

Workshop 2 – Establishing Local Support Structures and Linkages

1. Putting in Place the Essential Business Support Framework

The SEE Region EPPA provides a comparative assessment of enterprise policy performance across the SEE region. It identifies a series of benchmarks and good practice, presents assessment ratings on policy performance by entrepreneurs (owners and managers of small businesses), research on governments' performance in relation to enterprise policy, and highlights the key trends for the eight countries in question. The report shows where SEE countries stand relative to each other and successful practice in OECD countries, thus providing policy-makers with concrete pointers for reform.

The report focuses on six broad dimensions of the framework and environment supporting SME growth and development that are considered to be particularly important for governments in transition economies to implement, if they are to make small enterprise policy effective (OECD-UNIDO, 1999) namely:

1. Institutional framework for SME policy
2. Rule of law and the regulatory environment
3. Tax policy for small businesses
4. Financial instruments for fostering new businesses
5. Advisory services supplied to new and small businesses
6. Business incubator support to start-ups

To these can be added a seventh section – Human resources and entrepreneurship training.

The report referred to forms an integral part of this seminar.

Other dimensions of enterprise policy, such as provision of infrastructure, nature of the labour market and development of a culture of entrepreneurship, also play a role in relation to small enterprise policy performance in the SEE region. These dimensions are covered in other reports and some aspects, especially those related to the EU Charter for Small Enterprises, will be incorporated in future regional EPPA analyses.

The History of Business Development Services in Transition Economies¹

In general, traditional interventions by governments and donors have failed to provide quality, affordable Business Development Services (BDS) to a large proportion of the target population of small enterprises. There is a general feeling that publicly-provided and publicly-funded services have not achieved the objectives of donors and governments, i.e. enterprise productivity and

¹ This text draws from research carried out by many donor agencies in the past years as they sought the best methods to assist transition economies in the development of the private sector, and SMEs in particular. Organisations involved include ILO, World Bank, IFC, European Commission, USAID, DfID, GTZ, SDC and IADB.

competitiveness, job creation, poverty alleviation, and social mobility. Moreover, we have lacked good performance measurement to be able to evaluate and compare programs.

Achieving our economic and social goals is only possible by relying on non-government and non-donor actors to provide a diverse array of services. Relying on the private sector to achieve greater outreach means that we need to understand how BDS providers could be financially self-sustainable, or even profitable. If we agree on the basic goals of BDS interventions - outreach, sustainability, cost effectiveness, and impact - we must now identify how to do it.

Despite substantial work to date, it is clear that the field covers a wide range of possible interventions, and that definitive "best practice" has yet to be formulated and agreed. Current practice in many cases is still far away from the principles set forth here, so we also need to think about how to **grow from current practice to best practice**.

UNDERLYING ASSUMPTIONS AND PRINCIPLES

Vision

The ultimate objective of donor intervention in Business Development Services (BDS) is to improve SME performance in transition economies as a means to achieve higher economic growth and employment, reduce poverty, and meet social objectives. Improving SME performance requires many ingredients, which have been identified in the EU Charter for Small Enterprises.

A vision for BDS is a market with a diverse array of high-quality services that meet the needs of a large proportion of SMEs affordably. This vision outlines a private sector-led, market economy framework which reflects:

- a fundamental belief in the principles of a market economy, where the State has a role in providing an enabling environment, in correcting or compensating for market failures, and in the provision of public goods, but not in the direct provision of private goods that can be more efficiently provided by the market;
- the assumption that the majority of BDS are private goods and are thus similar in nature to any other service, so market rules apply; and
- the expectation that with appropriate product design, delivery and payment mechanisms, BDS can be provided on a commercial basis even for the lowest income segment of the entrepreneurial SME sector.

Scope of BDS

A distinction is sometimes made between "operational" and "strategic" business services.

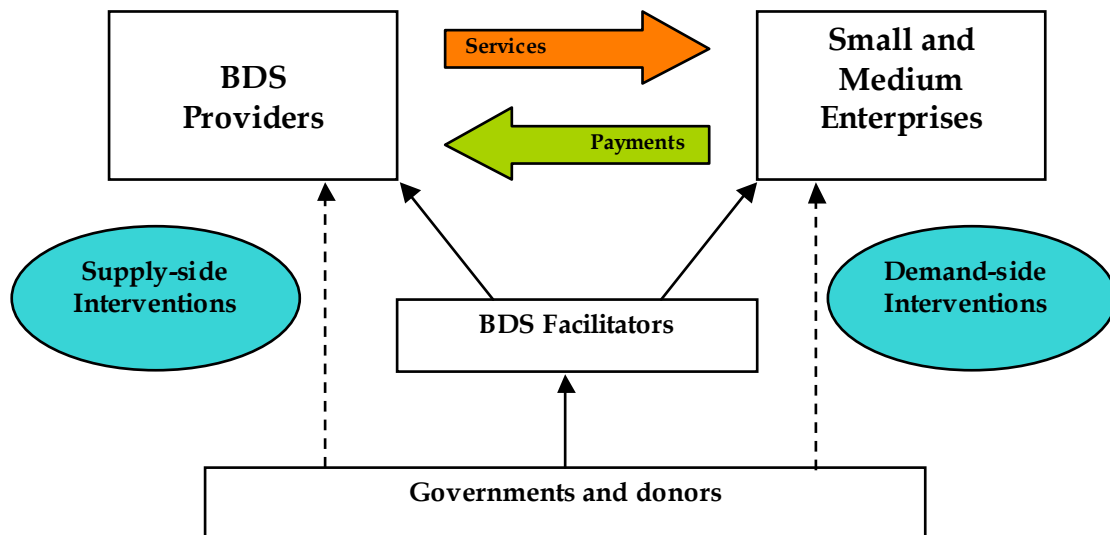
Operational services are those needed for day-to-day operations, such as information and communications, management of accounts and tax records, and compliance with labour laws and other regulations.

Strategic services, on the other hand, are used by the enterprise to address medium- and long-term issues in order to improve the performance of the enterprise, its access to markets, and its ability to compete. For example, strategic services can help the enterprise to identify and service markets, design products, set up facilities, and seek financing.

The market for operational services may already exist, since there is often articulated demand and willingness to pay for these services. In contrast, markets for strategic services for SMEs have largely failed to develop, and they are the focus of most donor interventions in BDS.

Actors and their roles

The diagram below shows the actors involved in donor-funded development of BDS markets:



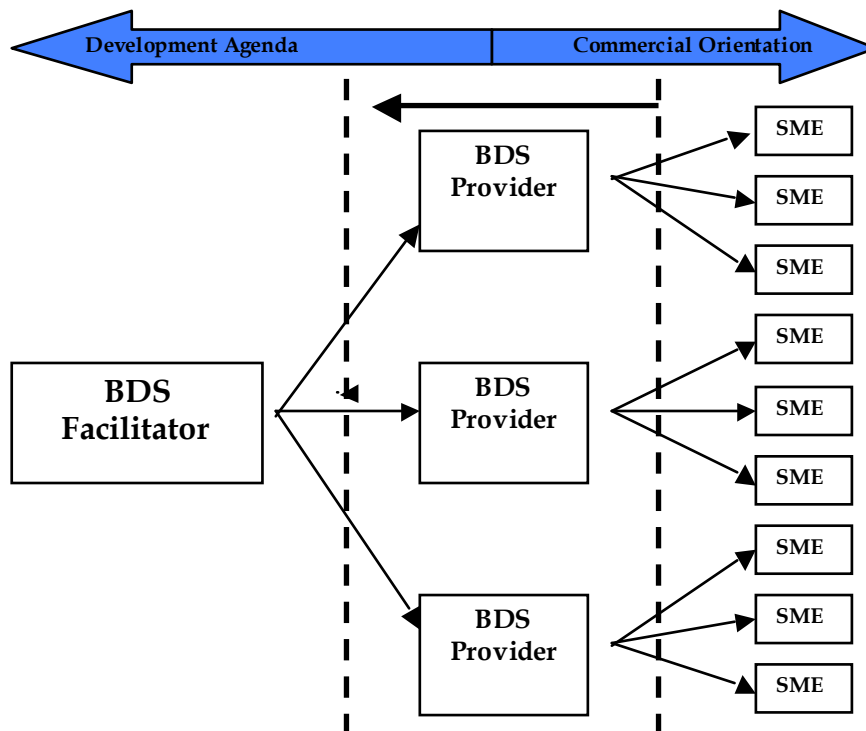
- SMEs, the demand side of the market, are mostly profit-oriented and are the actual or potential clients of BDS providers.
- BDS providers provide services directly to SMEs. They may be individuals, private for-profit firms, NGOs, parastatals, national or sub-national government agencies, industry associations, etc. They may be small enterprises themselves. They may also be firms whose core business is not services but who provide them as part of a broader transaction or business-to-business relationship.
- BDS facilitators support BDS providers, for example by developing new service products, promoting good practice, and building provider capacity. BDS facilitators can also work on the demand side, for example by educating SMEs about the potential benefits of services. In addition, a BDS facilitator may perform other important functions, including the external evaluation of the impact of BDS providers, and advocacy for a better policy environment for the local BDS market. BDS facilitators are normally development-oriented, though in some BDS markets, for-profit BDS facilitators are a normal part of the market structure. Some types of BDS are traded in fully private markets that have no facilitator role.
- Governments and donors who provide funding for BDS projects and programs. In some cases, the facilitator is the project office of a donor. These actors may intervene on the supply side of the market or on the demand side, and funds may be used to provide or subsidize BDS directly (dashed lines) or indirectly through BDS facilitators (solid lines).

The various market actors have different interests depending upon their commercial versus development orientation. A BDS facilitator is likely to be interested in BDS market development

as part of a broader economic and social agenda. For a commercially-oriented BDS provider, the BDS market development objective may be irrelevant or even in conflict with its commercial interests – for example, if market development implies a greater number of competing BDS providers.

Achieving outreach and sustainability

Traditionally, donors and governments have intervened in BDS markets at the level of the BDS transaction: directly providing services to SMEs via public BDS providers, or permanently subsidizing services delivered by other BDS providers. Traditional approaches have failed to achieve high outreach (access to services by a large proportion of the target population of SMEs), since the numbers of SMEs served is limited by the amount of subsidies available. In addition, institutional sustainability has been low, since programs often cease when public funds are exhausted. Also, services tend to be more developed around centres of population.



The BDS market development paradigm is driven by the belief that the objectives of outreach and sustainability can only be achieved in well-developed markets for BDS, and not by direct provision by donors and governments. This shifts the focus of public intervention away from direct provision and subsidies at the level of the BDS transaction, toward the facilitation of a sustained increase in the demand and supply of services. In the diagram above, the dashed line represents the divide between public and private funds. The objective of BDS market development challenges government and donors to push the commercial orientation of the BDS market as far as possible - represented in the diagram as moving the dashed line to the left. However, it is important to recognize that there may be a trade-off between outreach and sustainability for the lowest-income segment of the SME market, and that the potential sustainability of BDS facilitators is still an unresolved issue.

PROGRAM PLANNING AND DESIGN

BDS market assessment

Before designing interventions to develop BDS markets, it is critical to understand existing markets - in order to identify weaknesses and opportunities, the reasons behind the lack of demand for or supply of services, and the extent of market distortions. This understanding can help to identify local mechanisms of service delivery and payment, choose the intervention strategy and instrument, identify local institutions and networks to build upon, and provide a baseline for measuring progress in market development.

BDS market assessments need not be large studies - the scope of the assessment should fit the objectives of the institution doing it, and in many cases may be "quick and dirty". Governments and BDS facilitators doing initial market assessments may choose a broad scope that will allow them to benchmark the stage of development of BDS markets, identify existing or potential BDS providers to work with, and measure progress in expanding the demand and supply of services and the range of products available. For individual BDS providers, the market analysis is likely to be very narrow in scope, focusing on the specific service to be supplied, the characteristics of the target market, and existing or potential competitors. For both BDS facilitators and BDS providers, the relevant "BDS market" will need to be defined according to the specific type of service, target clientele, and geographical coverage.

When doing a BDS market assessment, it is important to consider:

- SME needs, awareness of services available, and willingness to pay for services – though recognizing that there may be a difference between "perceived needs" and "real needs", and that it is difficult to determine willingness-to-pay in underdeveloped and/or distorted markets;
- informal and indigenous sources of supply;
- services bundled with other goods and services or delivered as part of business-to-business relationships;
- potential crowding out (displacement) effect of direct or subsidized provision of services by donors and governments; and
- the evolution of BDS markets over time.

Demand-side versus supply-side interventions

The choice of demand-side and supply-side interventions to develop BDS markets should correspond to the market development constraints and opportunities identified in the market assessment. Examples of demand-side interventions are vouchers, matching grants, and information to raise SME awareness of the potential benefits of BDS. Supply-side intervention options include technical assistance and training for BDS providers, product development assistance, etc. Some interventions work on both sides – for example, strengthening business-to-business linkages.

Delivery and payment mechanisms

Reducing the risks and costs of BDS requires attention to delivery and payment mechanisms as part of the design of BDS products. Particularly for the smallest enterprises, flexible and innovative approaches to delivery and payment mechanisms are needed to boost demand for services. The use of indirect payment mechanisms for BDS – commissions and mark-ups rather

than direct fees – can reduce the cash flow burden on SMEs, allow them to share the risk that benefits from BDS will not occur, and reduce administrative costs for BDS providers. We should encourage BDS providers to design payment mechanisms that are appropriate to the local situation and the characteristics of their clients.

Subsidies

Long-term government or donor subsidies to the demand or supply of BDS are likely to distort BDS markets and crowd out the commercial provision of services, thus undermining the objectives of cost effectiveness, sustainability, outreach, and impact that are the pillars of the BDS market development paradigm. Subsidies may be justified in the short term to promote the development of BDS markets. However, even temporary subsidies can create distortions in BDS markets, and are justified only if their market development impacts outweigh their distortionary effects. Therefore, care must be exercised in the application and duration of subsidies.

In some transition economies, long-term sustainability has been supported by the development of partnerships with universities, chambers of commerce, regional governments, etc. This has not been considered distortionary as there have been mutual benefits accruing to the partners, the services continue to be demand driven and available under the same conditions to a wide market.

Exit strategy

Consistent with the temporary nature of subsidies, public sector and donor support to BDS interventions should have a clear exit strategy defined from the beginning. The exit strategy should be linked to the achievement of the intervention's market development objectives – for example, the creation of sustainable BDS providers.

Focus on technical assistance

Interventions should concentrate on technical assistance and incentives to encourage competitive performance of new and existing BDS providers, innovations, and the development of appropriate service products. These types of interventions often require relatively less financial assistance, but a higher level of skill and market knowledge. The proportion of total funds allocated to technical assistance is likely to be higher compared to that in traditional interventions

Selecting partner institutions

Successful BDS providers deliver services in a business-like manner. They are demand-led, entrepreneurial, and act as commercial market players. Often, successful BDS providers focus on a limited range of core businesses and do them well, rather than diversifying too broadly. BDS providers should develop transactional relationships with SME clients based on exchange rather than charity, and develop a sound understanding of the needs of their clients as part of their business strategy.

Private, for-profit providers or business partners providing the services as part of a business relationship tend to demonstrate these characteristics best. BDS providers should not have a charity orientation, but may have a social orientation combined with rigorous institutional performance targets. In reality, there are often many not-for-profit BDS providers already in the marketplace, and during the transition to a commercially-oriented model there is much work to be done to assist them become more sustainable and businesslike.

For BDS interventions to be both sustainable and locally owned, they must build on what is already there rather than supplanting it with imported visions or models. The choice of partner

institutions should also be guided by the principle of subsidiarity - delegating responsibility to the lowest possible level and to those who are closest to SMEs, both geographically and socially.

Finally, access to facilitation should ultimately be open to all market players in a certain service market that fulfil established criteria. Selecting only one or a few of the market players present for exclusive assistance would lead to further market distortions.

Role of BDS facilitators

BDS facilitators - often public institutions or donor funded project offices - usually are publicly subsidised short-term entities that should vanish once the market for a certain business development service or services has developed or move on to new market development issues. In some markets, there may be a long-term market function for facilitators (e.g., franchisors, for-profit training-of-trainers). In these cases, donor supported facilitators could be privatized, and there may be scope to simulate local, for-profit facilitators.

Because of their different objectives and interests, mixing the roles of facilitators and providers will lead to market distortions and inefficient use of resources. The exceptions to the rule are commercial, non-subsidized facilitators/providers and the temporary provision of innovative BDS by a facilitator for demonstration purposes.

Performance measurement and evaluation

Systematic performance measurement provides a good basis for improving the design of instruments in response to client demand, as well as facilitating decisions by donors on types of interventions. Three categories of performance measurement are relevant in BDS:

- impact, in terms of changes in SME performance (e.g., sales, value added, profitability), or broader social and economic impact (employment, poverty alleviation, etc.);
- market development, measured for example by the numbers and types of BDS providers, the price and quality of services available, the willingness to pay for services on the part of SMEs, and the degree of distortions in the market;
- institutional performance, according to indicators of outreach, cost effectiveness, and sustainability.

Different actors in BDS markets have different interests, which in turn determine the type and scope of performance measurement that are relevant to them. For BDS providers, performance measurement is a management tool that helps them design marketing strategies, monitor customer satisfaction, respond to changes in demand, manage costs, and establish staff incentives. BDS facilitators may be interested in monitoring the institutional performance of the providers they work with as well as progress in the development of BDS markets. Funds providers need to ensure accountability in the use of their funds and are often focused on the broader social and economic objectives of employment, enterprise competitiveness, and poverty alleviation.

2. Improving the Competitiveness of Local Companies

In order to improve the competitiveness of SMEs in transition economies, several priority areas for focused assistance have been identified². These closely resemble the 10 points outlined in the

² 2001 Best Procedure Report, European Commission

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European Charter for Small Enterprises, but are more specific to the needs of the transition economies (e.g. they make no mention of the single market). :

- Access to Finance: probably the greatest single impediment to start-ups and the expansion of SMEs, not least in transition economies. Many interventions are possible to alleviate this problem, including micro-finance, venture capital, seed capital, business angels, etc. However, rather than engaging in direct interventions which cause distortionary pressures, it is considered best that NGOs and financial institutions are assisted by governments and donors to provide the necessary capital under market conditions.
- Simplifying and improving the administrative and regulatory environment: This is still a problem in most advanced economies, but of critical importance in transition economies. Reference is made in the EPPA report of the need for communication and dialogue to help in reducing barriers.
- Promoting a favourable fiscal environment: a coherent, transparent and economy-friendly tax system is essential to the growth of business, and even more important for vulnerable SMEs. The tax system is an essential element in managing an economy, but it should not be hostile to business, thus stifling enterprise and leading to an expansion of the informal market.
- Ensuring and facilitating access to markets: Without assistance from outside agencies, SMEs can often find it very difficult to break into new markets. Barriers to markets must be addressed and support to emerging enterprises strengthened.
- Promoting entrepreneurship and facilitating start-ups: It is necessary to establish a systematic approach to facilitating start-ups. Enterprise policies must include measures to encourage risk-taking and actively assist start-ups.
- Education and the availability of skills: The education and training systems must adapt to include entrepreneurship and business-relevant skills in their curricula. Third level institutions in particular must ensure they are responding to industry and development needs in their courses.
- Supporting the availability and visibility of business services and business support services: Already discussed in this paper.
- Facilitating ICT uptake: adopting modern technology is essential for growth, competitiveness and employment. Measures must be taken to ensure that e-business becomes part of the economy.
- Development of business linkages: the concept of businesses working together towards common goals should be facilitated. Business representative associations and chambers of commerce should be developed. The development of clusters should form part of economic policy. R&D can be carried out as part of a consortium, with technical know-how from universities.

3. Using Existing Initiatives & Structures to Develop SMEs

Referred to above are the key areas of SME development requiring assistance. There are many agencies, governments, donors, NGOs, research institutions, etc. engaged in addressing these issues. From a regional perspective, ensuring that all these bodies act in a coherent and integrated manner as part of an overall strategy of development is crucial. Many transition economies are looking at ways of co-ordinating this assistance for maximum impact, and have set up Donor Co-

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ordination Units within a senior ministry. This level of co-operation is to be encouraged as part of a partnership approach to development.