



# Realising the Potential of Services SMEs in Developing Economies

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International Centre for Trade  
and Sustainable Development

Issue Paper



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## LIST OF ABBREVIATIONS

BPO	business process outsourcing
EIF	Enhanced Integrated Framework
GDP	gross domestic product
ICT	information and communication technology
LDC	least developed country
LIC	low-income country
SDG	Sustainable Development Goal
SME	small and medium-sized enterprise
TPP	Trans-Pacific Partnership
TTIP	Transatlantic Trade and Investment Partnership
UN	United Nations
WTO	World Trade Organization

## FOREWORD

Services are making an increasingly significant contribution to the economies of least-developed countries (LDCs) and low-income countries (LICs), and growth in services has been correlated with higher levels of employment and poverty reduction. A growing body of evidence suggests that the development of the services sector provides an important avenue through which the world's poorest countries can stimulate growth in their economies, boost employment, and generate foreign exchange earnings.

The contribution of small and medium-sized enterprises (SMEs) to economies in general has been, and is, widely discussed in the development literature and in policy circles. However, what is less well understood and examined is the role of SMEs in the services sector and the unique contribution which these firms can make to the achievement of sustainable development objectives in LDCs and LICs. Similarly, gaps in knowledge remain surrounding the particular impediments which limit the potential of SMEs to deliver employment and to generate local and international business opportunities and economic growth.

In this paper, Sonja Grater, Wilma Viviers, and Ali Parry of North-West University, South Africa, not only study the role of SMEs in the services sector in LDCs and LICs as well as the determinants of SME performance, but also examine the linkages between the development of SMEs in the services sector and the attainment of sustainable development objectives as articulated in the *2030 Agenda for Sustainable Development*. Additionally, the paper draws out the primary constraints to the development of competitive service sector-orientated SMEs and provides a number of policy options which could be used to boost SME performance in LDCs and LICs.

This paper, the third in a series of publications related to services and the Sustainable Development Goals (SDGs), is designed both to expand the body of knowledge in this area and to support positive and innovative service sector policy change in the globe's most vulnerable economies. We hope that this paper, as well as the companion pieces in the series, will be useful to researchers and policymakers.



**Ricardo Meléndez-Ortiz**  
Chief Executive, ICTSD



## EXECUTIVE SUMMARY

The tremendous technological advances that have taken place in recent years have created a new kind of world - one in which production processes are increasingly being split up and outsourced to different countries that have various cost-saving competitive advantages. This is the basis of the regional and global value chain phenomenon. Unfortunately, the least-developed countries (LDCs) and low-income countries (LICs) are poorly integrated into the global economy and make a very small contribution to global production. Instead, they are largely dependent on low-value exports, e.g. raw materials or simple manufactures.

However, global trade in services (such as information and communication technology, financial services, transport, education and healthcare) is showing strong growth, helped by the surge in regional and global value chain activity that relies heavily on services. This could herald a new era for LDCs and LICs, especially as it is often easier to transition to a range of service-related activities than to value-added industrial outputs. Services already make a major contribution to the gross domestic product (GDP) of many poor countries, although the majority of service businesses are still survivalist in nature with limited prospects of growing and creating more employment opportunities. Furthermore, poor countries' services exports—other than, say, those linked to tourism—are insignificant by global standards.

This scoping paper examines the potential of the services sector to extend an economic lifeline to the LDCs and LICs, which are concentrated in four regions: East and Southern Africa; West, North, and Central Africa; Asia; and the Pacific Islands. The paper focuses specifically on SMEs (small and medium-sized enterprises) whose economic potential tends to be suppressed by insufficient market knowledge, a lack of skills and access to finance, fierce competition from larger businesses, ailing or undeveloped national infrastructure, an unhelpful policy and regulatory environment, and excessive bureaucracy.

If these obstacles could be swept aside or at least minimised, SME service providers' competitive advantages (which might include being adaptable and eager to learn) would be more likely to be revealed, and they could make a more meaningful contribution to their countries' economies and to the global quest for sustainable development.

It is at the policy level that much can and should be done to create opportunities for SMEs operating in various service sectors in less-developed countries. While SMEs often feature on LDCs' and LICs' policy agendas, such references rarely translate into practical initiatives and concrete outcomes. As a result, most SMEs are relegated to the side lines, forced to watch larger and better equipped service providers dominate the playing field. However, with regional and global value chains creating openings for different types of economic contribution, SME service providers with limited capacity but appealing attributes in other areas, and with the necessary support at policy level, could well find their niche.



# 1. THE ROLE OF SMEs IN THE SERVICES SECTOR IN LDCs AND LICs

## 1.1 Introduction

In recent years, countries everywhere have been swept up in a torrent of technological change which has revolutionised the way people view their roles in society, interact with others, and make economic decisions. In particular, the dismantling of many traditional barriers to communication has helped to connect people in ways that were practically inconceivable not so long ago. In line with this, many new technology-powered jobs have appeared, helping to streamline business processes.

While the developed and many developing countries are taking advantage of the opportunities being spawned by shifting demand and production patterns, the poorer countries of the world—represented by the LDC and LIC groupings—are finding it difficult to make the necessary transition. Hampered by limited financial, physical, and human resources, most of these countries have not been able to escape the low-development trap and find a path to inclusive economic growth and wellbeing. As a result, there is a noticeable economic divide between the LDCs and LICs, on the one hand, and the rest of the world, on the other.

The conventional, rather one-dimensional, view of the LDCs and LICs is that they are heavily reliant on a narrow range of primary commodities for their export earnings which, given the volatility in global commodity markets, leaves their economies exposed and vulnerable. In many cases (particularly in Africa), this is true, with the countries in question under continuous pressure to diversify their economies and export offerings so that they can tackle their entrenched economic and social challenges. Yet the rising prominence of services throughout the world could be a game changer for the LDCs and LICs. From transport, information and communication technology (ICT) and financial services to energy, education, and healthcare, services put the flesh on the bones of an economy and give it a distinctive character and momentum.

Services already make a significant contribution to many of the LDCs' and LICs' domestic economies, often contributing as much as half of their gross domestic product (GDP) or more. Some LDCs, such as the small Pacific Island of Vanuatu, are largely fuelled by tourism—a leading service category that has huge potential for poor countries in different parts of the world. However, the types of activities that are performed in different service sectors vary enormously. For example, where services account for a high proportion of GDP in a country with a low per capita income, it might signal an abundance of survivalist (and thus precarious) economic activities set against a backdrop of low industrialisation. Ideally, more sub-sectoral analysis is needed to differentiate between those services that have the potential to transform an LDC/LIC economy and those that are not easy to replicate or diffuse value to other economic sectors.

Discussions of the importance of services to countries' (and especially poor countries') economies often include the issue of SMEs and their contribution to the services sector. Yet the scope and impact of SME-driven services in LDCs and LICs have received little formal attention, leaving something of a gap in the literature. SME-related studies have tended to focus on the manufacturing sector in developed countries, such as Germany, the UK, and the United States, and in emerging economies, such as India and Malaysia. However, there is growing evidence (gleaned from myriad policy documents, economic and business reports, and opinion pieces) that the services sector offers abundant opportunities to SMEs in the LDCs and LICs—as a source of employment, local and international business opportunities, and economic growth. Understandably, though, SMEs in these countries face significant hurdles when trying to take advantage of such opportunities, which can be a source of frustration and disillusionment and defer their business success.

Besides the usual infrastructural and institutional shortcomings that hinder productivity in the LDC and LIC services sectors, some of the most serious constraints emanate from a difficult policy and regulatory environment, which needs strategic foresight and political will to change. SMEs often appear on the policy agenda, but typically this does not translate into workable initiatives to streamline regulatory processes for small businesses—from business registration to tax compliance. Adlung and Soprana (2012) indicate that certain policies and/or regulations are problematic only for exporting SMEs and actually benefit their domestic counterparts, thus adding to uncertainty for policymakers.

Another important, though relatively unexplored, relationship is the one between the SME services sector in LDCs and LICs and the United Nations (UN) Sustainable Development Goals (SDGs), most of which are linked to the performance of specific service sectors, such as education, health, transport, and ICT. As the overarching aim of the SDGs is the elimination of global poverty, it makes sense that the SME services sector in the world's poorest countries should be probed, understood, and given the necessary support so that these countries will stand a better chance of overcoming their many difficulties.

This scoping paper sets out to cast more light on the potential of the SME services sector to make a well-rounded and meaningful contribution to the LDCs' and LICs' national economies and to their commitments under the SDGs. More specifically, the paper:

- Provides a brief overview of the important role played by SMEs in the services sector in the LDCs and LICs;
- Examines the factors influencing the performance and competitiveness of SMEs in the services sector in the LDCs and LICs;
- Explores the link between the development of the SME services sector in the LDCs and LICs and the realisation of the SDGs;
- Highlights the main constraints to the LDCs and LICs being able to develop competitive SME service sectors;
- Discusses a range of policy options that could help to alleviate the challenges faced by SME service providers in the LDCs and LICs.

The analysis for the scoping paper was conducted on a broad regional basis, in line with the global distribution of the LDCs and LICs, i.e. East and Southern Africa; West, North, and Central Africa; Asia; and the Pacific Islands. Although Haiti in the Caribbean is also classified as an LDC, it is not given specific attention in this paper.

Arriving at an appreciation of the interrelationships between services, SMEs, and the SDGs is an important (though complex) component of a services-driven strategy aimed at unleashing the potential of the poor countries of the world.

## 1.2 Understanding Some of the Terminology

### 1.2.1 LDCs and LICs

The fact that some of the LDCs enjoy relatively high levels of per capita income does not alter the fact that they are weighed down by severe developmental problems. For the purpose of this scoping paper, the LDC group has been used as the foundation of our analysis and the LIC group has been superimposed on top of it. A full list of the LDCs and LICs appears in Appendix A.

The LDCs and LICs are usually associated with: heavy involvement in agriculture or other primary activities; limited manufacturing capabilities; limited capacity to integrate technological change into economic activities; weak human capital and low labour productivity; poor education and health standards; inadequate physical and institutional infrastructure to stimulate development; and high economic vulnerability to exogenous shocks, such as severe market volatility, climate-induced

disasters and serious health threats. The outbreak of the Ebola virus in 2014/2015 and its devastating impact on countries such as Sierra Leone and Liberia are symptomatic of such countries' extreme vulnerability.

Of the 48 LDCs and LICs, 34 are in Africa, which is well above the numbers for Asia (9), the Pacific Island group (4) and the Caribbean (1). Some countries have "graduated" from the LDC list, e.g. Botswana, Cape Verde, the Maldives, and Samoa. Equatorial Guinea and Vanuatu are scheduled to be taken off the list in 2017 in view of the progress they have made in overcoming many of their development shortcomings.

It has been acknowledged that the various forms of official support given to the LDCs, including trade preferences under the banner of the World Trade Organization (WTO), have not produced their intended results (CDP 2010). However, at the Nairobi Ministerial Conference in 2015, WTO members agreed to extend the LDC services waiver until 2030, a special provision that allows non-LDC member countries to deviate from their most-favoured-nation obligations and grant preferential treatment to LDC services and service providers.

One of the main problems with official support measures is that they have not been designed to take the diversity within the LDC group sufficiently into account. For example, 16 LDCs are landlocked while 8 are islands; some LDCs have very small populations (such as Tuvalu) and some have very large populations (such as Bangladesh); still others are currently in or have recently emerged from conflict situations (such as Afghanistan, Sierra Leone, and South Sudan). The export focus also varies across the LDC group. For example, fuel dominates the export mix in 6 LDCs, minerals in 10, simple manufactures in 6, agricultural produce in 8, and services in 10. Furthermore, countries' varying per capita income status makes them eligible for different levels of financial assistance from multilateral and bilateral donors.

Because of lacklustre or declining economic growth rates and high levels of poverty, one of the greatest challenges facing LDCs and LICs

is creating productive jobs and sustainable livelihoods for the large numbers of young people entering the labour market each year. In the past, much of the labour force was routinely absorbed into the agricultural sector, but agricultural production has been declining in many of the poor countries due to difficulties in maintaining competitive farming sectors. Consequently, more and more people are flocking to the urban areas to engage in informal, survivalist-type economic activities. The need for economic diversification and a developmental boost has never been so urgent.

Clearly, from a policy perspective, there cannot be a "one-size-fits-all" approach to the LDC/LIC development challenge, and assistance packages and other strategic and practical interventions need to take countries' specific circumstances into account.

### *1.2.2 Small and Medium-Sized Enterprises*

The term "SME" (small and medium-sized enterprise) defies precise definition. What constitutes an SME varies from country to country, and even from industry to industry. However, the term is generally used to describe a business entity that operates with limited resources and generates modest financial returns when compared to larger corporates and multinationals.

The most common criteria for determining whether or not a business falls into the SME category are: number of employees; turnover; total net assets; and/or investment levels. For the purpose of this scoping paper, an SME is taken to mean a business with up to 100 employees, where a "medium-sized" enterprise would have 50-100 employees and a "small" enterprise would have fewer than 50 employees. Some people further distinguish between "small" enterprises (10-49 employees) and "micro" enterprises (fewer than 10 employees) (IFC 2016). Another distinguishing feature is whether a business is formally constituted or not (ITC 2014). Formal SMEs are generally businesses that have been officially registered for tax purposes, whereas informal SMEs have not.

The overwhelming majority of SMEs in the developing world are informal in nature. IFC (2016) data indicate that the number of formal SMEs in developing countries (about 30 million) is dwarfed by the number of informal SMEs (about 340 million). Linked to this is the phenomenon of the “missing middle” (UNCTAD 1995). In the LDCs, in particular, plenty of small and micro enterprises exist but there is a shortage of medium-sized enterprises that are growth-orientated and capable of making a difference on the employment, economic growth, and sustainable development fronts. This can be attributed in part to the absence of a coherent SME development strategy in many of these countries, which leads to structural imbalances between large, capital-intensive organisations and smaller entities.

SMEs in the LDCs and LICs tend to be less productive than their counterparts in more developed parts of the world, often because the former engage in more labour-intensive, low value-added economic pursuits (such as farming or mining) which do not produce the cost efficiencies generally equated with more capital-intensive activities, such as manufacturing (Wymenga et al. 2011).

### **1.3 The Contribution Of Services and the SME Services Sector to LDCs and LICs**

#### *1.3.1 The Growing Importance of Services to the LDCs and LICs*

There is mounting evidence that the services sector in many developing countries is outpacing the more traditional industrial sectors in terms of contribution to GDP growth and job creation. Services now account for about 75 percent of global economic activity, with the developing world taking credit for about 45 percent of this. Services are categorised differently in different classification systems, but frequently mentioned service categories include: education; healthcare; ICT; financial services; energy; transport and logistics; construction; business services (e.g. accounting, legal, management consulting) and business process outsourcing (BPO); tourism; cultural services; and recreational and sporting services.

While many services are tradeable in their own right, others—such as ICT, transport, and energy—facilitate the production of goods and other services, while also laying the foundation for a well-functioning society. Financial services, for example, facilitate innumerable business transactions and provide access to finance for investment purposes; education and health-related services help to create a well-trained, healthy, and productive society; energy-related services aim to provide sufficient power to keep the many forms of national infrastructure working optimally, and to keep businesses and households running; and legal and accounting services can contribute to efficient, transparent, and accountable behaviour in business and government. In the absence of these services, investors would look for alternative investment prospects, and the country would be unable to function at even the most basic level.

The Enhanced Integrated Framework (EIF), a multi-donor programme which runs a global Aid for Trade initiative designed exclusively for LDCs, has singled out tourism as the most important services sector for LDCs. Most LDCs themselves state that tourism is a priority area (EIF 2015). The creative economy (which produces outputs such as musical recordings and arts and crafts) has also been identified as a promising growth area, particularly in Africa, while an LDC such as Uganda sees its education sector as being ripe for international expansion (ITC 2013).

In general, the growth in services is correlated with poverty reduction and higher employment levels (OECD 2008). Furthermore, what is becoming increasingly apparent is that for poor, under-resourced countries, the development of the services sector can often provide a platform for “leapfrogging” the traditional manufacturing stage in the economic development process—provided an environment can be created in which service providers are able to deliver value and become internationally competitive. Many manufacturing businesses require significant upfront investment and a skilled workforce that can produce goods

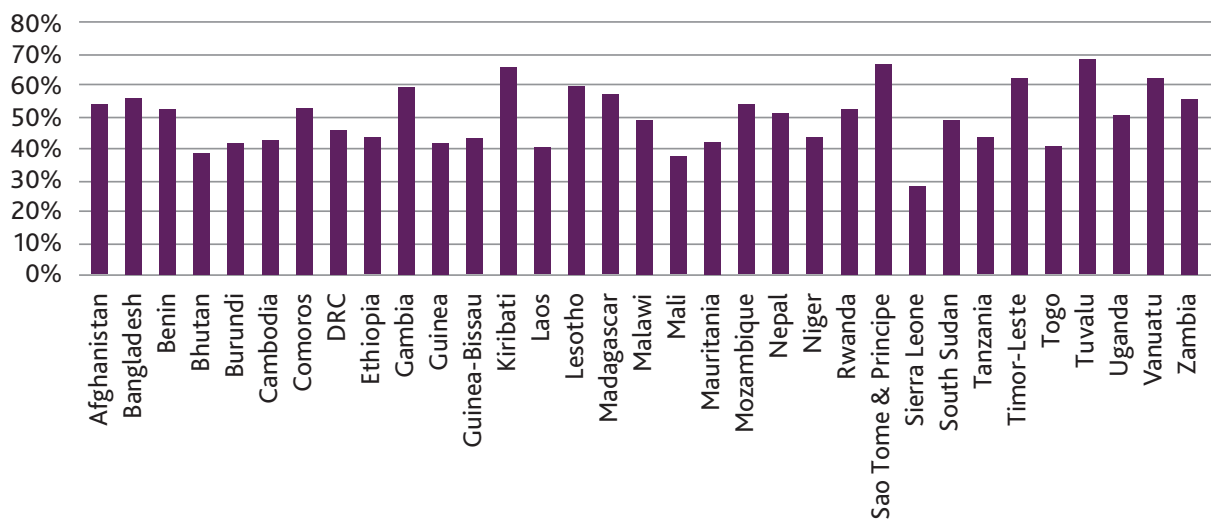


to prescribed industry standards. In a poor country where technical skills are in short supply and infrastructural deficiencies (roads, energy, telecommunications, and so on) can easily hobble a manufacturing concern's operation, developing the services sector might deliver quicker, less expensive, and more inclusive economic solutions. Yet there are many important, natural linkages between

manufacturing and services which are a source of myriad business opportunities and should not be overlooked (UNIDO 2013).

Figure 1 indicates that, on average, services contribute about 50 percent to GDP in those LDCs and LICs for which data were available, with the highest score recorded being 69 percent in Tuvalu.

**Figure 1: Contribution of the services sector to GDP in selected LDCs and LICs (2014)**



Source: World Bank (2015)

Services can be divided into two broad categories: modern services and traditional services. Modern services—used extensively, for example, in the financial sector—include ICT-intensive services that can be transported electronically through satellite and telecommunications networks. Traditional services are not ICT-intensive and are often associated with the hospitality/tourism, cultural, and sporting sectors. It is modern services that are showing the most rapid growth, thanks to their efficiency-enhancing technology and growing appeal as value-added links in regional and global value chains. However, these require special skill sets and often significant investment.

Although it is often assumed that ongoing advances in the ICT arena are displacing all but the most highly-skilled workers, this is not necessarily the case. Autor (2015) identifies three segments in the labour market: workers with high-level skills, workers with medium-

level skills, and workers with low-level skills. Whereas machines are increasingly eroding the job prospects of people with medium-level skills in an administrative or production environment, the same cannot be said for their impact on low-level and high-level work. Jobs demanding low-level (and typically manual) skills are difficult to “codify” and therefore face little risk of being swept aside in favour of automated systems. At the other end of the spectrum, the technology-rich character of many companies these days means that more and more value is attached to having knowledgeable and highly-skilled individuals on board who are capable of using innovation to drive the business forward.

Given their high unemployment rates but significant skills shortages, LDCs and LICs need to grow their routine, labour-absorbing jobs while also creating better conditions for technology-intensive jobs that can help to shore up these countries' competitiveness.

This effectively involves adopting a two-tiered approach to dealing with their development challenges.

Although all LDCs export commercial services, they typically run a deficit in the services account of their balance of payments. In other words, there is a surplus of services imports over services exports. There are, nevertheless, some net exporters of services, including Cambodia, Djibouti, Gambia, Laos, Nepal, Tanzania, and Vanuatu (ITC 2016).

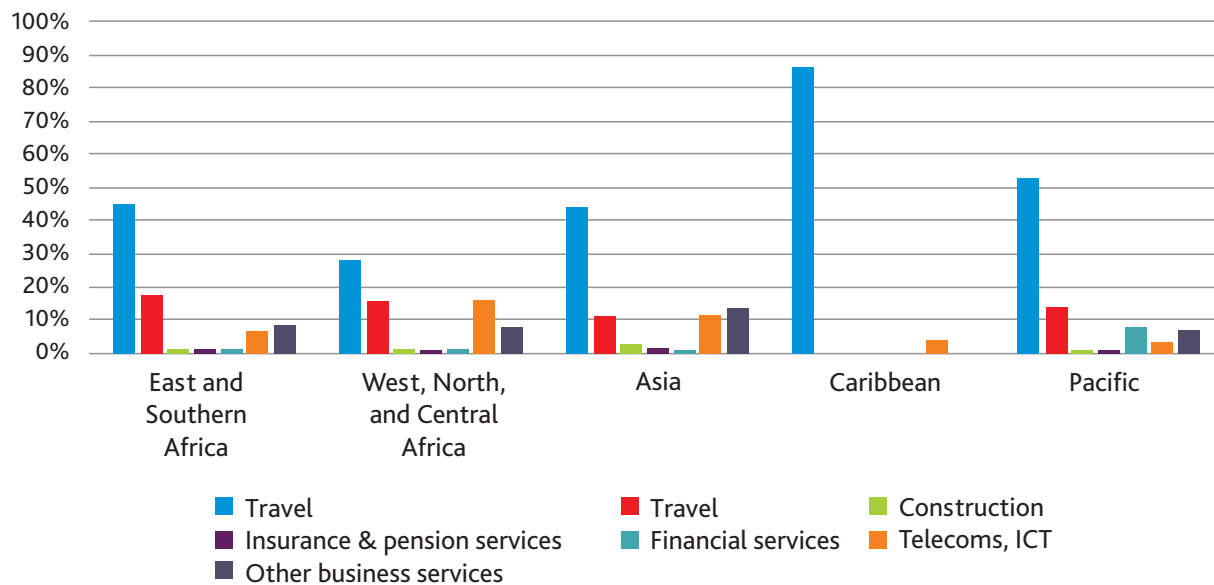
Figure 2 shows that travel (relating to inbound tourism) is the main services export sector in the LDCs/LICs across the different regions, followed by transport (relating to the movement of goods from their place of origin to the market).

Of interest is the fact that the telecommunications/ICT sector features more prominently

in the export mix of West, North, and Central Africa than it does in East and Southern Africa. The export results for the Caribbean and Pacific regions, in turn, have the typical hallmarks of small island economies heavily dependent on tourism. The generally meagre contribution of financial, insurance and pension, and construction services exports is a sign of undeveloped economies that are yet to embrace modern services on a meaningful scale.

The demand for business services is on the rise in many regions, but the LDCs' contribution in this regard is generally low. This is worrying as business services are one of the keys to successful participation in global services value chains. An exception, though, is Bangladesh which is exporting a wide range of ICT-enabled business services. In fact, it is by far the strongest performing LDC in this category, exporting four times more than its closest rival, Cambodia (ITC, 2016).

**Figure 2: Services sector contribution to total services exports in LDCs and LICs in different world regions (2013)**



Source: Authors' own calculations using ITC data (2016)



Clearly, there is much room for diversification and expansion on the services export front. Where LDCs and LICs have been making progress in developing their services export sectors, contributing factors have included supportive policies and regulations, natural competitive advantages (e.g. scenic beauty), or a strategic location.

### 1.3.2 *The Pivotal Role Played by SMEs in the LDCs and LICs, with Reference to the Services Sector*

There is a discernible link between services sector development, on the one hand, and GDP growth and poverty reduction, on the other (OECD 2008). SMEs could be key instruments in driving this process in the LDCs and LICs as their large numbers could (given the right conditions) help to disperse their economic influence throughout society. Moreover, because of their relatively informal constitution and business approach, SMEs are often quicker to react to commercial opportunities than larger firms which can be constricted by more complex decision-making processes and lengthy planning cycles (UNCTAD 2011).

Yet the influence of the SME services sector in LDCs and LICs tends to be limited. Like intermittent rain, small (often survivalist) businesses are unable to properly nourish the economy and bring about much-needed rejuvenation and new growth. Fjose et al. (2010) point out that SMEs only really start to become drivers of economic growth when they have scaled up their production capacity, are generating sizeable returns, and are contributing to the tax base. To reach this stage, SMEs operating in the services sector need to clear a variety of hurdles that typically stand in the way of their growth and prosperity. The challenges that these businesses face should not be underestimated and will be examined in Section 4.

To provide some additional context, in 2004 SMEs accounted for about 70 percent of employment in low-income countries and also generated the bulk of export earnings, and

more recently it is estimated that this could be even higher at 80 per cent (OECD 2004; Berrios & Pilgrim 2013). In another study, conducted by Kushnir et al. (2010), it was revealed that countries with higher per capita income have more SMEs per 1,000 people, but that SME growth is three times higher in low-income countries. SMEs play a large role in terms of numbers; their challenge is to make a more sustainable contribution to their countries' economies.

A study by UNCTAD (1995) showed that SMEs had a major role to play in the growth and development of Asia's leading economies. Contributing factors included the emphasis that SMEs in the countries concerned placed on using technology in business, their frequent interactions with larger firms that had access to extended (including international) markets, and the ready access that they had to government support programmes tailored to their specific needs. The study uncovered a very different picture, however, for SMEs in Asia's developing and least-developed countries. Here, SMEs were generally very small and informal, followed simple and traditional business practices, and served a very limited local market. In some of the countries, oppressive legal and regulatory regimes added to the SMEs' high cost burden. Accordingly, these entities' contribution to their countries' economic growth and development was found to be limited.

The results of the UNCTAD (1995) study highlight a generally held view that entrepreneurs are not in short supply in poor countries; rather, it is the shortage of *successful* entrepreneurs with growth potential that is the problem. Clearly, there is a big development gap that needs to be closed, which could be helped by well-considered policy shifts and interventions at both the macro and micro levels.

A key consideration in the increasingly spirited global conversation about LDC and SME development is the role of women in society. In poor countries, women invariably have to juggle income generation with caring for extended families; yet they are often involved

in low-level work which carries little financial reward or recognition. Often deprived of a decent education, women frequently operate on the fringes of the economy, unable to escape the circumstances that an unequal society has thrust upon them. The services sector offers important opportunities for women because it often lends itself to more flexible work methods and hours than primary or industrial pursuits.

The strong presence of SMEs in an economy is not the preserve of developing countries only. In Japan, for example, SMEs reportedly account

for more than 95 percent of business activity (Izumi 2015). Many of these small businesses operate in the services sector and, while not as well-known as some of Japan's technology and other services sector giants, constitute a vital support system for the economy as a whole. Perhaps the SME communities in the developing world can take heart from the fact that Japan's SMEs also face significant challenges, such as how to secure adequate finance for development purposes, how to find the right calibre of employee, and how to manage the high costs and logistical hurdles involved in becoming internationally competitive.

## 2. SMEs IN THE SERVICES SECTOR IN THE LDCs AND LICs—PERFORMANCE DRIVERS AND KEYS TO COMPETITIVENESS

This section explores what is required for SMEs, operating in various services sectors in LDCs and LICs, to perform optimally and attain the level of competitiveness that would enable them to trade internationally, including participating in regional and global value chains.

### 2.1 The Climate for SME Services Sector Development in Different World Regions

Fast-changing technologies, particularly in the ICT field, are empowering more and more people to run businesses with relatively few resources. In theory, SMEs in the services arena—once constrained by limited throughput and an inability to arrive at economies of scale—should be flourishing, considering that market and competitor information is relatively easy to access these days and that many services lend themselves to broad and rapid electronic delivery to large audiences. Internet-based training programmes, online banking services and mobile apps (for job seekers, gaming enthusiasts, and music fans, for example) all come to mind.

However, with new opportunities come new challenges, particularly as LDCs and LICs have to confront the globalisation phenomenon from a disadvantaged base.

#### 2.1.1 Africa

Africa has the dubious reputation of being home to 34 of the 48 LDCs/LICs, which are spread out across this vast continent of nearly 1 billion people. The African LDCs have highly variable topography, climatic conditions, natural resources, and economic circumstances, but they are broadly united in their low levels of industrialisation, vulnerability to external shocks, pervasive poverty, and severe developmental shortcomings—especially in the transport, energy, and telecommunications sectors.

Although many African countries have been praised for delivering strong economic growth

over the past decade or so and introducing reforms to make it is easier to do business (with countries like Benin, Cote d'Ivoire, the DRC, Senegal, and Togo leading the way in this regard), most economies are still sagging under the weight of huge numbers of unemployed and underemployed people. This problem has reached a critical stage as youth unemployment is at an all-time high, in 2012 it was estimate at around 12% (Lee 2013). In its 2015 review, *African Economic Outlook* commented that the economic growth rates being delivered by African countries are not producing the number or quality of jobs which the continuous stream of young people entering the labour market is demanding (AFDB, OECD, and UNDP 2015).

It is widely accepted that economic growth in Africa needs to be more inclusive so that more people will be able to make a contribution, rather than be a burden, to the continent in the years ahead. One of the factors exacerbating the unemployment problem in the LDCs/LICs in Africa is the marked discrimination against women in the workplace, which impedes their economic emancipation. Africa has also been wracked by a series of external crises. North Africa, for instance, has been gripped by political instability in recent times, while West Africa has had to deal with the 2014/2015 Ebola virus outbreak. However, East Africa appears to have been bucking the trend, emerging as the fastest-growing region on the continent and making significant progress in boosting its ICT capacity and encouraging the development of an entrepreneurial culture.

#### 2.1.2 Asia

The LDCs and LICs in Asia are loosely scattered across a large geographical area and constitute an eclectic mix of large and small, open and closed, peaceful and troubled economies. Bangladesh, for example, has a huge population (150 million) and all the attendant problems of large, sprawling urban developments. Bhutan, on the other hand, with a population of about

700,000, is a relatively tranquil retreat which has taken environmental protection to a whole new level with its reverence for nature and wildlife. It is heavily dependent on revenue from foreign tourists, while Timor-Leste, in turn, has been successfully growing its manufacturing capacity in recent years.

A common characteristic of the Asian LDCs/LICs, though, is the dominant role SMEs play in their economies. Yet governments are often not well geared to providing support to their small business communities, sometimes inadvertently suppressing job opportunities and creating a development deficit. When Kathmandu in Nepal was practically razed to the ground by a massive earthquake in 2015, thousands of small traders and service providers (including Sherpas attached to climbing expeditions to Mount Everest) lost their livelihoods. To this day, the Nepalese government has been slow to respond and much of the promised compensation has not yet materialised.

#### *2.1.4 Pacific Islands*

The four LDCs/LICs in the Pacific Island region are not only small geographically; they have small populations too. Given their limited domestic markets and technological prowess, they have not been able to benefit from economies of scale. In addition, their distance from major economic centres has left them marginalised from a regional integration standpoint. Not surprisingly, these countries' economies are dependent on just a few sectors and trading partners, leaving them vulnerable to exogenous factors that affect supply and demand.

Most economic activity and employment in the Pacific Island LDCs is provided by large, informal services sector SMEs. Unfortunately, unemployment tends to be very high in the Pacific region, with the large numbers of young people entering the labour market each year becoming a major concern. In the Solomon Islands and Vanuatu, for example, the youth unemployment problem has become acute (UNESCAP 2007; Pratt 2015)

In general, women find it more difficult to find work than men, and when they are employed they often occupy comparatively low status positions. The Pacific Island LDCs are also known for their inflexible labour legislation which keeps wages relatively low. This has resulted in skilled professionals in, for example, the medical profession being perennially underpaid and then deciding to relocate to other countries in search of better prospects.

Tourism offers huge potential as a source of employment and foreign exchange, but the rigid labour market and a dearth of training institutions could hold back the development of this sector. A country like Vanuatu, whose tourism sector is already well established, still experiences difficulty in finding suitably experienced hotel management and support staff, such as chefs.

## **2.2 Factors Driving SME Performance and Competitiveness in the Services Sector in Different World Regions**

There are many factors that drive SME performance in the services sector. First, there has to be strong demand for the services that SMEs offer or aspire to offer. Many of the LDCs and LICs have small domestic markets, but a service sector like tourism has almost unlimited potential. Where a country has natural attractions (e.g. scenic beauty, unusual geological formations, or evidence of a colourful history) that SME service providers can tap into, the road to success should be that much shorter.

To flourish, SME service providers also need a thorough knowledge of the market they have set their sights on, as well as easy access to it. This would be facilitated by, among other things, reliable and affordable transport and telecommunications/ICT systems. Reliable transport and ICT services also enable SMEs to keep track of what their competitors are doing so that they can adapt their business strategies accordingly.

The regulatory environment in which SME service providers have to operate has an important bearing on their success. Whereas many small companies are resistant to the idea of government regulation because compliance can be costly, time-consuming, and energy-sapping, regulations help to bring order and certainty to a business sector. In the absence of controls, there would be unfettered—and possibly unfair—competition and dubious performance standards, which could bring the whole sector into disrepute. What SMEs really want is a shift in emphasis from government meddling/control (evidenced in onerous regulations) to government support (evidenced in prescribed standards of performance and output, aimed at building companies' competitiveness) (Rogerson, 2001).

Another key performance driver among SMEs is access to continuous learning opportunities, both in a formal and informal sense. The latter, in particular, could flow from networking with other SMEs in the same or similar service sector, and attending talks delivered by industry experts and inspirational business leaders.

Although SMEs generally like the freedom to experiment with new technologies and business applications, they also need to adhere to formal financial and operational controls, which are a function of good management and effective leadership. Good management and leadership is a basic tenet of business, but it can be difficult to implement in small enterprises that are under pressure to survive on a daily basis. Yet developing human capital and commitment is one of the essential building blocks in SME development. The loss of a key staff member, for example, who is underappreciated or under-challenged, is felt more keenly in a small firm than it is in a large firm.

SMEs often have a stronger chance of success if they can partner with larger service providers (e.g. assuming the role of subcontractors), thereby being assured of regular business and benefiting from being associated with an established brand and reputation—be it in the education, hospitality, or business services, or any other field (UNCTAD 1995).

### 3. THE LINK BETWEEN DEVELOPING THE SME SERVICES SECTOR IN THE LDCs AND LICs AND THE SDGs

#### 3.1 The Role of the Sustainable Development Goals in Addressing Key Global Challenges

Despite all the technological advances that have gripped people's attention in recent years, poverty and inequality are still deeply entrenched in many parts of the world. The natural environment is also under huge strain from over-development and the gradual exhaustion of the world's resources, which has led to a demand/supply gap that will never be filled (Magdoff, 2013). In the past, many were content with believing that poverty and its many spill-over effects were the problems of just those countries in which they manifested themselves. Yet there is increasing recognition that poverty, inequality, and underutilised human potential constitute a global problem—requiring a coordinated global response.

In their eagerness to create jobs, many governments agitate for stronger economic growth, forgetting that more growth in the absence of supportive and responsible development programmes can erode a country's productive resources and do little to mend the divisions that social and economic circumstances have created between people.

In September 2015, at a United Nations summit, 193 countries adopted the *2030 Agenda for Sustainable Development*. It comprises 17 Sustainable Development Goals with 169 nested targets, which set out what countries should be doing to reverse the vicious cycle of poverty, inequality, underdevelopment, and environmental degradation that is evident in many parts of the world. Resting on three interlocking pillars—economic development, social development, and environmental protection—the SDGs envisage a future that has been rescued from the current tendency towards “short-termism” and greed.

The SDGs represent a significant step forward on the path to meaningful and sustainable

development and have particular relevance for SMEs operating in the services sector in LDCs and LICs. For example, many of the goals have an education and health theme. Tipping and Botwright (2014) suggest that SMEs operating in the services sector in the LDCs and LICs can, by following a committed SDG action plan, do much to diversify their service offerings and strengthen their capacity, thereby helping their countries' economies shift out of low gear.

#### 3.2 The Potential of SMEs in the Services Sector in the LDCs and LICs to Deliver Results under the SDGs

Most of the formal studies conducted on the role and impact of sustainable development relate to initiatives taken by multinational corporations and other large organisations that can afford to take bold decisions in the interests of the constituencies they serve (UNCTAD 2014). However, the link between SME performance and development, on the one hand, and sustainable development, on the other, is not so well understood (particularly in the LDCs and LICs where there is a dearth of reliable data).

As a starting point in bridging this knowledge gap, this section looks at the potential of SMEs operating in various service sectors in LDCs and LICs to make a tangible contribution to the realisation of the Sustainable Development Goals. As pointed out earlier in this paper, the services arena can offer a convenient economic “fast pass” to SMEs in poor countries that are seeing diminishing returns from their traditional primary activities but have so far not been able to build a competitive manufacturing sector.

The SDGs and associated targets cover a wide range of issues, and it would be unrealistic to assume that LDCs and LICs have the capacity or inclination to pursue all of them simultaneously. One approach would be for countries to prioritise the goals according to how well they dovetail with existing socio-economic concerns and programmes at a national level. For



example, Goal 1 (“End poverty in all its forms everywhere”) should resonate well with the LDCs and LICs since poverty, if left unattended, will continue to corrode their development efforts and leave their economies floundering indefinitely. Table 1 lists all the 17 SDGs .

**Table 1: UN Sustainable Development Goals (SDGs)**

GOAL 1	End poverty in all its forms everywhere
GOAL 2	End hunger, achieve food security and improved nutrition and promote sustainable agriculture
GOAL 3	Ensure healthy lives and promote wellbeing for all at all ages
GOAL 4	Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all
GOAL 5	Achieve gender equality and empower all women and girls
GOAL 6	Ensure availability and sustainable management of water and sanitation for all
GOAL 7	Ensure access to affordable, reliable, sustainable and modern energy for all
GOAL 8	Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all
GOAL 9	Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation
GOAL 10	Reduce inequality within and among countries
GOAL 11	Make cities and human settlements inclusive, safe, resilient and sustainable
GOAL 12	Ensure sustainable consumption and production patterns
GOAL 13	Take urgent action to combat climate change and its impacts
GOAL 14	Conserve and sustainably use the oceans, seas and marine resources for sustainable development
GOAL 15	Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss
GOAL 16	Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels
GOAL 17	Strengthen the means of implementation and revitalize the global partnership for sustainable development

Source: UNCTAD (2014), UNDP (2017)

In a nutshell, the SDGs look at the world holistically—stressing how countries have a responsibility to champion and facilitate economic progress, but in socially and environmentally responsible ways. Achieving harmony between economic, social, and environmental imperatives is a daunting prospect for most countries, but a necessary outcome if the world is to carry its burgeoning population into the future.

The potential of SMEs in the LDCs and LICs to contribute to the realisation of each of the 17 SDGs

is analysed below in relation to 12 key service sectors. Clearly, the SME services sector could change the nature of the development game in LDCs and LICs, particularly as it addresses many of the challenges highlighted in the SDGs.

Given the right policy environment and practical support, SMEs could unleash new and innovative ways of tackling the cycle of underutilised or misdirected human talent, grinding poverty, and disillusionment. Yet many obstacles still stand in the way. These are explored in the next section.

Table 2: Potential contribution of SME service providers in 12 service sectors to the SDGs

<b>1. EDUCATION</b>
<b>Ways in which SME service providers could contribute to the education sector</b>
<p>For an education institution to deliver quality results, its management and teaching staff need to be well educated themselves, with clear insights into the existing capabilities, and knowledge and skills requirements, of their target market. Many of the LDCs and LICs have weak education systems (from primary up to tertiary level), which are chronically under-resourced and out of touch with economic and commercial realities. Even if generous funding were to be found, it could take years to turn a lacklustre education sector around (Epstein and Yuthas 2012).</p> <p>A potential solution lies in LDCs and LICs forming education partnerships with foreign institutions for the delivery of better quality and more relevant programmes using face-to-face delivery and/or online tuition methods. Opportunities for SMEs could lie in their becoming agents/franchisees of the foreign institutions, and/or acting as tuition centres. In this way, SMEs would not have to carry the financial burden of establishing new, or rehabilitating existing, education facilities. Also, being “on the ground,” they could be a valuable source of market and competitive intelligence (Humphrey 2003). Such international-local partnerships could deliver results more quickly than if a purely local education strategy was being pursued. Furthermore, it would be a good way to provide more employment opportunities for women, who have been traditionally drawn to education.</p>
<b>SDGs that would benefit in particular from SMEs’ involvement in the education sector</b>
1, 2, 4, 5, 8, 9, 10, 11, 16, 17
<b>2. HEALTHCARE</b>
<b>Ways in which SME service providers could contribute to the healthcare sector</b>
<p>Countries’ healthcare sectors are typically managed by government and large corporate entities, since significant investment is involved in building and maintaining medical facilities and creating an environment that will attract qualified professionals. Unfortunately, in many LDCs and LICs, the public healthcare sector is in disarray due to a shortage of funds and poor management, giving rise to often dire working conditions that are extremely off-putting to high-calibre medical professionals (O’Donnell, 2007). The quality of private healthcare is invariably better but often very limited in scope and still at the mercy of an erratic power supply, equipment shortages, and ICT hurdles.</p> <p>SMEs are well-placed to play a meaningful role in the healthcare sector in several less-developed countries by providing services to state or private institutions on a contractual basis in the areas of, for example, computer systems design or support, accounting, training, radiography, and audiology. Such an arrangement could help to keep the medical institutions’ overheads down and their productivity levels up, and ease their overall management burden as well. The SME service providers, in turn, would be under less pressure to continuously pursue new clients as they would have regular work through their association with hospitals and clinics.</p> <p>A phenomenon observed in a number of developing countries (including LDCs/LICs) is the temporary “export” of doctors and nursing staff to other countries, given the shortage of jobs at home (O’Donnell, 2007). Provided these medical professionals do not stay away permanently and contribute to their countries’ brain drain, the foreign remittances they earn can be a vital form of support for their families. Another benefit is that working abroad can be a good learning experience for the individuals concerned, and their increased knowledge and expertise can often be put to good use once they return to their home countries.</p>



Table 2: *Continued*

<b>SDGs that would benefit in particular from SMEs' involvement in the healthcare sector</b>
1, 2, 3, 4, 5, 8, 10, 11, 16, 17
<b>3. ENERGY</b>
<b>Ways in which SME service providers could contribute to the energy sector</b>
<p>Having a reliable and progressive energy sector is one of the cornerstones of an efficient and productive society. In fact, few things are of greater concern to investors than frequent power outages, exorbitant electricity prices, and the costs to the environment of an over-reliance on “dirty” energy sources, like coal. Energy-related deficiencies such as these are all too common in the LDCs and LICs.</p> <p>The building of energy-related infrastructure is largely the responsibility of government, often in partnership with independent power producers. However, SMEs in the less-developed countries could (depending on how complex their country’s energy needs are and how accommodating the national industrial policy framework is for small businesses) act as energy consultants to larger entities, offering civil, mechanical, and chemical engineering services, as well as repairs and maintenance.</p> <p>Large energy projects in poor countries (which are typically built using foreign expertise) often underperform or fail completely because there are insufficient skills within local government-run entities to perform essential maintenance and upgrades and to plan for the future. Having a cohort of small-scale energy specialists could go a long way towards ensuring that each economic sector has enough power to function efficiently.</p>
<b>SDGs that would benefit in particular from SMEs' involvement in the energy sector</b>
1, 3, 7, 8, 9, 11, 12, 13, 16, 17
<b>4. TRANSPORT AND LOGISTICS</b>
<b>Ways in which SME service providers could contribute to the transport and logistics sector</b>
<p>The transport sector broadly refers to a country’s system of roads, railways, seaports, airports, and pipelines—and all the activities associated with their design, upkeep, and development. Transport is often paired with logistics because, in a commercial context, the former can be incomplete without the latter. For example, tangible export and import cargoes are often subject to a range of administrative, inspection, and clearance procedures before they may leave or enter a country, which can add considerably to the cost and time involved in transporting goods from their places of origin to their respective markets.</p> <p>It is often in the areas of transport and logistics that LDCs’ and LICs’ developmental shortcomings are most apparent. The result of underinvestment, skills shortages, and general mismanagement, many poor countries’ road and rail systems are in a parlous state, while their seaport and airport facilities are ill-equipped to handle the type of traffic needed to stimulate high levels of growth and attract ongoing investment. Trade-related logistics operations can be painfully slow and inefficient, adding to buyers’ and sellers’ costs (OECD &amp; WTO 2015). Airports and land border posts also strongly influence visitors’ impressions of a country as a business or leisure tourist destination. Therefore, ensuring a pleasant visitor experience should be a priority.</p> <p>Despite these problems, there are many opportunities for SMEs in the transport and logistics sector in LDCs and LICs—helped by the fact that transport and logistics are labour-intensive and often have less strenuous educational criteria than other sectors. For example, road haulage companies, consolidation and packing companies, inspection companies, and service outlets at</p>

Table 2: *Continued*

airports and border posts are well-suited to the SME community. At a more specialised level, ongoing advances in the ICT sector are creating opportunities for suitably experienced service providers to design and oversee the implementation of computerised freight management systems aimed at controlling the passage of freight internationally. While providing employment opportunities across the gender and age spectrums, the transport and logistics sector also contributes to a country's competitiveness, trade performance, and positive image in the eyes of the world.
SDGs that would benefit in particular from SMEs' involvement in the transport and logistics sector
1, 2, 8, 9, 10, 11, 12
<b>5. CONSTRUCTION</b>
<b>Ways in which SME service providers could contribute to the construction sector</b>
<p>A country's economic progress and attractiveness as an investment location are heavily dependent on its construction capabilities. The government relies on the construction sector to build much of the national infrastructure, as evidenced in roads, railways, airports, seaports, water and sewerage systems, schools, hospitals, and military installations. The private sector, in turn, relies on the construction sector to build offices and factories so that businesses can engage in various commercial pursuits that will deliver local and export returns. Construction is an area that has seen quite strong growth in LDCs and LICs in recent years, although its impact has not been even across these countries. A country like Angola, for example, which has dense urban areas, has seen much building activity in the wake of surging interest in the country's oil and gas sectors. In contrast, some LDCs have not had the local sources to fulfil their construction needs as the "real cost" of construction is often underestimated, forcing these countries to import technical assistance from other countries (Lopes, Oliveira and Abreu 2011).</p> <p>The construction sector lends itself quite well to participation by SMEs which can provide construction-linked services in their capacity as surveyors, draughtsmen, builders, electricians, and plumbing specialists, as well as miscellaneous business support services (e.g. in the accounting or legal fields). A disadvantage of the construction sector from an SME point of view is that projects come and go. Therefore, unless they are attached to a few clients that give them regular work, these businesses could periodically encounter lean times. While there would be opportunities for small, survivalist-type firms offering casual labour, the real opportunities in the construction sector appear to lie in the more highly-skilled professions of building specialists and business consultants—particularly if projects involve a strong foreign element.</p> <p>A benefit of SMEs acquiring experience and expertise in the construction sector is that such skills are often in short supply in other countries and are therefore transferable. Moreover, young people could—given the right amount of mentoring and career shaping—be trained up in various areas, thus helping to address the high youth unemployment problem that plagues many poor countries.</p>
SDGs that would benefit in particular from SMEs' involvement in the construction sector
1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 16, 17

Table 2: *Continued*

<b>6. INFORMATION AND COMMUNICATION TECHNOLOGY (ICT)</b>
<b>Ways in which SME service providers could contribute to the ICT sector</b>
<p>The quality of ICT services has become a leading determinant of a country's economic growth trajectory, since the ICT sector plays a crucial role in connecting producers and service providers with their markets, facilitating all sorts of financial transactions, and generally ensuring that businesses stay abreast of developments in their field. Using a variety of electronic and digital platforms (such as telecommunications networks and satellite systems) and tools (such as laptop computers, mobile phones, and tablets), the ICT sector is complex and continuously evolving.</p> <p>The LDCs and LICs are comparatively disadvantaged when it comes to ICT development, as the sector relies on high-level technical skills (at least at the design/implementation level), significant and ongoing financial investment, a reliable power supply, and a buoyant commercial environment that justifies the ongoing expenditure—attributes that are in short supply in poor countries. A country's telecommunications infrastructure is generally the responsibility of government because it is one of the central pillars of the economy and calls for significant investment. Where state resources are limited, though, the telecommunications sector is often neglected.</p> <p>Although trade statistics show that the ICT sector has been making a growing contribution to some of the poorer countries' services exports in recent years (notably in North and West Africa, and Asia), SMEs in the LDCs and LICs are often not very technology-savvy and therefore struggle to develop adequate market reach or business momentum (Humphrey 2003). Internet penetration among small businesses, for example, remains limited. However, there has been strong growth in the mobile phone sector and this is set to continue.</p> <p>Opportunities for SME service providers in the ICT sector in the LDCs and LICs can be found in: computer programming and systems design; computer maintenance; consulting to ICT users on the operational aspects of online banking and education services; and running call centres (on an outsourced basis) that specialise in telecommunications and other ICT-related services.</p>
<b>SDGs that would benefit in particular from SMEs' involvement in the ICT sector</b>
1, 2, 3, 4, 5, 7, 8, 9, 10, 11, 12, 13, 16, 17
<b>7. FINANCIAL SERVICES</b>
<b>Ways in which SME service providers could contribute to the financial services sector</b>
<p>The financial services sector broadly covers banking, financing, asset management, and insurance. Its importance for a country's development lies in the fact that it has tradeable products and services in its own right, but also helps to oil the economy as a whole, facilitating innumerable local and international business transactions.</p> <p>Much investment has found its way into developing countries' financial services sectors in recent years—particularly from foreign sources keen to capitalise on relatively untapped markets. In the LDCs and LICs, however, a large proportion of the population is excluded from the traditional financial services market, mainly because of prohibitive borrowing costs and bank charges, and people's geographical displacement from main centres where financial institutions are located. While microfinance institutions have made significant inroads into those segments of the market that are not served by the formal banking sector, they have mainly focused on the provision of credit. Many poor communities, though, are used to dealing in cash only (Beck and Cull 2014).</p>

Table 2: *Continued*

<p>Interestingly, the growth of the mobile telephone industry in recent years has cleared the way for the ‘unbanked’ population in several LDCs and LICs to come in from the cold and benefit from modern financial services. For example, M-Pesa (“m” stands for mobile and “pesa” means money in Swahili) is a mobile phone-based money transfer and financing service that was launched in Kenya in 2007 and has since spread to several other countries, including Tanzania and India. The service enables users to use their mobile phones to execute various transactions, to send secure text messages to other users, and to deposit money with, and withdraw money from, a network of agents in various locations. SMEs are good candidates for assuming the “agency” role (working on behalf of a specialist financial institution as principal), which would see them accepting and disbursing cash in designated outlets.</p> <p>M-Pesa, which has been praised for giving millions of people easier and more affordable access to financial services and reducing crime in largely cash-based societies, has spawned similar services in other parts of the world, including Cambodia’s WING mobile payment system which runs along very similar lines. Making it easier for the poor to access finance for business start-up or expansion purposes is an important step in stimulating entrepreneurship and fuelling growth in various economic sectors, from agriculture to retail. It also enables women, who are often marginalised from a mainstream employment perspective, to commercialise their talents and become more independent.</p>
<b>SDGs that would benefit in particular from SMEs’ involvement in the financial services sector</b>
1, 3, 4, 5, 8, 9, 10, 11, 16, 17
<b>8. BUSINESS SERVICES</b>
<b>Ways in which SME service providers could contribute to the business services sector</b>
<p>Business services refer to a wide range of professional services delivered by, for example, accountants, bookkeepers, lawyers, financial advisers, real estate agents, engineers, and many others. In the case of small business concerns, it is common to contract out various professional services to third parties (an activity known as “business process outsourcing”) with a view to keeping overheads as low as possible.</p> <p>Business services make a country more attractive from a tourist and investment point of view, which has important medium- and long-term economic consequences. As countries move up the development ladder, the need for business services inevitably grows, with more employment and entrepreneurial opportunities opening up to high-calibre, motivated professionals.</p>
<b>SDGs that would benefit in particular from SMEs’ involvement in the business services sector</b>
4, 5, 7, 8, 9, 10, 11, 12, 16, 17

Table 2: *Continued*

<b>9. ENVIRONMENTAL SERVICES</b>
<b>Ways in which SME service providers could contribute to the environmental services sector</b>
<p>Environmental services typically deal with the protection and enhancement of nature and other areas in which humans interact with their environment. Environmental services thus range from geological and forestry activities and conservation to sanitation and sewerage management and refuse disposal. Many LDCs' and LICs' desire for faster and more inclusive growth is at loggerheads with the need to preserve the environment so that it can be a sustainable and healthy source of economic opportunities into perpetuity.</p> <p>SMEs could make a direct contribution to the environmental services sector by, for example, providing specialist protection services in game (animal) or marine reserves; carrying out geological/land surveys for various interest groups; and partnering with large conservation groups in initiatives to better understand and protect endangered wildlife. They should also continuously educate their employees and suppliers in the importance of ensuring that the environment remains a robust backdrop against which economic activity can take place.</p>
<b>SDGs that would benefit in particular from SMEs' involvement in the environmental services sector</b>
2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17
<b>10. TOURISM</b>
<b>Ways in which SME service providers could contribute to the tourism sector</b>
<p>Tourism is big business all over the world, and for LDCs and LICs it can offer a much-needed lifeline in the face of limited economic alternatives. A thriving tourism sector has the potential to create employment opportunities at all socio-economic levels and across the gender and age spectrums as well. It also enables a country to showcase its natural and cultural treasures and often stirs up feelings of national pride, which can contribute to greater internal social cohesion.</p> <p>Rampant tourism, however, can have very negative consequences, as evidenced in: growing air and noise pollution in urban areas, once-pristine landscapes being scarred by new hospitality-gearred developments, coral reefs being destroyed, the natural order being disturbed by big game hunting, and so on. Clearly, just as tourism can make a positive contribution to several SDGs, it can also fly in the face of others. Therefore, checks and balances are needed to ensure that tourism remains a responsible (and renewable) source of economic growth and development.</p> <p>Several relatively basic tourism-related services lend themselves to the involvement of SMEs, e.g. running small lodges and guest houses, acting as tour operators and guides, providing shuttle services to and from airports, providing hairdressing and beauty treatments, and tailoring. When it comes to business tourism, SMEs are also well-placed to provide various forms of business support, including translation, printing, and courier services. In Maputo, Mozambique, plans are afoot to attract more business visitors to the capital, with local business associations having ambitions to develop conference centres and host business events that will rival those in neighbouring South Africa. Of course, an expanding tourism footprint, directed at the leisure or business market, boosts construction. This can create opportunities for SME builders and other service providers to the building trade.</p> <p>In the face of strong competition, SMEs keen to gain a foothold in the tourism sector in LDCs and LICs could consider forming alliances with other complementary service providers and offer a package of services, e.g. airport transfers with guest house accommodation and business support services. This could give these small concerns the competitive edge they need to withstand competition from larger rivals.</p>

Table 2: *Continued*

<b>SDGs that would benefit in particular from SMEs' involvement in the tourism sector</b>
1, 2, 3, 5, 8, 9, 10, 11, 12, 14, 15, 16, 17
<b>11. ARTS AND CULTURE</b>
<b>Ways in which SME service providers could contribute to the arts and culture sector</b>
As cities in many of the poor countries become increasingly crowded and more retail establishments—from markets to more formal establishments—spring up, the cultural foundations and identity of these countries often start to crumble (ETEC 510 contributors 2007).
Culture is inextricably linked to history, which should be on show as it allows people to understand what has influenced a country's development. The arts and culture sector has a natural link to tourism, as history, art and architecture, music and other forms of entertainment are typical draws for tourists. SMEs involved in various tourism-related pursuits could expand their repertoire to include cultural offerings through appropriate partnerships. A stronger focus on culture—aimed at local as well as foreign visitors—could spawn many new production and sales opportunities as well.
With the right mentoring and financial backing, the development of musical talent has particular potential in Africa, which has already produced some world-renowned artists, as African music has a mixed heritage and appeals to a broad cross-section of people. Music is also very unifying and can help to send powerful messages about the importance of uniting against the abuse of women and children, ethnic violence, and climate change.
<b>SDGs that would benefit in particular from SMEs' involvement in the arts and culture sector</b>
1, 3, 4, 5, 8, 9, 10, 11, 12, 16, 17
<b>12. SPORTS AND RECREATION</b>
<b>Ways in which SME service providers could contribute to the sports and recreation sector</b>
Recreation and sport are critical to the wellbeing of society, enabling people to relax, socialise, and stay fit and healthy—all of which are important drivers of creativity and productivity at work too. In many LDCs and LICs, unfortunately, good recreational and sporting facilities are in short supply.
Where sporting and recreational facilities do exist (often the spin-off of a fairly well-developed tourism sector), there are a number of opportunities for SME service providers. For example, they could align themselves to hotels and resorts and offer golf, tennis, or other types of coaching as may be required by an upmarket client base. SMEs could also offer cleaning and garden maintenance services under contract to public parks, sports arenas, and show grounds. In addition, there might be scope for SMEs to get involved in event management, e.g. marketing specific sporting events, selling tickets, hiring equipment, and sorting out catering and security arrangements. It is important to try and ensure that sporting events do not simply benefit SMEs in the short term but rather that they lay a foundation for more business opportunities to take root in local communities. Giampiccoli et al. (2013) investigated some of the mega sporting events that have been staged in South Africa in recent years, including the 2010 FIFA World Cup. While many SMEs benefited from a spike in tourist numbers while the World Cup and other events were taking place, no real sustainable benefit has been noted at the regional/community level.
<b>SDGs that would benefit in particular from SMEs' involvement in the sports and recreation sector</b>
1, 3, 4, 5, 8, 10, 11, 16, 17



## 4. THE MAIN CONSTRAINTS TO THE LDCs AND LICs BEING ABLE TO DEVELOP A COMPETITIVE SME SERVICES SECTOR

All over the world, SMEs operating in the services sector are wrestling with the challenges of finding a steady customer base, ensuring that their offerings are appealing and adding value, and are generating profits on a regular basis. SMEs in LDCs and LICs, however, find it that much harder to prosper, or even survive, because they have to operate in an economic and regulatory climate that is generally not conducive to entrepreneurship and small business development.

Although each of the LDCs/LICs has its own set of needs and priorities, the following are typical stumbling blocks to the development of a competitive SME services sector.

### 4.1 Inadequate SME Focus at the Policy Level

Although SME service providers are playing an increasingly important role in poor countries' economies, they receive scant attention at the official policy level. LDC and LIC economic, trade, and investment policies tend to make little reference to the SME community, or if they do, they do not differentiate between the comparative advantages and strategic priorities of different economic sectors. Where policy documents do acknowledge the importance of SMEs in services sector development, it is usually only in passing. As a result, many SME service providers find themselves in limbo, as no one really wants to assume responsibility for the sector's growth and development.

Consequently, practical initiatives and action plans are slow to take shape (UNCTAD 1995, Beck et al. 2005).

A glaring omission in many countries' policy documents is how SME service providers could be contributing meaningfully to regional and global value chains, thereby assisting their countries' export and development efforts. With value chains comprising interlocking product and service components, SMEs albeit

with limited capacity should be well-placed to contribute one or a few of the links in the chain. However, all too often, they are ill-equipped to supply to the extent and to the standard expected of value chain participants. Many governments of less-developed countries also have mixed feelings about multinationals which dominate value chain structures and frequently establish operations in these countries to take advantage of available resources and low labour costs when producing for export. While they bring capital, new technologies, and job opportunities, multinationals are also perceived as a threat to local industry.

As a largely neglected group from a policy standpoint, SME service providers often end up, by default, having to adhere to the same rules and regulations as those that apply to larger firms—the latter, though, being able to meet their compliance obligations more easily because of their more ample resources and capacity.

Where a clear enough distinction is not made at the official level between large service providers and SME service providers, the latter often find standard business processes to be extremely onerous—from registering a business and securing a business licence to obtaining permission to operate from particular premises, registering for tax, or applying for export-related financial assistance. In East Africa, countries like Kenya, Rwanda, and Tanzania have been making a concerted effort to streamline the regulatory environment so as to fast-track business registration and licensing processes and to facilitate easier access to finance. Yet SMEs in these countries still struggle to become competitive in the face of high taxation rates, a plethora of financial reporting requirements, and a great deal of bureaucracy. Difficult and costly compliance requirements can sound the death knell for a potentially vibrant SME services sector. The emphasis in the policy environment should be on SME support, rather than on control.

A contributing factor to the SME services sector being accorded inadequate attention at policy level is that in LDCs and LICs, most SME service providers are unregistered micro businesses operating informally. They are therefore “under the radar” in an economic sense, and difficult to track and form a coherent opinion about. If indeed government assistance packages are available for small businesses, these micro enterprises might not meet the criteria, which would almost certainly start with the requirement to be formally registered as a business.

Furthermore, small and largely voiceless SME service providers are no match for large firms, from transport companies to hotel groups, which can lobby government for the introduction of various operating standards and/or concessions. If these have anti-competition motives, SMEs would be at a disadvantage.

In cases where LDC and LIC governments do turn their attention to SME service providers, they tend to design their interventions around the needs and challenges of business start-ups. However, there are also larger and more established SMEs, which are growth-orientated, that would benefit from a more conducive policy environment and government support programmes (such as financial assistance/grants and subsidised training and mentoring). These larger entities are already proving their capabilities and making a tangible contribution via taxation and job creation.

The expansion of the micro enterprise sector has important socio-economic implications but the real drivers of growth are the larger SMEs, or at least those with greater technological capacity, as these are in a better position to get involved in exporting and to participate in regional and global value chains. These larger SMEs tend to be more competitive, have more skilled labour and proactive owners/managers who recognise the potential benefits of international engagement (ADB 2015.)

## 4.2 Lack of Access to Finance

An inability to grow their businesses due to a lack of finance is high up on many SME service providers’ list of challenges. It is a particular problem for SMEs that are too big to qualify for microfinance facilities but too small to interest mainstream commercial lenders (ADB 2015).

Some studies have shown that firms that are able to access external sources of finance have better prospects of growing a sustainable business than those relying on personal savings. This is because with an external financier, the funding put forward might be greater than that which can be amassed from personal reserves, thereby giving a stronger kick-start to the business. The pressure to make regular repayments could also give the business added momentum.

However, the high cost of borrowing and other eligibility barriers prevent many small businesses in the LDCs and LICs from accessing regular commercial capital and finance. In Africa, for example, where many countries’ financial sectors are underdeveloped, personal savings are by far the main funding source for SMEs. Some governments also offer financial assistance to eligible SMEs in the form of low-interest loans or matching grants for designated activities.

However, an East African innovation like the M-Pesa mobile money transfer system, which is gaining traction in the region and elsewhere (see Table 2 Section 7), demonstrates that there are some entrepreneurial alternatives being rolled out to counter the more staid offerings that are better suited to sophisticated regulatory environments. Merchant Capital, a fairly young South African financial institution, is making serious inroads into the local SME market by using an ingenious business model that extends finance to small businesses without insisting on the usual collateral or regular monthly repayments. Instead, repayments on the loan



amount advanced are collected as automatic deductions (on a certain percentage basis) from point-of-sale machines when business is transacted. This means that repayments are tied to the ebbs and flows of the business, thus helping to protect SMEs from bankruptcy during difficult times. Thousands of small businesses in South Africa (from restaurants to hair salons and gentlemen's outfitters) have already benefited from the Merchant Capital model, which could conceivably be extended to LDCs and LICs in other parts of Africa where the financial services sector has the technology to support it.

### 4.3 Limited Domestic Market

A common feature of LDCs and LICs is the small size of the domestic market. This could be due to the country's physical size (e.g. the Pacific Island LDCs); the fact that much of the population is poor, with limited buying power; and/or the fact that a few large entities dominate in key economic sectors, making it difficult for smaller businesses to make inroads into these sectors.

A limited domestic market does not augur well for SME service providers being able to expand into exports—unless the export market comes to them (in the form of, say, visiting foreign tourists) and they have a niche offering, such as a spa facility, a “tuk-tuk” transport service that can evade some of the traffic snarl-ups in congested cities, or an on-location tailoring service at an upmarket hotel. Alternatively, SMEs could consider clustering with other services exporters, which would expand their offerings and contribute to greater cost efficiencies.

### 4.4 Low Education and Skills Levels

Education forms the bedrock of any society and is a key determinant of how well a country fares socially, economically, and environmentally. The education standards of the LDCs and LICs are among the lowest in the world, and this translates into serious skills deficiencies across most service sectors (Beck et al. 2005). Apart from shortcomings in maths

and science education at the secondary school level, many tertiary level curricula are too theoretical or academic, and are out of step with other developing or emerging economies' strategies to develop people's vocational skills and promote a culture of entrepreneurship.

The causes of LDCs' and LICs' education and skills deficiencies are complex and deeply entrenched and are indicative of years of neglect. As a result, SMEs are at a natural disadvantage vis-à-vis their counterparts in more developed parts of the world. Another worrying trend is that women are frequently disadvantaged in the labour market because they have not been afforded the same education and skills development opportunities as men.

The labour-intensive nature of much services sector work creates openings for people with limited education and skills, yet it can also be SMEs' Achilles' heel. This is because it makes it more difficult for services to be performed according to global industry standards, which often demand a high-level skill set and a fair degree of technological awareness. Meeting the professional standards demanded by large (e.g. multinational) firms operating in the local market or in export markets can be very difficult for SMEs, as these standards generally have a strong educational dimension as well as require demonstrable business expertise. It is also difficult for small businesses to market their services efficiently to a designated target market and grow their customer base if they do not have access to technology-powered communication channels.

The generally poor education standards and the limited training opportunities in the LDCs and LICs have left many SME service providers ill-equipped to manage and grow their businesses efficiently. This is evident in the difficulties many SMEs face in formulating viable business plans, securing funding, attending to corporate governance requirements, managing cash flow, nurturing the talents of their employees, and embarking on quality improvement or expansion plans. The more informal an SME service provider's operation, the more difficult it will be to compete, grow, and become sustainable,

since many of the critical foundation stones are not in place.

#### 4.5 Insufficient Networking Activity

Throughout the world, business networks and clusters have been found to contribute to SMEs' success and continuity. For example, networking with other business entities and establishing clusters for the purposes of joint marketing or training to leverage other people's knowledge and experience can ultimately lead to cost savings. This can be very valuable when there is limited formal assistance available from the state or other sources.

#### 4.6 Lack of Economic Opportunities for Women

Many of the disadvantages that SMEs face that have already been spoken about (e.g. lack of access to finance, low education and skills levels, a policy landscape that does not understand or support small business activity) are felt more acutely by women because of entrenched biases about their role in society and their often conflicting responsibilities as caregivers, defenders of family values, and economic participants. As a result, women's true economic potential is often suppressed.

It is an unfortunate reality that women are frequently discriminated against in the workplace, from being paid less than men for comparable work, to being denied various job opportunities due to, for example, their inferior education, having no 'connections' in certain industries or firms, or simply chauvinistic attitudes. Women in poor countries are often relegated to low-skilled work (with correspondingly low status and pay) in sectors such as healthcare, education, and tourism. As a result, there is a general shortage of female professionals, such as accountants, doctors, and business managers, with few rising through the ranks to positions of authority. Keeping women out of the mainstream of the economy (both as producers and consumers) constitutes a waste of valuable human resources and economic opportunity.

Former US President Barack Obama recently remarked that there is a strong link between a country's level of development and the educational opportunities enjoyed by its female population (Obama, 2015). Similarly, Islam and Amin (2015) point to a strong relationship between educational enrolment and the likelihood of women heading up and capitalising on the potential of SMEs.

#### 4.7 Infrastructural and Institutional Weaknesses in the External Environment

All companies are at the mercy of the external environment in which they operate. For example, the state of a country's transport infrastructure, the quality of its telecommunications services, and the reliability of the electricity supply all have a significant bearing on businesses' operational efficiency. Companies are further affected by less tangible economic forces like the exchange rate, the inflation rate, interest rates, fuel prices, and so on. One could say that all these factors reflect how skilfully a country is able to tackle its home-bred and internationally-imposed challenges, and also its institutional capacity.

LDCs and LICs are generally known to suffer from severe infrastructural and institutional weaknesses. This is a particular hardship for SME service providers because they already have the odds stacked against them in so many ways. Registering a business, for example, should be a relatively simple transaction, and it certainly is in more developed parts of the world. In an LDC or LIC, though, it could end up being a very protracted and frustrating exercise.

Poor infrastructure and inefficient institutions can also wreak havoc on SME service providers' regular, day-to-day operations. For example, congested and unmaintained roads (which increase travelling time between service providers and their clients), unreliable and often expensive electricity and telecommunications services, opaque

or contradictory legislation, and excessive red tape can have dire consequences for productivity and competitiveness. Given SMEs' limited resources, those individuals who should be actively running the business and serving the customer base often find themselves shouldering a heavy bureaucratic burden.

#### **4.8 Corruption**

Corruption in its many forms is a serious scourge throughout the world, but it is more in evidence in poor countries where there is economic hardship and therefore more opportunity to tempt and be tempted.

Corruption is completely incompatible with competitiveness, which rewards businesses for their efficiency and responsiveness to market needs rather than their links to well-connected individuals or their skill in elevating their interests above those of others through bribery and other devious means. To build truly competitive SME services sectors in the LDCs and LICs, a culture of clean business practices must be nurtured—in both the public and private sectors. This will help to ensure that financial and other resources will be allocated efficiently and fairly, and that the few will not end up benefiting at the expense of the majority.

## 5. POLICY OPTIONS TO HELP STEER THE DEVELOPMENT OF A COMPETITIVE SME SERVICES SECTOR IN THE LDCs AND LICs

The intangible nature of services and the informality of much of the SME sector in LDCs and LICs have created a situation in which neither services nor SMEs are adequately catered for at the policy level. Even where SME service providers are given some policy attention, plans and initiatives often fail to get off the drawing board because of weak institutional capacity and the general difficulty of engaging with disconnected SME communities.

### 5.1 Policies Aimed at Assisting the SME Services Sector to Grasp Opportunities and Manage Threats both Locally and Internationally

The relative responsiveness of the external environment to SMEs' needs is heavily linked to a country's policy and regulatory framework. An underperforming SME sector often signals policy and regulatory deficiencies. However, the possibility of internal management and operational shortcomings should not be overlooked. If a country is serious about building a strong SME sector, it needs to formulate policies and accompanying strategies and interventions that skilfully address issues both external and internal issues to SMEs.

#### 5.1.1 *The SME services sector needs more focused attention at the policy level*

An important step in creating a more accommodating environment for SME service providers in the LDCs and LICs will be to devise policies that will enable SMEs to manage the many opportunities and challenges presented by the external environment. Without receiving greater attention at the policy level, many micro enterprises operating in the services sector will continue to struggle to make the transition from a survivalist-type operation to one with growth prospects, while the more viable SMEs will remain in the shadows of large competitors and their intrinsic growth potential will be stunted.

In the developing countries, industrial policy tends to take centre stage and absorb much of the government's attention and development expenditure. However, a comprehensive services policy should sit at the same level as a country's industrial policy, with the synergies between the two helping to inform the content of each one. Having an integrated view of the scope and potential of both the industrial and services sectors can be especially useful when regional and global value chain strategies are being formulated.

There are, however, encouraging signs coming out of some of the LDCs/LICs. For example, Cambodia makes a detailed case in its *National Strategic Development Plan 2014-2018* for advancing the interests of SMEs, emphasising the need to strengthen institutional capacity and forge stronger partnerships with the private sector. In addition, Myanmar's Ministry of Industry established an SME development centre in 2013 to give SMEs business advice and practical assistance (Abe and Dutta 2014). Bangladesh, in turn, has established a new organisation called the SME Foundation to attract multi-institutional support that will boost the country's SME sector (Bakht 2015). The efficacy of these initiatives will be tested as time goes by. There is much wisdom in ensuring that SME services-related policies and strategies are aligned to a country's national development imperatives and objectives, which hopefully also make specific reference to its commitments under the SDGs.

#### 5.1.2 *Policies need to hit the right notes among different types of SME service providers*

SME service providers differ by size, sector, location, and even stage in their life cycle. Thus, a one-size-fits-all approach to policy formulation will not work. Rather, the right type of attention needs to be given to different categories of SMEs according to their

particular attributes, e.g. labour-intensive or capital-intensive, formal or informal, start-up or more experienced, young or older staff, predominantly female or predominantly male, and domestically focused or internationally active.

Although many SMEs in different service sectors will be clamouring for support from government, it might be prudent to prioritise certain sectors according to how likely they are to produce positive spill-over effects. For example, if a country has a strong transport network, visitor-friendly visa policy, plenty of natural attractions, and a solid healthcare system, it might be well-placed to build a competitive “medical tourism” sector. South Africa, for example, actively markets “medical safaris,” which entail foreign visitors undergoing some medical or cosmetic procedure in the country and then going on to a game reserve to recuperate (IMTJ 2009).

#### *5.1.3 Policies should take SME service providers’ size and capacity limitations into account*

Over and above the general need for streamlined interactions with government departments, SME service providers could benefit from special treatment in certain areas, e.g. tax holidays for a period after business start-up, lower fees for business registration or licensing, simpler auditing requirements, and a dedicated SME desk at the country’s internal revenue department to handle various tax-related queries and process tax clearance certificates.

Some professions, such as accounting, higher education, and healthcare, require service providers to be formally accredited with government quality assurance bodies or professional councils. As this can be an onerous and expensive exercise in developing countries—and a deterrent for many small enterprises taking steps to become formal business entities—it would make sense to simplify the process and introduce a concessional fee structure. This could help to open the floodgates to the professionalisation of many small businesses in the LDCs and LICs, which would otherwise prefer to remain under the radar. Such government

quality assurance bodies or professional councils should ideally play a developmental role as well, offering SMEs advice and assistance to enable them to advance in their particular fields. Of course, the provision of developmental assistance requires strong capacity on the part of the quality assurance bodies and professional councils.

#### *5.1.4 Trade and investment policy should consider the growth potential and contribution of the SME services sector*

LDCs’ and LICs’ trade and investment policies largely centre on tangible products as these dominate the export mix—although this is a problem not confined to the LDCs and LICs. As services do not call for tariff schedules, clearance procedures, or easily measurable quality standards, they become difficult to incorporate in a trade or investment policy.

A key consideration in LDCs’ and LICs’ trade policies, for example, is how liberal services trade should be. On the one hand, liberalising the trade in services clears the way for more incoming foreign direct investment in sectors such as financial services or ICT (which has the advantage of enhancing internet connectivity across the economy as a whole). This in turn creates opportunities for SMEs to supply services to these foreign entities, including local subsidiaries thereof, and become participants in established value chain networks. Even manufacturing-gearred value chains have a strong service dimension and should be given the necessary consideration at the policy level. The idea is that SMEs—as they become more integrated regionally or globally—should aim to advance to more productive stages of the value chain, which will have a snowball effect on their growth and development.

However, large multinationals (typically the driving force behind regional and global value chains) are often not inclined to source from small, local suppliers. There might be a need for government incentives, ranging from encouraging large firms to procure from local SMEs to building SMEs’ capacity and willingness to supply to large firms. To take advantage of



the economic opportunities associated with regional value chains, LDC and LIC governments could also ensure that regional trade and investment policies concerning services are harmonised. These might make provision for intra-regional recognition of educational and industry standards, compatible rules regarding the hiring of foreign workers, the protection of intellectual property rights, and so on.

On the other hand, regulating the trade in services can be an important policy tool as it helps to contain foreign competition and afford local service providers some protective space in which to grow. It also ensures the quality of incoming services (provided by hotel groups, building contractors, and educational institutions, among others) and reduces the risk of environmental degradation resulting from excessive levels of commercial development.

The little country of Bhutan, for example, is extremely conservation conscious, with more than half its land area designated as national parks, nature reserves, and biological corridors. Bhutan also has an entrenched “low impact-high value” tourism policy which, among other things, limits tourist numbers in certain areas. Interestingly, this respect for the environment has much to do with Bhutan’s metaphysical heritage. For example, spiritual qualities are ascribed to animals, while forests are considered to be a source of spiritual health.

It is perhaps understandable that some of the LDCs and LICs are alarmed by the financial muscle of large, international service providers and want to erect barriers to protect their own industries. Yet this can be a short-sighted strategy which ignores the more deep-rooted problem of a lack of local skills and capacity. International service providers like hotel groups, banks, health clinics, and many other entities can bring expertise, technology, employment opportunities, and, importantly, capital (ADB 2015). The challenge is for LDCs and LICs to devise services trade and investment policies and strategies that also stimulate the growth and professional development of local SME service providers. As managing an economy is

enormously complex, it can happen that well-meaning policies devised by certain government departments clash with policies and regulations introduced by other departments. For example, policies designed to support the growth of the tourism sector might be seriously out of sync with visa and work permit regulations.

Evidence from around the world suggests that SMEs are often in a better position than larger firms to respond to economic opportunities timeously and to provide work for people with widely varying education and skills levels. Yet this capability rarely comes naturally. SMEs need a highly supportive external environment and an ongoing strategy of building internal business competencies. Unfortunately, the failure rate among SMEs, both in developed and developing countries, is very high (Humphrey, 2003). This points to general difficulties experienced by businesses in getting off the starting blocks and staying in the race amid competitive pressures and other obstacles.

According to an OECD/WTO report (2015), the most serious problems faced by developing country SMEs in attempting to trade internationally are a lack of information (about regulations, standards, opportunities in foreign markets, and so on) and actual procedural obstacles. These add significantly to the cost of trade. Where capacity and trade promotion facilities at a local level have been lacking, the global Aid for Trade programme has often been utilised effectively by trade support institutions in developing countries. Designed to help firms overcome constraints such as policy uncertainty and infrastructural weaknesses, as well as a lack of technical knowledge or business acumen, Aid for Trade initiatives have been rolled out in many poor countries with the specific purpose of building knowledge and capacity among SMEs, and of correcting gender imbalances (ITC 2014). Of course, the medium- to long-term objective should be to invigorate the economies of the LDCs and LICs, thereby reducing their dependence on foreign development assistance and special trade treatment, and making them more attractive as investment prospects and trading partners.

Given the long history of troubled WTO trade talks, plurilateral trade negotiations have been growing in popularity. Two products of such negotiations are the (still-to-be-adopted) Trans-Pacific Partnership (TPP) between the United States, Canada, and 10 other countries bordering the Pacific Ocean and the Transatlantic Trade and Investment Partnership (TTIP) between the European Union and the United States. The economic significance of these agreements places them both in the category of “mega-regionals.” Although in principle they present opportunities for non-member countries to take advantage of increasing value chain opportunities, these groupings are also likely to have a significant trade diversionary effect, which could catch many countries on the back foot. The governments of the LDCs and LICs would be advised to proactively determine how best to promote and position their SME service sectors both in the surrounding region and further afield.

## 5.2 Policies Aimed at Building Strong Infrastructure and Public Institutions

If the SME services sector in the LDCs and LICs is to have any hope of becoming competitive and an economic force to be reckoned with, a country’s infrastructure and public institutions need to be fit for purpose. This will allow the country to diversify into other areas if a leading sector such as mining is hit by a global slump in commodity prices.

### 5.2.1 Strong infrastructure and institutions should be the cornerstones of the economy

In an infrastructural context, the transport system should make it easy for producers and service providers to visit their clients; the telecommunications/ICT sector should allow quick and affordable voice communication, internet access, and online transactions; electricity should be affordable and reliable; and municipal water should be of a consistently high quality. Government institutions, in turn, should be staffed with people with the right skills and attitudes and have sufficient funds to be able to carry out their respective mandates—

from running the country’s public education and health systems to providing national postal and broadcasting services.

SME service providers are no different from larger businesses in their need for well-functioning infrastructure and public institutions, as these constitute the cornerstones of a growth- and export-orientated society. Where government does not deliver on the infrastructural and institutional fronts, SMEs feel the impact more harshly, however (Hadjimanolis 1999).

The infrastructural and institutional weaknesses that are characteristic of poor countries are not always attributable to a policy vacuum. Indeed, countries often have an impressive array of policy and strategy documents, covering a wide range of economic areas and concerns. The problem lies in the implementation of such policies or strategies. In some cases, policies are not thought through and/or do not receive the blessing of all affected parties and are therefore met with resistance. In other cases, policies are not translated into coherent strategies and regulations and simply cause confusion at the operational level.

The question is, then, how should LDCs and LICs tackle these fundamental weaknesses, which are so obvious but remain so deeply entrenched?

### 5.2.2 More private sector involvement can aid policy formulation and implementation

Because of the huge expense involved in building and maintaining a country’s national infrastructure, funding for the latter usually comes from government. Furthermore, government tends to keep a firm grip on service sectors like energy and telecommunications because they are in the national interest and affect the population as a whole. However, greater involvement from the private sector at both the strategic and operational levels could do much to alleviate the inefficiencies of many state-run institutions (ADB 2015).

In many developing countries, the government and private sector are not natural allies, as the

government favours control and regulation, while the private sector abhors red tape but wants to be part of the consultative process. The private sector can bring its business and management expertise to partnerships with government, which might help to transform sluggish procedures and attitudes. In addition, opening up the field to private ownership in, say, the telecommunications or energy fields could encourage higher quality offerings and more competitive pricing. A country like Botswana, for example, has some of the highest telecommunications charges in Africa. However, with the recent partial privatisation of the telecommunications sector in that country, prices may fall in the face of greater competition.

#### *5.2.3 Accountability helps to drive performance and results*

Few strategies and plans will deliver their hoped-for results unless there is clarity as to who is accountable for which outcomes. Accountability (to shareholders) is one of the central pillars of private business operations and a key measure of individual performance. Government is ultimately accountable to the electorate but ministries and departments often have complex reporting channels, with the result that accountability lines become blurred. In addition, the long-term nature of many public sector initiatives (e.g. the rollout of an economic growth strategy or integrated transport plan with a 20-year time horizon) serves only to complicate the matter of accountability.

#### *5.2.4 There is no place for corruption*

It is often at the national infrastructure level—where government commits billions of dollars to transport, energy, water, and other projects—that corruption puts down its deepest roots. The high incidence of corruption in poor countries helps to explain how large sums of money can be provided by donors, development agencies, and private investors but there is sometimes little to show for it at the end of the day (UNODC 2011). Greater transparency in financial reporting, tighter accountability, and ethical leadership in both the public and private sectors are essential for reversing this trend.

### **5.3 Policies Aimed at Building Internal Skills and Capacity among SME Service Providers**

Even if the external environment is accommodating towards small business, many SMEs are unable to sustain themselves or grow because their skills are not particularly marketable and/or they have difficulty taking competitive service offerings to the market.

#### *5.3.1 Capacity building should augment skills training*

While skills training is a fairly clear-cut, narrowly-focused activity, capacity building is multi-faceted, covering coaching/mentoring, sourcing fresh talent, introducing new technologies, improving work methods, expanding the scope of the operation, and so on—all with a view to delivering value to the market. For small companies, however, day-to-day management and operations tend to be all-consuming. A key message in this is that regulatory compliance requirements need to be kept as simple as possible for SMEs so that they can allocate their limited time and resources efficiently.

#### *5.3.2 Government can play a supportive role in capacity building*

Capacity building is generally the responsibility of individual business concerns. However, if capacity-building assistance is available from the government and/or its development partners (such as the WTO and other organisations spearheading Aid for Trade initiatives), the interventions in question would need to be structured in ways that minimised people's time away from work.

In the face of limited financial and human resources and an inability to benefit from efficiency-enhancing economies of scale, some SMEs have adopted a “clustering” strategy. This involves several small businesses pooling their knowledge, workforces, and/or service outputs, and entering into collective marketing arrangements that have greater visibility and clout in the eyes of potential customers. From a government policy perspective, clustering



activities could be incentivised if they were shown to lead to job creation, particularly among marginalised groups such as women and young people.

#### **5.4 Concluding Remarks**

The development of the SME services sector has a crucial role to play in driving economic and job growth in LDCs and LICs, and needs to come out of the shadows at the policy level. Clearly, a competitive SME services sector can only be achieved if there is cooperation

between government, the SME community itself, and myriad other economic stakeholders in the LDCs and LICs.

In a nutshell, the policy imperative of government as far as the SME services sector is concerned is not just to create jobs; it is to encourage the establishment of businesses that have the capacity to employ people and become sustainable. This involves providing a supportive environment in which the costs of doing business are kept low and innovation is allowed to flourish.

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## APPENDIX A: LIST OF LDCA AND LIC

### Africa (34 Ldcs)

	UN classification	World Bank classification
<b>EAST AND SOUTHERN AFRICA</b>		
Angola	Least developed	Upper middle income
Burundi	Least developed	Low income
Comoros	Least developed	Low income
Democratic Republic of Congo	Least developed	Low income
Lesotho	Least developed	Lower middle income
Madagascar	Least developed	Low income
Malawi	Least developed	Low income
Mozambique	Least developed	Low income
Rwanda	Least developed	Low income
Tanzania	Least developed	Low income
Uganda	Least developed	Low income
Zambia	Least developed	Lower middle income
Zimbabwe	Least developed	Low income
<b>WEST, NORTH, AND CENTRAL AFRICA</b>		
Benin	Least developed	Low income
Burkina Faso	Least developed	Low income
Central African Republic	Least developed	Low income
Chad	Least developed	Low income
Djibouti	Least developed	Lower middle income
Equatorial Guinea	Least developed	High income
Eritrea	Least developed	Low income
Ethiopia	Least developed	Low income
Gambia	Least developed	Low income
Guinea	Least developed	Low income
Guinea-Bissau	Least developed	Low income
Liberia	Least developed	Low income
Mali	Least developed	Low income
Mauritania	Least developed	Lower middle income
Niger	Least developed	Low income
Sao Tome and Principe	Least developed	Lower middle income
Senegal	Least developed	Lower middle income
Sierra Leone	Least developed	Low income
Somalia	Least developed	Low income
South Sudan	Least developed	Low income
Togo	Least developed	Low income



**Asia (9 LDCs)**

	UN classification	World Bank classification
Afghanistan	Least developed	Low income
Bangladesh	Least developed	Lower middle income
Bhutan	Least developed	Lower middle income
Cambodia	Least developed	Low income
Laos	Least developed	Lower middle income
Myanmar	Least developed	Lower middle income
Nepal	Least developed	Low income
Timor-Leste	Least developed	Lower middle income
Yemen	Least developed	Lower middle income

**Caribbean (1 LDC)**

	UN classification	World Bank classification
Haiti	Least developed	Low income

**Pacific (4 LDCs)**

	UN classification	World Bank classification
Kiribati	Least developed	Lower middle income
Solomon Islands	Least developed	Lower middle income
Tuvalu	Least developed	Upper middle income
Vanuatu	Least developed	Lower middle income

Source: UN (undated)

Other recent publications from ICTSD's Programme on Inclusive Economic Transformation include:

- *Inclusive and Sustainable Growth: The SDG Value Chain Nexus*. By Raphael Kaplinsky, 2016.
- *Services and Sustainable Development: A Conceptual Approach*. By ICTSD, 2016
- *Trade Policies and Sustainable Development in the Context of Global Value Chains*. By ICTSD, 2016.
- *The Gender Dimensions of Services*. By Julia Lipowiecka and Tabitha Kiriti Nganga, 2016.
- *African Integration: Facing up to Emerging Challenges*. By ICTSD, 2016.

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