goal at the Hangzhou Summit in 2016, where G20 leaders reaffirmed their intention to support the development of SMEs and linkages to GVCs.

### Formal and Informal Economies

SMEs number an estimated 400 million in the global developing markets. Most (93%) are formal or informal micro firms. Importantly, informal firms outnumber formal firms by a ratio of 3.4 to one.

According to the 2017 GPMI report on SME Finance, about half of the SMEs (200 million) have unmet credit needs totalling about US\$2.1 to US\$2.6 trillion. They also maintain an estimated US\$14.6 to US\$17.8 trillion in cash balances, of which US\$3.3 to US\$4.1 trillion are held outside of banks. They hold the remainder, or US\$11.2 to US\$13.8 trillion, in current, savings, and investment deposit accounts.

Deposit account balances and transaction flows provide real-time visibility into SMEs' rolling net cash flows for credit decisions, which are often superior to out-of-date and unreliable SME financial statements. They provide indicators about incoming sales, outgoing expenses, debt payments, whether the business is growing or contracting, and how well the SME is handling overdrafts.

**Global developing markets' formal and informal SME market size**



### Supporting SMEs across the GVC (and move from informal to formal) by leveraging on digital

Today, online e-commerce platforms support millions of SMEs by enabling them to deliver goods and services to international markets with unprecedented ease. SMEs have never before been able to access infrastructure and global logistics networks with so little capital expenditure.

## Strategic Vision

We recommend the G20 establishing coordinated strategies and policies aimed at greater digital inclusion for SME's to enhance transaction processing capabilities and improve funding options to:

- Support informal firms move into the formal economy;
- Systematically gather data, which includes new uses of both traditional data (bank, accounting, transactional, and sales data), which previously may have not been shared and may have not been effectively utilized by banks, as well as alternative data (online ranking and social media, mobile, and individual data, such as psychometric testing);
- Such data, if properly structured, verified and channelled, can support both SME lending and public administration, for example for tax purposes (please refer to **Box 2**), making compliance automatic, simple, and cheap, as well as making the relationship with the administration more transparent;
- Similarly, it can support firms, suppliers and administrations to significantly grow efficiencies such as netting payments, hence improving timeliness of payments, a long-standing low hanging fruit.
- Finally, the connections across the GVC can support SMEs to access wider markets, hence supporting trade activities.

At the 2018 OECD Ministerial Conference on SMEs, Ministers discussed how stronger participation by SMEs in global markets can create opportunities to scale up, accelerate innovation, facilitate technology spill-overs and managerial know-how, broaden and deepen the skillset, and enhance productivity. Discussions highlighted the role of clusters in supporting productivity growth and business internationalization.<sup>xxiii</sup>

Increased trade integration over the last two decades has changed the nature of industry clusters by further separating the stages of production, including geographically. This online transition is both pervasive and fundamental; such improvements in productivity could benefit billions of people by spurring inclusive<sup>xxiv</sup> growth, structurally addressing the international fragmentation of production and creating millions of jobs in both developed and underdeveloped regions, while consumers benefit from ever-lower prices. A study by McKinsey<sup>xxv</sup> estimates that digital financial services have the potential to provide 1.6 billion people in emerging economies with access to a formal financial account and increase the GDP across emerging economies by 6% by 2025.

## Implementation policies

At the same time, as the world's leading e-commerce platforms continue to grow, they inevitably attract political and regulatory scrutiny. Their rapid rise and giant scale are fuelling calls for new rules in the areas of anti-trust, data privacy, and taxation. If such regulations are introduced in a fragmented and hurried manner, there could be grave consequences for modern entrepreneurship. We strongly encourage any regulatory responses to be coordinated at the G20-level and based on comprehensive impact analysis.

### How – Creating “SME Hubs” and “GVC Passports”

In 2006, 25% of Kenyans had access to banking products. By 2014, this figure had jumped to 68%. Almost half of these users do not have a formal bank account, with formal banking in Kenya remaining at 23%. This result was achieved by the M-Pesa platform launched by Vodafone's Safaricom mobile operator in 2007 as a simple method of texting small payments between users. The M-Pesa system performs financial transactions: deposit and withdraw money, transfer money to other M-Pesa users and non-users, pay bills and purchase airtime, inclusive of a credit-scoring algorithm for first-time borrowers.

The product has received global attention due to its uniqueness, innovativeness, rapid adoption, and the impact it has made to a large population, mostly people who are poor and frequently analphabetic. The product connected a population which was hitherto disconnected from accessing financial services.

Fast forward to China, online payments reached CNY 57.7tr in 2016, which is 50x the volume of transactions in the United States. Of these, CNY 38.5tr were made using mobile devices, and the amount continues to grow rapidly, with mobile payments up by 113% in 1Q-2017. Two thirds of smartphone owners in China use them for mobile payments. From online shops to restaurants and taxis, this is today the default method of payment, with cash and cards an afterthought or not available. Payment platforms like Alipay can be used for purchases in multiple ways<sup>xxvi</sup>, but Alipay has taken even the step beyond payments and now allows its customers to invest any excess cash into a low risk money market account.

The above are successful examples of creating a digital payment ecosystem. Payments are typically the entry point in the use of financial services by the previously excluded, but it is only the first step. Global technology companies are now moving into financial services, and many SME lenders have their origins in online marketplaces, search engines, payments, social networking, e-commerce, or computer technology (a wide review of digital initiatives is available in [GPFI, 2017a]). Leveraging existing, traditional, data and new data arising from these innovative solutions, being built-up by countries, (at local, regional, sectoral and nationwide levels) can allow the creation of “Data Hubs” dedicated to SMEs: an “**SME Hub**”.

The difference today in financing SMEs is that far more can be served, and it can be done with systemic solutions aimed to both private and public needs. The key ingredient in an SME Hub is having public-private cooperation in promoting responsible data sharing. A **SME Hub can be the base for a service platform** bringing SMEs together with local and national authorities, banks, etc., bringing benefits to all players.

SMEs	Local & National Authorities	Banks	GVCs	Governments at systemic level
<ul style="list-style-type: none"> <li>• Access to services &amp; visibility otherwise unknown or too complicated to achieve.</li> <li>• Simplification to all administrative activities as well as access to Finance</li> <li>• Easy 24/7 finance access, but better tailored to the actual business (or seasonal) needs.</li> <li>• Supporting multiple delivery channels and so improve documentation management</li> <li>• e-invoicing:               <ul style="list-style-type: none"> <li>• Timely payments from public and private</li> <li>• Collateral for Banks.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Ability to support SMEs in their administrative commitments.</li> <li>• Improve meeting local regulation.</li> <li>• Reduce tax evasion</li> <li>• Appreciation of the genuine business volume in each area.</li> <li>• Ability to net credit and debit from SMEs, minimising bureaucracy.</li> </ul>	<ul style="list-style-type: none"> <li>• Access to financials and actual business volumes</li> <li>• Cross-border data access with the authorities to allow better credit assessment of SME with improved risk parameters and hence better pricing.</li> <li>• Digital on-boarding change.</li> <li>• Offering diverse range of finance 24/7 to SMEs</li> <li>• Digital invoices offer collateral, hence better credit and lower pricing.</li> </ul>	<ul style="list-style-type: none"> <li>• Facilitate SME participation to GVCs</li> <li>• Share data across the GVC to facilitate the SME participation</li> <li>• Invoice financing and trade credit facilitate access to credit.</li> </ul>	<ul style="list-style-type: none"> <li>• Allow informal firms to emerge.</li> <li>• Overcome cultural, educational, and bureaucratic barriers.</li> <li>• Massive progress in transparency.</li> </ul>

Progress in developing such systems depends on all stakeholders working together so that private and public sector leaders can align on common interests, as emphasised by the GPFI report on digital payments ecosystems<sup>xxvii</sup>. In 2016, the G20 published the “*High-Level Principles for Digital Financial Inclusion*”, designed to inform national plans to leverage digital financial services. These principles aim to sustainably increase financial inclusion while fostering inclusive growth, sustainable development and protecting users of digital payments.

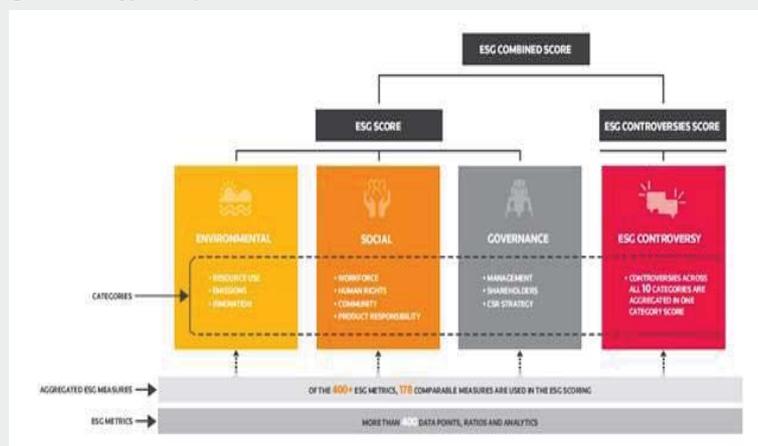
By joining GVCs, SMEs contribute to strengthened sustainability in developed markets and in emerging economies<sup>xxviii</sup>. Standards increasingly govern GVCs. Examples include national regulations covering environmental protection, and voluntary sustainability platforms such as fair trade or organic certification (refer to Box 5). By leveraging the data and information gathered through the SME data hubs (for example, SME.Market<sup>xxix</sup>), firms can start to be accredited with reliability indices. This enables them to apply GVC standards and meet formal registration and compliance requirements. Such accreditation becomes formalised through a ‘**GVC Passport**’ that they can use across the GVC, nationally and internationally. However, creating a *GVC passport* is only achievable by strengthening data quality, and through the formal recognition of *SME hubs*. This is must be done by all parties, and across-borders, and requires a strong G20 commitment to support both the vision of a ‘*GVC Passport*’ as well as to create an enabling regulatory environment to use cross-border data through mutual recognition.

### Box 5: Data Hub -- Environmental, Social & Corporate Governance (ESG) Index

**Data driven challenges to address ESG** – Issues such as climate change, diversity, human rights, ‘license to operate’, business ethics and corporate governance are at the forefront of public and political attention. The private are increasingly expected to factor these issues in to their business model. For instance the global landscape to reduce corporate greenhouse gas emissions continues to emerge, which will increasingly impact the profitability of businesses across various sectors. Furthermore, increasing political and regulatory pressure for gender equality – for instance, the European Commission put the issue of women on boards high on the political agenda and submitted a proposal for a minimum of 40% of each gender amongst non-executive directors by 2020. How companies respond to these issues is becoming as important as traditional financial metrics when evaluating corporate performance. For investors, it plays a central role in decision-making efforts to identify long-term opportunities and risks for companies. In fact, analysing ESG metrics is key in assessing risk exposure. According to the United Nations Principles for Responsible Investment, engagement in Europe is the third most popular responsible investment strategy. It is carried out by managers of more than €4.27 trillion assets under management, a figure that grew by 30% in the two years to 2016 [Eurosif, 2016]. Adherence to ESG principles is widely regarded as a key indicator of the sustainability of companies’ business practices.

**Thomson Reuters’ ESG Index**– Unlike financial reports, ESG data disclosure is unstructured and can be published at any time of the year. To make the data more meaningful, Thomson Reuters created its ESG Index with the aim of standardising and simplifying analytics. It was designed to transparently and objectively measure ESG performance across 10 themes (emissions, environment product innovation, human rights, shareholders, etc.). The data collected includes over 6,000 public companies and real time ESG signals from 75,000 sources. Increasingly organisations are conducting negative screening to identify companies involved in activities such as alcohol, tobacco and armaments in order to manage their risk exposure.

In fact, more investors/pension funds are mandating an ESG investment strategy being proactive in ‘responsible investing’ with dedicated Sustainable Investment teams, which can help differentiate their funds. The **ESG Index** allows organizations to conduct peer analysis by viewing strengths and weaknesses of their ESG practices in comparison to other firms and take necessary steps to address them before they negatively impact their company.



Such solutions go to the heart of the *G20 Action Plan on SME Financing* that provides a framework to facilitate a dialogue between the relevant international fora and G20 work streams. We encourage the OECD to expand and strengthen its analysis and guidance in this field, building on the OECD Scoreboard on Financing SMEs and Entrepreneurs<sup>xxx</sup> and the *G20/OECD High-level Principles on SME Financing*<sup>xxxi</sup> to encourage greater peer review and closer monitoring of regulatory reforms, and may provide opportunity for peer learning and identification of good practices, including with regard to regulatory reforms and the framing of coherent policies to enhance SME access to diversified sources of finance. Robust coordination with other global players gathering similar data, such as the International Monetary Fund, the Alliance for Financial Inclusion, the International Chamber of Commerce, the European Commission and the European Central Bank and others would help to deliver this.

Estonia is a case in point of a society increasingly becoming a fully “digital economy”. However, the IMF shows that available evidence suggests that the “digital sector” is still less than 10% of most economies if measured by valued added, income or employment [IMF 2018].<sup>xxvi</sup> Despite this, digitalization having penetrated many activities, almost the entire economy could be included in the “digital economy” when more broadly defined, spreading across all sectors, from agriculture to warehousing.

## RECOMMENDATIONS AND NEXT STEPS

Continuing from the previous years' recommendations to G20 Leaders, our overarching recommendations in 2018 are:

- 1. Pursue balanced reforms that promote productivity, as well as economic growth and stability, recognising that to focus on each of these alone will not deliver a balanced outcome of sustainable growth.*
- 2. Work towards interoperable global regulatory frameworks and commit to the consistent implementation of rules via coordination and consultation, supported by independent impact assessments both pre and post implementation, to minimize cross-border and cross-policy inconsistencies and so unintended regulatory burdens or impediments to invest in infrastructure.*
- 3. Develop digital policies and strategies aimed at facilitating growth in the SME sector and stronger inclusiveness by eliminating cross-border differences, particularly supporting informal economies to emerge. This can include the creation and development of SME data hubs and favour GVC Passports, in order to raise access to finance (both debt and equity) through an integrated financing approach, fostering timely payments, simplifying tax compliance, better leveraging on opportunities offered by digital and trade finance.*
- 4. Maximize data access and information sharing through digital platforms for a coordinated response to global challenges: cyber security, the digitalization of society and the transition to a low-carbon economy.*

On the road to the G20 Leaders' Summit in December 2018 in Buenos Aires, we encourage G20 Sherpas to use these recommendations, and this publication as a point of reference in preparing the G20 Leaders' Summit Communiqué. The importance of continuity between G20 Presidencies, in ensuring adequate review of progress made and ensuring forward momentum is crucial to ensuring policy consistency for long-term financial stability, economic growth, and return on investment.

## Annex 1

### 4<sup>th</sup> Roundtable on SMEs Access to GVCs: The productivity challenge in financing inclusive and sustainable growth

28 May | OECD Conference Centre

#### 11.30 am - 11.35 am | Setting the scene: the journey to date and focus of this year

- Gianluca Riccio, Chair of the roundtable

#### 11.35 am - 12.05 pm | Introductory Remarks

- Erol Kiresepi, President International Organisation of Employers (IOE) and Co-Chair B20 Task Force on Employment and Education
- Carolina Castro, B20 Executive Sherpa

#### 12.05 pm - 12.55 pm | Tackling the cumulative regulatory burden across global value chains

*Format & Objective:* Roundtable discussion to identify recommendations that will deliver better regulatory implementation across sectors. This includes agreeing where synergies and trade-offs exist between B20 taskforces paying particular attention to fostering innovation and more open market environment.

- Alexander Shokhin, President, Russian Union of Industrialists & Entrepreneurs
- José Manuel González-Páramo, Executive Board Member, BBVA, and Co-Chair B20 Task Force on Financing Growth and Infrastructure
- Vieri Ceriani, Economic Advisor to the Italian Minister of Finance, and Chief Executive, SOSE
- Victor Dosoretz, B20 SME Co-Chair, Treasurer of Argentine Chamber of Commerce and Services
- *Moderator:* Kent Andrews, Senior Vice President, Regulatory Risk and Risk Capital, TD Bank, and Chair, BIAC Finance Task Force

#### 12.55 pm - 13.40 pm | Strategic recommendations to foster productivity and SME financing

*Format & Objective:* Roundtable discussion to identify and prioritize B20 recommendations that support productivity growth and sustain SME financing and participation in GVCs. This includes agreeing where synergies and trade-offs exist between B20 actions across the different taskforces with attention to the role of digital platforms, improved access to data, greater financial inclusion, and mitigating challenges such as resources' misallocation and cyber risk.

Keynote speaker: Inés Berton, Chair SME Task Force, and CEO & Founder of Telaosophy

- Matthew Gamsler, CEO, SME Finance Forum
- Miriam Koreen, Deputy Director of the Centre for Entrepreneurship, SMEs & Local Development, OECD
- Pedro Cascales, B20 SME Co-Chair, Secretary of Argentine Chamber for Medium Size Enterprises
- *Moderator:* Eduardo Coduri, EY Argentina CEO, B20 SME Knowledge Partner

#### 13.40 pm - 14.00 pm | Conclusions and B20 priorities

- Gianluca Riccio, Chair of the roundtable
- Daniel Funes de Rioja, Chair B20 Argentina

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<sup>i</sup> The 3-axis (Economic Growth, Financial Stability & Return on Investment) equilibrium concept was developed by Gianluca Riccio in 2013 as part of the BIAC work on unintended consequences of Financial Regulation – BIAC (2014) “The case for a more coordinated approach to financial regulation: A BIAC discussion paper.”

<sup>ii</sup> Drawings have been generated by RANEPa since the first G20 Washington summit. The dataset on commitments is at <http://www.ranepa.ru/eng/ciir-ranepa/research-areas/g20/commitments-adopted-at-the-g20-summits/g20-commitments-by-issue-and-evaluation>; and the one on compliance is at <http://www.ranepa.ru/eng/ciir-ranepa/research-areas/g20/analytics>

<sup>iii</sup> OECD (2016), Labour productivity forecast (indicator). doi: 10.1787/cb12b189-en (Accessed on 01 April 2016)

<sup>iv</sup> Abramovitz Moses. 1956. Resource and output trends in the United States since 1870. American Economic Review 46 (2); Solow Robert, 1957, Technical change and the aggregate production function. Review of Economics and Statistics 39 (August).

<sup>v</sup> OECD (2016), OECD Economic Policy Papers, No. 18, OECD Publishing, Paris.

<sup>vi</sup> OECD (2017), Pilot Project on Benchmarking Policies for Stronger SME Performance, OECD Working Party on SMEs and Entrepreneurship, Paris.

<sup>vii</sup> OECD (2018), Strengthening SMEs and Entrepreneurship for Productivity and Inclusive Growth, Key Issues Paper, OECD SME Ministerial Conference, 22-23 February 2018, Mexico City, <http://www.oecd.org/cfe/smes/ministerial/documents/2018-SME-Ministerial-Conference-Key-Issues.pdf>

<sup>viii</sup> OECD (2018), Chair’s Summary, OECD SME Ministerial Conference on Strengthening SMEs and Entrepreneurship for Productivity and Inclusive Growth, 22-23 February 2018, Mexico City, <https://www.oecd.org/cfe/smes/SME-Ministerial-Chairs-Summary.pdf>

<sup>ix</sup> OECD (2015), The Future of Productivity, OECD Publishing, Paris.

<sup>x</sup> IBM, 10 Key Marketing Trends, 2017

<sup>xi</sup> Google calculates humans produced 5 exabytes of data from the dawn of civilization to 2003. We now generate 2.5 exabytes of data every single day, and IDC estimates that the amount of data will double every two years to 2020.

<sup>xii</sup> OECD (2018), Data Analytics in SMEs: Trends and policies, Working Party on SMEs and Entrepreneurship, OECD, Paris

<sup>xiii</sup> FSB (2017) – Financial Stability Board, Summary Report on Financial Sector Cybersecurity Regulations, Guidance and Supervisory Practices, 13 October 2017

<sup>xiv</sup> FSB (2018) – Financial Stability Board, Progress Update on Cyber Lexicon Report to 19-20 March 2018 G20 Finance Ministers and Central Bank Governors Meeting Buenos Aires, Argentina

<sup>xv</sup> CBI, Disrupting the future how businesses can embrace artificial intelligence, blockchain and the internet of things. October 2017

<sup>xvi</sup> WEF (2017) – World Economic Forum, Accelerating Workforce Reskilling for the Fourth Industrial Revolution, July 2017 <https://www.weforum.org/whitepapers/accelerating-workforce-reskilling-for-the-fourth-industrial-revolution>

<sup>xvii</sup> OECD (2018), Declaration on Strengthening SMEs & Entrepreneurship for Productivity and Inclusive Growth, OECD Ministerial Conference on SME, February 2018, Mexico City, <http://www.oecd.org/cfe/smes/ministerial/SME-Ministerial-Declaration-ENG.pdf>

<sup>xviii</sup> OECD Guiding Principles for Regulatory Quality and Performance. 2005 – Adopted by the OECD Council of Ministers, confirm the seven principles of the 1997 Recommendations, adding new supporting perspectives.

<sup>xix</sup> We refer to Basel IV following most common terminology used in International fora, as Basel III inclusive of latest 2016 and 2017 changes and enhancements.

<sup>xx</sup> For example, there may be differences at subsidiary and group consolidated levels in terms of which assets qualify as high-quality liquid assets for the purpose of meeting the Liquidity Coverage Ratio (LCR). This may discourage banks from holding EMDE (Emerging Markets and Developing Economies) assets, with a detrimental impact on EMDE sovereign debt issuance and trading. This in turn may pose challenges for broader capital and money market development.

<sup>xxi</sup> European Commission consultation on Basel III implementation – HM Treasury response.

<sup>xxii</sup> BIAC-IFAC, 2018 – International Federation of Accountants (IFAC) and Business at OECD (BIAC), Regulatory Divergence: Costs, Risks, Impacts, February 2018.

<sup>xxiii</sup> Industry clusters are local concentrations of companies, typically SMEs, working in the same or related industries and whose development is helped by co-existence of suppliers of intermediate inputs and specialized services.

<sup>xxiv</sup> The G20 High-level Principles for Digital Financial Inclusion, <https://www.gpfi.org/sites/default/files/documents/G20%20High%20Level%20Principles%20for%20Digital%20Financial%20Inclusion%20-%20Full%20version-.pdf>

<sup>xxv</sup> McKinsey 2016 – McKinsey Global Institute, Digital Finance for All: Powering Inclusive Growth in Emerging Economies, 2016

<sup>xxvi</sup> You can use a password, but the easiest way is with a smartphone, by scanning a QR code either online or in the physical world. The same method can also be used to pay utilities and taxes, buy airline tickets, or contribute to charities. It can even be used to easily transfer money between individuals, commission free.

<sup>xxvii</sup> GPFI 2017b – Global Partnership for Financial Inclusion (GPFI), Financing SMEs in Sustainable Global Value Chains; Washington, D.C., May 2017.

<sup>xxviii</sup> GPFI 2017c – Global Partnership for Financial Inclusion (GPFI), Building Inclusive Digital Payments Ecosystems: Guidance Note for Governments; Washington, D.C., May 2017.

<sup>xxix</sup> “SME.Market” is World SME Forum’s (WSF) global online sales, channel management and knowledge-based platform for SMEs to overcome barriers in adopting and utilizing e-commerce. The platform targets SMEs from developing countries with little or no access to e-commerce and aims to boost their productivity and growth, through increasing their skills, visibility and funding, through capacity building and certification programs.

<sup>xxx</sup> OECD (2018), Financing SMEs and Entrepreneurs 2018: An OECD Scoreboard, forthcoming.

<sup>xxxi</sup> OECD (2015), “G20/OECD High-Level Principles on SME Financing.”

<sup>xxxii</sup> IMF (2018), International Monetary Fund (IMF), Measuring the digital economy, Washington, D.C., February 2018.





**Business at OECD (BIAC)**

The Business and Industry Advisory Committee to the OECD

13-15 Chaussée De La Muette

75016 Paris

France

[@BusinessAtOECD](https://www.bioc.org) | [www.bioc.org](http://www.bioc.org)

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