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Financing SMEs in Asia and Europe

by Eleonora Poli and Maria Elena Sandalli



ASIA-EUROPE MEETING

ABSTRACT

This report summarises the proceedings of the ASEM seminar on “Financing SMEs in Asia and Europe” organised in Rome on 29-30 October 2015 by the Italian Ministry of Foreign Affairs and International Cooperation (MAECI) and Banca d'Italia, in cooperation with the Istituto Affari Internazionali (IAI). The seminar saw the participation of high-level speakers coming from both Asia and Europe. The aim of the seminar was to present and assess measures and policies to be implemented at local, national, regional and international level to assist SMEs in obtaining adequate financing in order to expand, modernise and internationalise their economic activities. In both regions SMEs constitute a large share of firms, make a fundamental contribution to job creation and are crucial engines of growth thanks to their versatile and adapting nature. At the seminar, the importance of SMEs in accelerating the economic growth was widely emphasised. Moreover, a consensus emerged on the need to reduce information asymmetries, create new channels for funding and improve international transparency and cooperation to help SMEs seize market opportunities. The conclusions of the seminar were presented at the 12th ASEM Foreign Ministers Meeting, and are expected to be reported as well at the 12th ASEM Financial Ministers Meeting and at the 11th ASEM Summit, both of which will be held in Mongolia in 2016.

Asia | European Union | ASEM | Financial services



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by Eleonora Poli and Maria Elena Sandalli*

Introduction

Launched and organised by the Italian Ministry of Foreign Affairs and International Cooperation (MAECI) and Banca d'Italia, in cooperation with the Istituto Affari Internazionali (IAI), the ASEM seminar on "Financing SMEs in Asia and Europe" gathered Ministerial-level participants, Government officials, private stakeholders, think tankers and representatives of international organisations to discuss a wide range of issues related to SMEs' access to finance in the two regions.¹

The aim of this initiative, also co-sponsored by China, Indonesia, Philippines and the EU, was to follow up on the 10th ASEM Summit held in Milan in October 2014 and, in particular, on the provisions of the ASEM 10 Chair's Statement underscoring the "pivotal role" of small and medium enterprises (SMEs) for promoting sustainable growth and employment in Asia and Europe and the importance of improving frameworks and working conditions of ASEM SMEs, including their access to credit.² Access to third country markets is crucial to reinforce ASEM's connectivity. ASEM partners must address the challenges of promoting adequate access to financial resources to support their companies' international economic endeavours. At the seminar, policy makers and relevant business and financial stakeholders shared opinions and lessons learnt, drawing from significant findings and experiences.

All participants recalled the strategic role played by SMEs in Asia and Europe, both as an engine for national economies and job creation, and as a tool to foster sustainable and inclusive forms of economic growth and cooperation. In ASEM

¹ An event photoset is available on Flickr: <https://www.flickr.com/photos/59317822@N05/albums/72157658478095114>. Two videos (in Italian) are available in the Italian Foreign Ministry's official Youtube channel: Asem: sostegno alle attività Pmi in Europa e Asia, <https://youtu.be/mHT2SgiVaps>; Asem: le conclusioni, <https://youtu.be/PAbH1LmOXX8>.

² Chair's Statement of the Tenth Asia-Europe Meeting, Milan, 16-17 October 2014, par. 12, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/145154.pdf.

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· Report of the seminar on "Financing SMEs in Asia and Europe", held in Rome on 29-30 October 2015. The seminar has been organised by the Italian Ministry of Foreign Affairs and International Cooperation (MAECI) and Banca d'Italia, in cooperation with the Istituto Affari Internazionali (IAI).

countries, SMEs account for a very high percentage of all enterprises (98 percent in Asia, 99 percent in Europe). In both continents, SMEs represent the backbone of the economic activity. Over the past five years, almost nine new jobs out of ten were created by European SMEs. SMEs accounted for 30 percent of total Asian export value between 2007 and 2012.



From left to right: Rudy Salahuddin, Benedetto Della Vedova and Massimo Gaiani

However, compared to larger companies, and independently from their economic activity or location, ASEM SMEs continue to face limited access to funding, which prevents them from improving their operations, upgrading and expanding their production capacity. In a global environment characterised by big uncertainties and unstable capital flows, this “market deficiency” is undermining the ability of ASEM SMEs to benefit from globalisation and the development of international markets and supply chains. Overall, despite the vital role they play in the economic cycle, this inhospitable environment is hindering SMEs’ ability to fully leverage their intrinsic potential.

Throughout each panel, participants highlighted a variety of “best practices” and offered policy recommendations to address these particular issues and obstacles while promoting new forms of SMEs financing and support. Particular attention was also given to innovative solutions, which can support or complement the traditional bank-financing model, improve the national and international rating systems applied to SMEs, and promote a better coordination between ASEM countries on the issue.

Over the course of the two-day event, the discussions developed in three panels, respectively focusing on: Framework and working conditions for financing ASEM SMEs (Panel 1); Access to capital and private equity funds: boosting new forms of investment for ASEM SMEs (Panel 2); A globalised market for ASEM SMEs: seizing the opportunities for credit and finance (Panel 3). In turn, the three panels assessed the prevailing lending practices and risk and rating systems applied to SMEs, brainstormed new forms of private and public investments, which can foster the internationalisation of SMEs, and discussed joint actions and international agreements among ASEM governments aimed at a more harmonised regulation for enhanced transparency and coordination within the market.



Seminar participants

Panel 1. Frameworks and working conditions for financing ASEM SMEs

In Panel 1, participants noted that ASEM SMEs largely depend on the banking sector. However, SMEs' financial data is not always easy to interpret and many SMEs feature a "risky" profile that is unfit for the traditional bank lending system. In addition, SMEs operating on a cross-border basis face further difficulties

in securing external finance compared to large companies, considering that international lending practices are often affected by a lack of reliable financial data and information asymmetries between lenders and borrowers. The role of the state is also of prime importance because it still remains one of the main creditors for SMEs even when innovative financing is taking root. At the same time, however, governments' over-regulation can hamper and discourage SMEs' growth and expansion. Within this framework, greater ASEM cooperation should aim at:

- *Boosting the role of private sectors in working with regulators to favour alternative sources of finance*, like credit funds, circuits and networks, or to encourage a larger role for venture capital and crowd-funders. The ASEAN business community is currently crafting a proposal based on a combination of guarantee systems and crowd funding, which will be presented at the 27th ASEAN Summit to be held in Malaysia in November 2015.
- *Strengthening and harmonising the banking systems*. Bank credit is and will remain the backbone of SMEs' funding in the foreseeable future, but in Europe, for instance, the lack of a unique credit system and the presence of different normative frameworks harms SMEs' access to liquidity. In this respect, the completion of the Banking Union can foster a deeper integration of the credit industry and a more adequate bank lending to the economy, including SMEs.
- *Developing standardised information systems on regional credit rating for SMEs*. One of the structural problems of the Eurozone is that credit conditions for SMEs are affected by the credit rating of the sovereign debt of the countries in which they are located. This geographical and political bias has been exacerbated so far by the absence of a genuine banking union in the Eurozone with more fiscal risk sharing.
- *Enhancing traditional forms of financing* such as public credit guarantee systems to boost SMEs' capacity building. This would also help unlock credit markets for firms unable to provide sufficient collaterals. Alternative credit market players might assume an enhanced logic of selection that takes into account and evaluates qualitative (as opposed to quantitative) assets as well as intangibles usually

overlooked by traditional analysis.

- *Helping SMEs, operating in informal sectors, to move into the formal sector in view of facilitating their access to credit and finance.*

Panel 2. Access to capital and private equity funds: boosting new forms of investment for ASEM SMEs

In Panel 2, participants stressed the need for alternative and diversified channels for financing SMEs, such as financial securities, private equity funds, venture capital funds and private debt instruments. Private equity and venture capital, in particular, can play a key role in modern economies by providing capital to support development programs and new strategies as well as technical know-how. There is some quantitative evidence that companies that avail themselves of private equity generally perform better on the market, achieve higher revenues, create more employment and undergo a pronounced internationalisation. The EU's Capital Market Union Action Plan,³ launched in September 2015, is aimed at creating a unique European financial market which is able to cut intermediation costs and favour the pooling of financial resources, hence overcoming market fragmentation. However, inefficient, fragmented and out-dated infrastructures and regulations undermine the potential role of non-banking institutions in financing SMEs. In this context, panellists suggested to promote:

- *New private equity funds.* For instance, following international best practices, the Italian Cassa Depositi e Prestiti has created two new funds, namely the Fondo strategico italiano and the Fondo italiano di investimenti, to fix the deficiencies existing in the Italian investments markets, although with a focus on medium-large firms rather than on SMEs. Companies backed by private equity funds have shown positive trends of growth and better performances, hence confirming the ability of such funds to act both as good investors and mentors. Joint strategies involving private equity players and public decision makers can support the spread of an equity culture.



Zhang Jinliang and Valeria Sannucci

³ European Commission, *Action Plan on Building a Capital Markets Union* (COM/2015/0468), 30 September 2015, <http://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex:52015DC0468>.



Ettore Greco and Domingo P. Nolasco

- *Cross-border funds.* A number of global partnerships between players supporting SMEs has already proven to be effective. The Mandarin Capital Fund and the BPI France partnerships with Chinese banks have been successful not only in financing SMEs, but also in providing them with the necessary expertise and know how in order to help entrepreneurs search for the right partners, avoid pitfalls and expand abroad.

- *New partnerships between multilateral and local players.* As demonstrated by the World Bank Venture Schemes, supporting SMEs through local financial intermediaries is more effective to overcome information asymmetries and to improve risk analysis. Local players and authorities are, moreover, closely in touch with SMEs and can testify to the needs and difficulties faced by local businesses. Although often criticised due to their role in the recent financial turmoil, the creation and promotion of special purpose vehicles (SPVs) to back cross-border activities across Europe and Asia should also be considered as an option. Such instruments could offer key information to banks and investors and constantly balance risks.

- *Digitalisation of information.* Providing more and better information to SMEs would have a twofold result. On the one hand, it would allow SMEs to acquire better knowledge of existing financing channels, making it easier for them to access credit. On the other, it would allow effective best practices to be replicated. For instance, Italy has launched a web portal through which start-ups can communicate, share information and experiences, and interact with the venture capital community. The Bank of Thailand has stressed the benefits deriving from the use of information technologies as Thailand moves toward a digital economy. The digitalisation of information can alleviate information asymmetries by simplifying data registration, verification and storage. An electronic payment and banking system that supports the three stakeholders, namely the government, businesses and consumers, and that is efficient, safe and stable, is also on the governments' agenda. Widespread internet access and digital technologies are also of utmost importance to speed up transactions as Thailand increases its export capacity and competes with foreign markets.

- *Transparency.* The development of an SME Credit Risk Database (CRD) reflecting SMEs profiles could facilitate their access to finance. The Japanese government, for example, has established a CRD Association to gather credit data relating to SMEs. The CRD contributes to the effective screening of SMEs by financial institutions and its data can be used for statistical analysis of SMEs to enhance risk management by financial institutions.

- *Better training and “capacity building.”* Training business capacity and financial literacy is essential to allow SMEs to meet the necessary standards to integrate in the supply chain. For instance, the World Bank SMEs Venture Scheme in Africa and Asia provides technical assistance to local SMEs through peer-to-peer mentorship and by training local fund managers to identify gaps in the market.



From left to right: Jiraphant Asvatanakul, Anna Gervasoni and Fabrizio Saccomanni

Panel 3. A globalized market for ASEM SMEs: seizing the opportunities for credit and finance

In Panel 3, panellists noted that, while there is a large potential for both European and Asian SMEs to expand in each other's markets, SMEs are still insufficiently internationalised. This is partly due to information asymmetries between lenders and borrowers that are insufficiently equipped to handle and analyse relevant information. SMEs have poor knowledge of foreign markets and often require managerial assistance and training. Large companies, in fact, can bear the high costs of processing information, while SMEs lack adequate capital, management, information and skills to develop their abilities in the global market. Banks do not easily finance the internationalisation projects of SMEs because of the lack of data assessing their financial position. In this respect, disclosure of the financial status of companies and better analysis of business plans and balance sheets can improve risk pricing of SMEs. Panellists recommended a variety of measures in view of improving access to relevant information that may foster SMEs financing, including the development of:

- *Business networks*, which could directly help SMEs and their organisations to more easily access third country markets. For instance, the Enterprise Europe Network, which helps SMEs find partners in the Asian markets, is designed to facilitate international partnership services: brokerage events, matchmaking, company missions and technology transfers. Moreover, the European Commission has established a number of EU business cooperation centres in Asian markets (i.e. the EU SME Centre in China, the EU-Japan Centre for Industrial Cooperation, the European Business and Technological Centre in India and the European ASEAN Business Centre in Thailand), which advise SMEs on how to invest and seize business opportunities abroad. These programmes are complemented by the IPR SME Helpdesks in China and ASEAN countries to advise and help SMEs in new markets. The Commission is also finalising a number of free trade agreements (FTAs) with countries in Asia, most notably Vietnam and Singapore, that contain specific provisions for SMEs, as well as the so called “regulatory dialogues” to facilitate



From left to right: Pascal Lagarde, Pham Thi Thu Hang and Lorenzo Stanca

the understanding of the regulatory environment in which SMEs invest.

- *Case by case technical assistance.* Since the nature of SMEs is very diversified across countries, national commercial banks, which are in direct contact with local enterprises and possibly their direct funders, should be encouraged to provide case-by-case technical assistance. SMEs are to be treated as distinct entities and, due to the variety of sectors in which they operate, the

information and technical assistance they receive must be adjusted accordingly. In line with this suggestion, the Japan Bank for International Cooperation (JBIC) has established a network with commercial banks in ASEAN countries, to provide market information to SMEs willing to invest abroad. Moreover, JBIC, which is 100 percent government-owned, positively interacts with Japanese financial institutions, in particular regional banks that operate in small cities and towns where they are rooted and where they work closely with SMEs. Given that SMEs consult regional banks on a day-to-day basis, JBIC is working toward intercepting the needs of SMEs with the intermediation and technical assistance of regional banks. Similar practices are also supported by the Bank of Thailand through the “one district, one product” project aimed at increasing specialisation and diversifying production. The European Investment Bank is also feeding local commercial banks in a comparable case-by-case manner and argues that, due to their intrinsic specificity, SMEs need a focused, operational and objective approach.

In addition, panellists suggested a variety of measures in order to provide banks with the necessary information to finance SMEs, including the development of:

- *SMEs credit rating systems.* Such systems have the potential to benefit both banks and SMEs. On one hand, SMEs’ databases would provide banks with information on SMEs’ financial health, reducing their financing risks. On the other hand, SMEs would also benefit from such system as they could raise funds from banks more easily and gain access to the securitised debt market. For example, the Japanese Government and SME Agency established a Credit Risk Database, which contains data from 14.4 million SMEs. In Japan still, 52 credit guarantee cooperation hotspots located across the country provide guarantees and incentives in order for SMEs to borrow money from financial institutions. Over the past ten years, 44 million databases have been collected including 1.7 million databases on defaults. Given that considerable amounts of reliable and correct data yield a normal distribution, abnormal data can be easily identified and corrected as well as SMEs that report such data. This system has increased SMEs’ reliability and attractiveness and banks are therefore further encouraged to lend them money. Additionally, the adoption of this cluster analysis and the application of various financial variables to the

SMEs in Asia has enabled banks to classify SME clients based on their financial health, to adjust interest rates on loans, and to set lending ceilings for each group accordingly.

- *Regional funds or hometown investment trust funds (HIT)* which can promote lending to start-up companies and more volatile SMEs. Regional trust funds, financial products riskier than deposits, can be sold under certain conditions through branch offices of regional banks, post offices, credit associations and large banks in order to provide SMEs with additional financial sources. Due to strict capital requirements and since banks have become stricter in borrowing to SMEs, it is urgent to develop regional funds.

Conclusion

The seminar was a timely opportunity for a fruitful exchange of proposals and success stories between leading Asian and European experts dealing with the daily challenge of funding SMEs. The increasing political interest in the framework and working conditions for financing SMEs was further underlined by the fact that, in addition to the Italian government, the seminar was sponsored by three other ASEM partners, namely China, Indonesia and the Philippines. The seminar discussed a number of possible steps and offered valuable insights and policy recommendations based on best practices. One particular suggestion stood out, namely the assessment of the opportunity and feasibility of setting up a new bi-regional instrument with a view to providing finance to SMEs active on a cross-border basis, including the possibility of engineering a specific public-private funding model with adequate and accepted risk sharing agreements. From the Italian perspective, this can play a high role in strengthening cooperation within ASEM. It is indeed a firm belief of the Italian government that the internationalisation of SMEs can be accomplished only through robust partnerships on the global scene, and particularly with Asian markets. Along with these proposals, panellists provided inspiring ideas and policy recommendations that can serve as food for thoughts for the ASEM governments as they construct targeted and effective policies for the delicate needs of SMEs. Finally, the seminar was a valuable occasion to develop networking and to promote a mutual understanding between experts and officials operating on the field.



From left to right: Manabu Homma, Umberto Del Panta, Naoyuki Yoshino and Pierre Delsaux

Annex. Programme and Agenda

Seminar Programme

Rome, 29-30 October 2015

Opening Session

Chair **Massimo Gaiani**, Director General for Global Issues and for Asia, Sub Saharan Africa, Latin America, Italian Ministry of Foreign Affairs and International Cooperation, Rome

Opening Addresses

Speakers **Benedetto Della Vedova**, Under-Secretary, Italian Ministry of Foreign Affairs and International Cooperation, Rome
Valeria Sannucci, Deputy Governor of Banca d'Italia, Rome
Ettore Greco, Director, Istituto Affari Internazionali (IAI), Rome
Cesar V. Purisima, Secretary of Finance, Department of Finance, Republic of the Philippines, Manila (co-sponsoring country)
Rudy Salahuddin, Deputy Minister for Creative Economy, Entrepreneurship, and Cooperatives & SMEs Competitiveness, Coordinating Ministry for Economic Affairs of the Republic of Indonesia, Jakarta (co-sponsoring country)
Zhang Jinliang, Executive Vice President, Bank of China, Beijing (co-sponsoring country)

Panel 1

Frameworks and Working Conditions for Financing ASEM SMES

The panel aims to assess the current financial, legal and fiscal frameworks affecting the working conditions of ASEM start-ups and SMEs, with particular regard to their access to finance for sustaining international activities, expansion and growth. In view of the current trends and opportunities offered by international markets and trade, participants shall focus on the prevailing lending practices (debt credit and trade credit; bank funding and non-banking lending models; public guarantees etc.), as well as on the risk and credit rating systems generally applied to SMEs. In this framework, participants shall evaluate how the bank financing model may be complemented and/or supported through better regulation or through specific public-private endeavors and international agreements.

Chair **Luca Ferrari**, Deputy Director General for Global Affairs/Principal Director for Multilateral Economic and Financial Cooperation, Italian Ministry of Foreign Affairs and International Cooperation, Rome

- Speakers** **Giorgio Gobbi**, Head of Financial Stability Directorate, Banca d'Italia, Rome
Hosuk Lee-Makiyama, Director, European Centre for International Political Economy (ECIPE), Brussels
- Discussants** **Rebecca Fatima Sta. Maria**, Secretary-General, Ministry of International Trade and Industry of Malaysia, Kuala Lumpur, and General Commissioner for EXPO Milano
Miguel Otero-Iglesias, Senior Analyst on the European Economy and Emerging Markets, Elcano Royal Institute, Madrid
Than Tun, Chairman, Small & Medium Industrial Development Bank, (SMIDB), Yangon

Panel 2

Access to Capital and Private Equity Funds: Boosting New Forms of Investment for ASEM SMES

The panel will address how public and private investment can foster the internationalisation of ASEM SMEs. In light of the trends of the capital markets and the prospects of different forms of direct investment, ranging from mini-bonds to private equity funds, the panel will highlight a range of new funding opportunities for SME-driven business, production and trade. In this framework, participants shall explore how specific public measures and financial regulations can facilitate these forms of public and private investments, including through a better international transparency and cooperation.

- Chair** **Fabrizio Saccomanni**, Vice President, Istituto Affari Internazionali (IAI), Rome
- Speakers** **Anna Gervasoni**, Director-General, Italian Private Equity and Venture Capital Association (AIFI), Milan
Anita Bhatia, Director of Development Partner Relations, International Finance Corporation (IFC), World Bank Group, Washington
- Discussants** **Pascal Lagarde**, Executive Director of BpiFrance, Paris
Jiraphant Asvatanakul, Treasurer, Thai Chamber of Commerce and the Board of Trade of Thailand, Bangkok
Pham Thi Thu Hang, Secretary General, Vietnam Chamber of Commerce and Industry, Ha Noi
Lorenzo Stanca, Managing Partner, Mandarin Capital, Milan
Tokiko Shimizu, Deputy Director-General of International Department, Bank of Japan, Tokyo

Panel 3

A Globalized Market for ASEM SMES: Seizing the Opportunities for Credit and Finance

In light of the discussions of Panel 1 and Panel 2, the last Panel of the Seminar will draw some relevant conclusions, based on best practices and 'lessons learnt', and will assess some possible strategies for ASEM cooperation. In this framework, the panel shall highlight a number of innovative solutions aimed at promoting access to finance for ASEM SMEs, in view of sustaining their economic growth and performance, as well as to increase their ability to seize international market opportunities. Among these, to what extent could a better public regulation ease international lending practices, both through the traditional banking model and other non-banking credit systems? In which way could an enhanced coordination between ASEM Governments facilitate the transparency of available funding methods and opportunities? And, finally, which joint endeavors or international agreements could support the connectivity of ASEM markets through the internationalisation of ASEM SMEs?

Chair **Pietro Ginefra**, Principal Manager, International Relations Directorate, Banca d'Italia, Rome

Speakers **Pierre Delsaux**, Deputy Director General, DG Growth, European Commission, Brussels
Naoyuki Yoshino, Dean, Asian Development Bank Institute (ADBI), Tokyo

Discussants **Manabu Homma**, Special Advisors for SMEs, Japan Bank for International Cooperation (JBIC), Tokyo
Tongurai Limpiti, Deputy Governor, Bank of Thailand, Bangkok
Umberto Del Panta, Managerial Advisor Central Asia, European Investment Bank, Luxembourg

Final Remarks

Conclusions by Panel Chairs

Benedetto Della Vedova, Under-Secretary, Italian Ministry of Foreign Affairs and International Cooperation, Rome

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