

Executive Summary

This essay seeks to identify areas that should be addressed through policy interventions that help to improve the global competitiveness of small and medium enterprises (SMEs). Some aspects existing policy framework in Latin America and the Caribbean will be explored, with addition focus on Trinidad and Tobago. Weaknesses in the current macroeconomic environment will be identified, especially barriers that limit firm productivity. Additionally, the present and future implications of the global coronavirus pandemic are considered.

If governments and policy making bodies desire to improve the global competitiveness of the region and prevent a worsening of inequality for their constituents, policy decisions must be made with sustainability and future growth in mind. Consequently, policy recommendations will be made to improve the overall business environment enabling firms, particularly SMEs maximise their productive potential. These recommendations will be accompanied by areas of focus for governments to ensure sustainable development and the reduction of inequality.

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Background and Literature Review

SMEs are commonly referred to the 'backbone' of economies, especially in developing countries. SMEs are defined differently depending on the country or organisation, but they are commonly determined by the number of employees and/or the annual turnover of assets. The International Monetary Fund (IMF) and Organisation for Economic Co-operation and Development (OECD) define an SME as an enterprise employing less than 250 persons. The category is subdivided into micro (1-9 employees), small (10-49 employees) and medium (50-249 employees) enterprises.

These enterprises represent over 50% of employment worldwide (The World Bank, 2020), making them important for social stability. SMEs contribute to output, help fulfil social objectives, attract considerable foreign reserves into a country and are very important in providing employment (Al-Mahrouq, 2010, pp. 89-90). This is especially true for LAC, where SMEs account for over 99.5% of firms in the region and generate 60% of formal productive employment (CAF, 2019). The LAC region has been dubbed the 'most unequal' region in the world. Hence, higher quality employment and sustainable long-term economic growth are the foremost problems for regional policy makers. Improving the competitiveness of SMEs may be one of the keys to solving these problems.

First, we must dissect competitiveness. At the country level, the World Economic Forum defines it as "the set of institutions, policies and factors that determine the level of productivity of a country" (Cann, 2016). At the firm level, it is defined as the "competence of an organisation to produce and sell products/services that meet the quality of the markets at the same or lower prices and maximise returns on the resources consumed in producing them" (Maravilhas, Melo, & Oliveira, 2018).

"Productivity" is a staple in definitions of competitiveness because the level of productivity is generally an indicator of how competitive a country or firm is. Generally, more productive firms have higher levels of income and offer better quality employment. This can be expanded to the country level, where productivity leads to growth, which results in higher levels of income and ultimately improved well-being (Cann, 2016). This view ignores a fair bit of nuance, as there are many examples of countries with high productivity

and relatively high levels of high inequality. Regardless, increased productivity is the goal for both countries and firms.

Next, we must understand the factors that contribute making SMEs competitive. The importance of SMEs and their role in the growth of economies is generally agreed upon. However, academic discourse about improving the competitiveness of SMEs has largely been divided among the entrepreneurial, external, and internal factors.

Metcalfe et al (2002) assess both the entrepreneurial and internal factors of firms, arguing that competitiveness is represented in the attributes of the firm. These attributes are the current efficiency and effectiveness of the use of resources, the willingness to invest and the ability to innovate. Innovation improves the technology and the organisation ultimately boosting efficiency and effectiveness of resource use. They add that new competitive advantages are created by innovation and introduction of new productive combinations. The entrepreneurial factors influence how these productive combinations are employed.

In other research, entrepreneurial factors are highlighted as important success determinants for SMEs. The direction, vision, and leadership of an SME ultimately rests on the shoulders of those running the SMEs. The knowledge, skills, psychological traits, risk tolerance, and other traits of the entrepreneur will influence the firm's behaviour in the market. These traits also have an effect on the success of SMEs in spite of the external environment (Chong, 2012) (Ensari & Karabay, 2014) Mihajlović et al (2015).

Metcalfe et al. (2002) chose to focus on the competitive strategies and attributes of firms, but also acknowledged the wider systemic context, which was addressed in-depth by Meyer-Stamer (1995). In Meyer-Stamer's (1995) perspective, competitiveness is created at the firm level, but it also occurs as a result of various complex interactions between government, enterprises and other actors. The influences of the wider environment are not identical across countries. Hence, context is important when considering SME development strategies for specific countries.

Mihajlović et al (2015) simplified the discourse by refining the factors into two main categories. Individual characteristics and abilities of the entrepreneur and non-individual factors that affect SMEs. The non-individual factors were subdivided into internal and

external influences. Internal non-individual factors describe the operations inside the enterprise, while external non-individual factors refer to the environment and the outside influences that affect organisational performance. These external-non individual factors include political, economic, technological, environmental, and legal factors that are all beyond the firm's control.

The Mihajlović et al (2015) reinterpretation was useful, as previous research mainly addressed the groups of factors in isolation, often ignoring their correlation and their joint influence. Jahanshahi et al (2011) also addressed this topic, focusing on the relationship between government policy and the growth of entrepreneurship in micro, small and medium enterprises (MSMEs) of India. The paper showed that government policy could either be conducive or unfavourable to the development of MSMEs independent of the internal and entrepreneurial factors. Hence, policy should be directed at creating an environment as conducive as possible, especially for firms that positively demonstrate the attributes outlined by Metcalfe et al (2002).

Given the importance of government policy to the creation of an ideal external environment, we must establish universally applicable conditions for SME development and global competitiveness. These conditions can later be used to address the specific context within the LAC region. Policy documents and discussions provide good reference points for strategies that were implemented by governments and economic institutions. They also show which strategies were effective and the lessons learned over the years, allowing us to understand what can be applied across different contexts.

The 2nd OECD Conference of Ministers Responsible for SMEs (2004) established conditions that should apply to any country regardless of region and stage of development. According to the paper, governments should strive to create an attractive investment environment by ensuring peace and stability, as war and crime are viewed unfavourably by private investors, especially foreign investors (OECD, 2004). It noted that governments should also invest in physical infrastructure and business services. These investments can be further facilitated by increasing the implementation capacity of policy makers and the effectiveness of other support systems such as financial services and business development services. SMEs in general benefit from these initiatives, however,

underserved SMEs in rural and/or remote areas greatly benefit from such improvements, e.g. better access to credit or better national telecommunications infrastructure to support web-based SMEs. The OECD also discussed enhancing women's ability to participate in SME development especially as a means of poverty reduction.

Identifying these areas for improvement within the country is best facilitated by dialogue between stakeholders. Input from the public and private sector as well as civil society helps to inform the overall SME development strategy. The OECD guidelines follow Meyer-Stamer's (1995) position that the interaction of external actors affects the competitiveness of SMEs.

Hence, the OECD paper suggests that the success of the SME development strategy hinges on "the ability of governments to implement sound macroeconomic policies, the capability of stakeholders to develop conducive microeconomic business environments, and the ability of SMEs to implement competitive operating practices and business strategies" (OECD, 2004).

Interestingly, these conditions stood the test of time, as they underpinned the discussions at the OECD 2018 SME Ministerial Conference. At that conference, increasing the capacity of SMEs to innovate and to scale up were central to the discussion. The newer areas of focus were influenced by the dramatic changes in the global economy and the technological advancement that occurred since the last meeting. The OECD focused on SMEs improving participation in the global economy and competitiveness through digitalisation (the adoption of digital technologies in business processes) and improving access to appropriate financing for SMEs through alternative means such as fintech. This confirms that policy should also focus on SME capacity building at any stage of development. Jahanshahi et al (2011) also demonstrated Indian policies aimed at SME capacity building. This capacity building, in conjunction with a business-friendly macroeconomic environment allows SMEs that maximise their internal attributes (i.e. effectively and efficiently use resources) to grow and compete globally.

There are sceptics and critics of SME support policies. The primary argument is in support of the idea that large firms benefit from economies of scale and thus create higher quality and more stable jobs than SMEs. Another argument comes from the very research that

is often used to justify SMEs receiving aid. This argument presents that SMEs are objectively worse at creating jobs than large firms, meaning that governments are throwing money at inefficient firms.

To counter these views, some experts stress improving the general business environment for all sizes of firms. The same “low entry and exit barriers, well defined property rights, and effective contract enforcement that characterize a business environment that is conducive to competition have been at the centre of policy agendas in LAC” (OECD/CAF, 2019). Also presented to support the idea of SME policies is the idea of reducing inequity as SMEs account for a large share of employment especially of unskilled workers. In this view, investing in SMEs means improving the livelihoods and living conditions of those employed by SMEs.

While public policy has never been the sole determinant of SME growth or competitiveness, it is still an important contributor to the process. A competitive business environment and sound macroeconomic policies are generally observed in countries and regions where SMEs are highly productive. Therefore, in regions where glaring macroeconomic inefficiencies and/or institutional ineffectiveness are present, policy intervention is the most prudent solution.

Diagnosis: The Latin American Context

The condition of the LAC region is best expressed through an expansion of the “backbone” analogy often used to describe SMEs. The entrepreneurial and internal factors of an SME are like the spinal cord, the core of the system, which is important but vulnerable to external shocks. The external factors comprise the column of vertebrae that surrounds and protects the spinal cord. As the research has proven, these groups of factors are interdependent, much like the spinal cord and vertebral column. If the external environment fails to facilitate SME growth and development the result is injurious to the national economy and by extension the regional economy. A lack of growth in the sector which provides most of the formal employment is akin to a serious back injury for the LAC region. If the analogy is accepted and we believe the former statements to be true, then

it is safe to say that the LAC region has some serious back problems. Available data reveals the extent of the back injury.

The importance of SMEs to the LAC region is great, unfortunately, the contribution of the SME sector to regional gross domestic product (GDP) is weak. While accounting for 60% of formal productive employment in the region, SMEs only account for 25% of the total production value of LAC economies (Dini & Stumpo, 2018). This contribution pales in comparison to the contribution made by European SMEs. Between the regions, SMEs account for almost equivalent shares of employment, however, in Europe SMEs contribute twice as much to the GDP. This suggests a productivity gap between LAC and Europe, but it also highlights an obvious gap in productivity between SMEs and the larger firms in the LAC region.

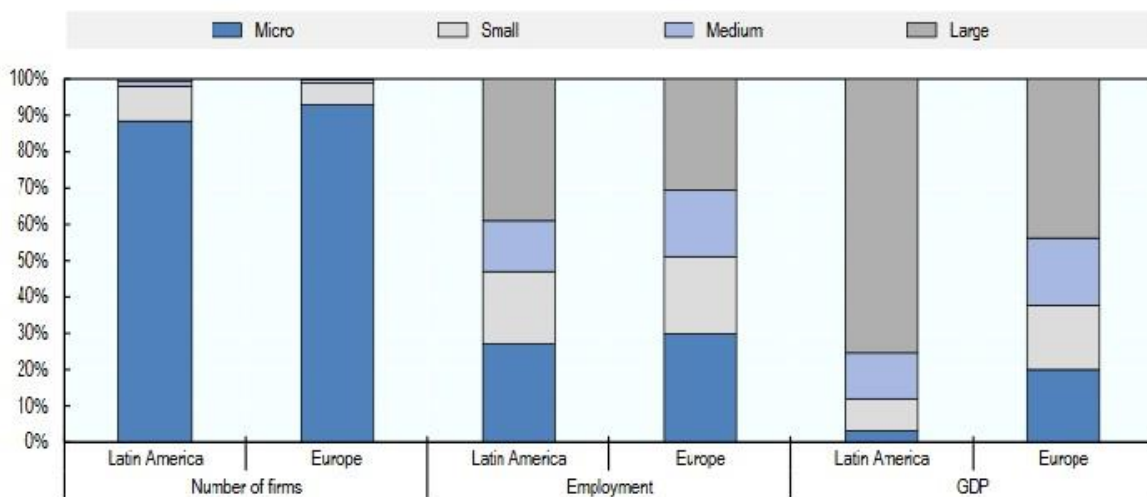
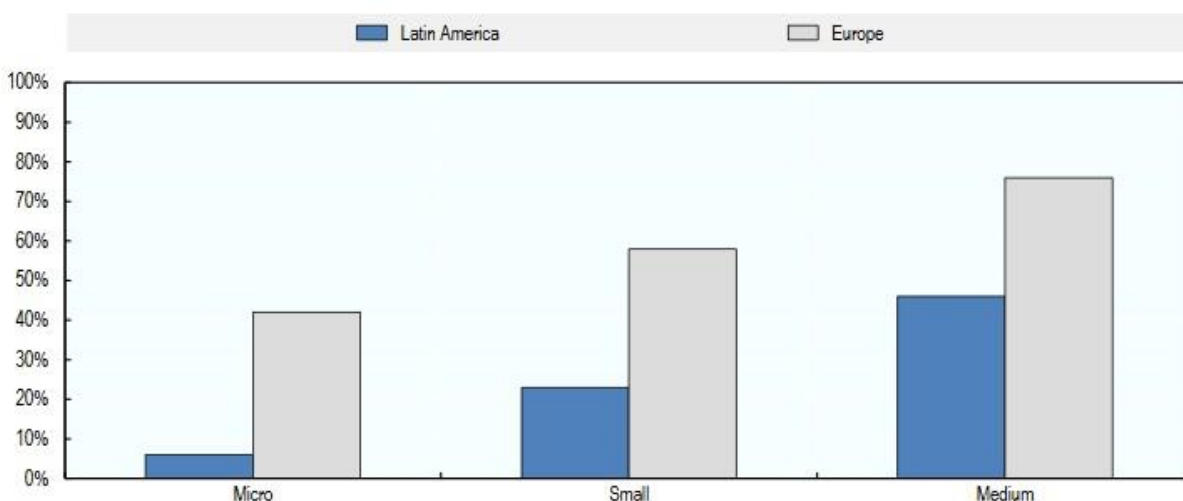


Figure 1.1. Chart showing the number of firms, share of employment, and share of gross domestic product (%) contributions by enterprise type. Latin America and the Caribbean 2019: Policies for Competitive SMEs in the Pacific Alliance and Participating South American countries, OECD and CAF Development Bank of Latin America, 24 Apr 2019 Retrieved from https://www.oecd-ilibrary.org/development/latin-america-and-the-caribbean-2019_d9e1e5f0-en Copyright 2019 by OECD and CAF Development Bank of Latin America.

An analysis of productivity within the SME sector in the LAC region reveals the primary area of injury. Microenterprises are notably underproductive, reaching only 6% of the

productivity of large firms (OECD/CAF, 2019). Small and medium enterprises are many times more productive than microenterprises, but their productivity also pales in comparison to large firms. Medium enterprises are only half as productive as large enterprises and small enterprises only managed one quarter of the productivity of large enterprises. The same positive relationship between firm size and productivity is observed in Europe. However, medium enterprises had just over 70% of the productivity of large firms, small enterprises had 60% of the productivity of large firms and micro enterprises managed about 42% of the productivity of large enterprises.



Note: Average productivity levels for micro, small and medium enterprises are expressed as a percentage of that of large enterprises, with average large enterprise productivity totalling 100%.

Figure1.2 Chart showing SME internal productivity relative to large enterprises (LAC/Europe Comparison). Latin America and the Caribbean 2019: Policies for Competitive SMEs in the Pacific Alliance and Participating South American countries, OECD and CAF Development Bank of Latin America, 24 Apr 2019 Retrieved from https://www.oecd-ilibrary.org/development/latin-america-and-the-caribbean-2019_d9e1e5f0-en Copyright 2019 by OECD and CAF Development Bank of Latin America.

It is important to note that a regional comparison excludes the unique context of each country. However, the data suggests that the current macroeconomic environment in is not conducive to SME growth. While the macroeconomic environment may not be ideal, it does not completely explain the current phenomenon. Throughout LAC, SMEs are

disproportionately operating in sectors that have low productivity and low added value (OECD/CAF, 2019). LAC SMEs are also less likely to be exporters, something that is positively associated with productivity. Their sales are heavily reliant on domestic markets, which tend to be small, especially in the case of Caribbean countries (World Bank, 2010). In LAC, SMEs dominate sectors such as agriculture and retail which are less knowledge intensive, less complex and have lower barriers to entry (ILO, 2015).

The productivity problem becomes even greater when the informal sector and self-employed are included. These groups are generally overlooked because official measures focus on the formal sector. Using available data, we can attempt to fathom the true magnitude of the productivity gap. “The typical country in Latin America produces 40% of GDP and employs 70% of the labour force informally” (Loayza, Servén, & Sugawara, 2009). Excluding the self-employed sector, the average output of an informal worker is 35% lower than their formal counterparts (Toledo, et al., 2019). Although the picture is imperfect, these statistics imply that the productivity gap is not merely an internal problem. It is problematic in relation to firms that operate in more technologically advanced societies. To make a better diagnosis, the factors that influence competitiveness must be assessed. The predominant barriers to competitiveness must also be identified.

Individual Factors

The first problem in LAC is that a large number of SME enterprises, especially microenterprises, are started by individuals who were unable to remain sustainably employed in the formal sector (ILO, 2015). This was affirmed by a 2013 CAF report which stated that 75% of microentrepreneurs in the region could be classified as “subsistence entrepreneurs” (CAF, 2013). This is because their job satisfaction and incomes are not much different from those in the informal sector.

Rampant subsistence entrepreneurship also points to the lack of skills among entrepreneurs and the wider labour market. This “skills gap” helps to partly explain the concentration of SMEs outside of technical sectors that require productive complexity (ILO, 2015). Applying the framework of Metcalfe et al (2002), we can see how that an unskilled entrepreneur is less likely to apply the resources of the firm in the most efficient

manner, thus limiting the productive capacity of the firm. They may also be less likely to innovate, which is another important factor in increasing business productivity.

This is part of a vicious cycle where the low income and productivity of SMEs attracts fewer skilled workers, and the unskilled labour contributes to lower income and productivity. Micro and small enterprises are especially unable to make the human capital investments that medium and larger firms are capable of (ILO, 2015). This is not a problem that can solely be addressed through financing or by the action of the entrepreneur.

Therefore, policy intervention would be useful in breaking cycles like these. As analogised earlier, the entrepreneurial and internal factors of the firm must be protected like a spinal cord, as they are the essence of an SME. Otherwise, the lack of skilled labour will continue to contribute to chronic back pain for LAC.

Non-individual Factors

In the World Bank's "Doing Business" rankings, the LAC average rank is 116 (World Bank, 2020). This ranking is slightly below average, suggesting that the typical business environment in the region is likely to be subpar and a bit unfavourable for SMEs. The most common problems for SMEs across regional economies are access to finance, informality and tax administration (ILO, 2015). All three of these problems are largely created by the laws and policies that are currently employed by governments across the region.

Another area of concern is SMEs' lack of integration into regional and global value chains. This is primarily due to the concentration of SMEs into low productivity sectors with poor differentiation. These are sectors that tend to also have high market concentration as larger firms can dominate due to economies of scale. SMEs best integrate as providers of specialized/made-to-order goods and services for clients or by providing intermediate goods and services for larger firms (OECD/CAF, 2019).

Value chain integration is a multifaceted problem. First it is dependent on the firm's willingness to export and compete in international markets. Then comes the competence and efficiency of the firm's operations, to ensure that it can compete globally. Last, but not least are the existing laws and policies that either facilitate or hinder international trade

by SMEs. The latter issue is very significant, as LAC has the highest cost to import and to export of any region tracked by the World Bank (World Bank, 2020). These high cost acts as barriers to SMEs who are less capable of paying them. It is also concerning for SMEs that need to import factors of production. This suggests that regional governments need better coordinate economic policies and likely reduce tariffs, especially for intra-regional trade.

Access to technology is another factor that requires attention in LAC. While access to technology extends beyond information and communication technology (ICT) infrastructure, ICT remains an urgent area of development for LAC. The International Telecommunication Union (ITU) has described digitisation as critical to the transformation of industries worldwide (ITU, 2020). Unfortunately, Latin America and the Caribbean are behind developed regions in this area as well. This is likely the most important external factor for LAC governments as robust ICT infrastructure will be fundamental in the coming 4th Industrial wave. ICT is already an essential part of daily business operations and international trade. This means that, access to ICT for SMEs is also important for participation in the present and future global economy.

Unsurprisingly, the ITU recommends government intervention in the development of the ICT sector as a means of economic development. In their 2020 Global Econometric Modelling report the ITU found that “regulatory and institutional maturity in the ICT arena make a significant difference – and are important in the growth of digitisation.” It goes without saying, therefore, that this is another urgent area for policy intervention in LAC countries.

The case of Trinidad and Tobago

The regional focus allows for a general understanding of the situation for SMEs within the region, however, it is impractical for sound policy intervention recommendations. The regional context generally conceals heterogeneity among countries.

Trinidad and Tobago (T&T) represent a curious case within LAC. Given its small population in comparison to other LAC countries and relative obscurity globally, T&T is easily lost in the regional statistics. This is not without good reason, as T&T does share

many of the typical struggles of LAC countries, especially in relation to SMEs. However, there are a few areas where T&T outperforms the LAC region and some areas where it has unique difficulties.

The Central Statistical Office records that MSMEs in T&T constitute 85% of all registered businesses in T&T and contribute an estimated 28% of GDP. Also noted is the high participation of SMEs in the manufacturing sector, making up 70% of the firms (Bar Business TT Magazine, 2019). These figures are not much different from the regional averages. The World Bank Ease of Doing Business Report is where the differences in T&T begin to appear.

The World Bank classifies the twin island republic as a high income country and ranks it at 105 globally and 12th regionally in the World Bank's "Doing Business" report (World Bank, 2020). T&T ranks 2nd in LAC (43rd globally) for getting electricity. It also ranks 3rd in the region and 57th globally for protecting minority investors. Getting credit is another area where T&T ranks well both regionally (11th) and globally (67th). The World Bank notes the range of financing options available to SMEs, beyond commercial banks which are less likely to offer loans to SMEs because they lack credit history. T&T ranked very poorly in trading across borders (134th globally), registering property (158th globally), paying taxes (160th globally) and enforcing contracts (174th globally) (World Bank, 2020).

When examined holistically, T&T has one of the better business environments in LAC, albeit with a few major flaws. The wide range of financing options and the relative ease of starting a business and getting hooked up to the power grid are all encouraging to potential entrepreneurs and businesses in their infancy stage. After the business is up and running, the problems in the economy become relevant. Just like the rest of LAC, T&T has some serious back injuries as well.

One of the primary obstacles in the T&T economy is the availability of skilled labour. Some 30% of firms expressed that this was a problem for them in the World Bank Enterprise Surveys (WBES) (World Bank, 2010). This is interesting, considering that T&T has multiple tertiary education institutions and has for a long time heavily subsidised tertiary education level. In the absence of reliable data, the reasonable assumptions would be a

high level of brain drain or a skills mismatch between the skills offered by the market and demanded by firms.

The next three biggest concerns for T&T firms in the WBES were crime and disorder (17.4%), access to finance (12.7%) and choosing the informal sector (10.6%). These statistics are in line with the main areas of focus for creating an ideal business environment outlined by the OECD (2004). Following the results of this survey, the T&T government conducted 6 public consultations between 2012 and 2013 engaging several key stakeholders to produce new policies.

Consequently, to address the issues affecting SMEs the T&T government launched the Micro and Small Enterprise (MSE) Development Policy in 2014. The policy covered many of the key areas for improving SME competitiveness. The main policy areas were Improving the business environment, increasing the capacity of and access to business development and support services, improving market networks, improving access to financing, and improving SME advocacy to better inform future policies (Ministry of Labour and Small Enterprise Development, 2014).

The precise results of these initiatives are not yet clear as no comprehensive report of the SME sector in T&T has been compiled since. To this end, it is recommended that the government conduct more frequent monitoring, evaluation, and reporting of national SME data.

COVID-19: The virus that broke the region's back

The effects of the global coronavirus pandemic were certainly felt by SMEs worldwide. Even the largest and most favourable economies for SMEs were unable to shield them from the harsh economic effects of a worldwide lockdown which resulted in reduced trade and economic activity. This situation is no different for LAC, governments must move quickly to provide stimulus for the SME sector to prevent a deepening of existing inequalities and a possible collapse of a large part of the SME sector.

The pandemic has also shown the importance of ICT infrastructure and its necessity to firms in 2020. Many companies have already transitioned to remote work. Larger firms

are already pushing more rapidly to automate their business processes. This makes technology an important investment for the present and the future.

The T&T government has already acted in response to the coronavirus pandemic and launched a SME stimulus loan facility. It is “a government guaranteed loan granted for a maximum of 5 years with a 2-year moratorium on principal payments” (Ministry of Finance, 2020).

The pandemic has made the regional priorities quite clear moving forward. Governments must take stock of the far-reaching effects of such a crisis and plan to brace the “backbone” of the economy from future shocks. While stimulus loans are useful, they are reactionary and may have unmeasured long-term effects on the economy.

Conclusion and Recommendations

If SMEs are truly considered to be the “backbone” of the LAC economy, creating the best possible environment for these firms should be a top government priority.

In this analysis major issues that highlight the need for policy intervention were highlighted, as well as areas where policies were inadequately applied. The major issues highlighted in LAC were a lack of regional and global value chain integration, a lack of skilled labour and the need for greater proliferation of ICT in the region.

The case of Trinidad shows an example within LAC of a country taking the initiative after key weaknesses were identified to address issues in the macroeconomic environment. Just like a real back injury, the issues that exist for SMEs in LAC cannot be left unaddressed for too long. Global crises such as the coronavirus have made these issues even clearer.

While the issues highlighted in this paper are by no means addressed exhaustively, this has been done in hope of casting light on important areas for improving the global competitiveness of LAC SMEs. Given the lagging state of LAC, it would be unwise for governments to sit idly by and not attempt to improve the business environment through policy.

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