

“Regional Aspects of Entrepreneurship and Employment in South Eastern Europe”

Skopje, 8th and 9th November 2004

Issues Paper and Questions for Consideration

1. Introduction

The purpose of this paper is to provide background and issues for consideration at the seminar in Skopje, especially during the workshop sessions. Brief questions under the main themes have been posed in the agenda. This paper seeks to support review and dialogue on the main themes.

“The challenge for governments is to provide a business environment that supports the competitiveness..... and that promotes a vibrant entrepreneurial culture”¹.

Governments and policy makers today at national, regional and local levels have a vital role to play in creating the right environment and maximising the employment, economic and social benefits of small and medium-sized businesses (SMEs).

Within the European Union, SMEs make up 99.8% of all enterprises and two-thirds of all jobs². While the number of SMEs as a percentage of all enterprises within the SEE region compares favourably with EU figures, the rate of new start-up (on this measure SEE countries vary from as low as one tenth to a half of the EU average rate of start-ups per capita) and level of employment at 47% does not³. It has long been the policy within the EU and other advanced economies that any national or regional development strategy must take account of the development and growth of SMEs, in conjunction with other elements of industrial growth, such as clustering and FDI. Such development strategies must recognise and understand the reality of the needs of SMEs and of industry in general. It must also be based on competitiveness of SMEs, which therefore demands an analysis of competitive advantages.

A framework to enable governments in the SEE region to develop and guide a supportive environment for small businesses in the region was outlined by previous research⁴:

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
7. Access to technology, human resources and entrepreneurship training.

The annual reports of the European Charter for Small Enterprises on the implementation of the charter in the member states give a great deal of emphasis to the need to take a long term approach to the development of SMEs and an entrepreneurial culture. They underline that “if

¹ OECD 2003

² EC 2002

³ SEE Region – Enterprise Policy Performance Assessment – OECD 2003

⁴ OECD/UNIDO 1999

governments don't think small first, they might never think small at all". In the preparation of both national and regional strategies and policies for SMEs, policy makers should⁵:

- a) Keep small business high on the agenda
- b) Listen to small businesses
- c) Learn from each other
- d) Bridge the performance gap
- e) Concentrate on key areas, and
- f) Share responsibility

The role of government in managing the economy is to create an enabling environment, which allows SMEs and industry to grow and expand, in its turn generating income for the economy (for industry in the form of profit and for government in the form of taxes). Successful policies can lead to creation of employment, alleviation of poverty, and allow government to invest in and improve the quality of life of its citizens through improved healthcare, education, housing and infrastructure and better regional spread of development. But national enterprise and SME development strategies, even if coherent and successful, don't automatically translate into effective regional strategies. Even in the most successful countries individual regions struggle to attain national levels of development and suffer from unemployment and low levels of enterprise with consequential impact on the regional economy. In transition economies where fledgling market economies are emerging individual regions and local communities face added challenges.

2. Putting Regional Development Strategies in Place

Competitive Advantage

In general a region will succeed where the regional circumstances support the pursuit of the proper strategy for particular industries and where it has a competitive advantage. It will succeed where its enabling environment is both dynamic and challenging, and where it stimulates and encourages industry to invest and expand in its advantages⁶. The steps of identifying and developing a region's competitive advantages may thus be seen as a building block for regional development and help to provide impetus to individual firms and industry sectors to exploit their value chains, creating employment and expanding incomes for the region as a whole.

Considerable work and research on SMEs and industry has been undertaken throughout the world over the past years and the theory of international success is well documented. This may also provide a guide for individual *regions within countries*. Four broad attributes or determinants (referred to as Porter's diamond) shape the environment in which local enterprises compete and these either support or detract from the creation of competitive advantage:

1. Factor Conditions – the nations (or region's) position in factors of production, such as skilled labour force or infrastructure able to compete on a global basis in a given industry
2. Demand Conditions – the nature of (home) demand for the industries products or services
3. Related and Supporting Industries – the presence (or absence) of internationally competitive supplier industries and related industries
4. Firm Strategy, Structure and Rivalry – the conditions in the nation (or region) governing how companies are created, organised and managed, and the nature of domestic rivalry.

The potential influence of Government in supporting the enabling environment for SME and industrial development, and therefore the promotion of Regional Competitive Advantage across all

⁵ Report from the Commission to the Council and the European Parliament on the Implementation of the European Charter for Small Enterprises, Brussels, 13-2-2003

⁶ The Competitive Advantage of Nations, Michael Porter 1990

the elements of the value chain, is significant. But is this adequately recognised by national and regional governments? The role of Government in enhancing factors such as education and training, physical infrastructure, fiscal policies, etc., as well as influencing domestic demand conditions, is considered crucial. The SEE Region currently has a number of factors that support its economies, some of which are sustainable but some - such as relatively low labour costs - are not sustainable over time.

The Social Partnership Approach – Securing Acceptance and Fostering Ownership

Social partnerships have gained in application throughout the developed and developing world, primarily out of a recognition that conflict between government, industry, labour and others was self-defeating and destructive of resources. Much more can be gained from consensus and agreement on a common agenda.

This is evident in many European countries. For example, Ireland has transformed itself from a rural agrarian society to an industrial state capable of competing – and succeeding – in a global market. Much of this success was built on the social partnership approach where each segment of the economy was able to contribute to a practical, transparent, agreed, resourced and well communicated development plan which concentrated on the country's competitive advantages. Where there is recognition of each party's roles and responsibilities, and their respective aims, agreement may be reached more easily on the key goals and ownership of the plan by all. In short, regional development and economic success at national, regional and local levels is often highly influenced by a partnership approach among all the active economic segments – i.e. goal congruence. This includes the unemployed. Each party must recognise the positive part that the others can play in achieving economic growth, and take advantage of the opportunities this partnership presents. Experience suggests that the opportunities which arise from social partnerships can be sustainable and beneficial.

National Development Strategies encompass Regional Development Strategies?

In the absence of appropriate co-ordinated and focussed Government policies and strong implementation, medium term development of the economy and the region's potential competitive advantages will be restricted. The role of Government in establishing, communicating and implementing a shared vision throughout the public and private sectors of an economy driven by competitive advantage rather than by ad-hoc opportunism and a short-term perspective cannot be overstated. Government must lead, but cannot dictate, the process of strategy development. In this framework regional development should be a key aim.

Key Questions:

- * Why are some regions more successful in their development strategies than others? What are the key components of successful regional development strategies?
- * Can these components be created? And how? How can regions build regional development strategies that will lead to new enterprise, more SMEs and high growth companies?
- * How vital is social partnership in this process of regional development?
- * Do the transition economies in South East Europe have successful regional models that can be shown as a guide and possibly transferred to other regions in SEE?

3. Establishing Local Support Structures and Linkages

Business Development Services in Transition Economies⁷

There is a general feeling that publicly-provided and publicly-funded services have not fully achieved the objectives of donors and governments, i.e. enterprise productivity and competitiveness, job creation, poverty alleviation, and social mobility. If we agree on the basic goals of BDS interventions - outreach, sustainability, cost effectiveness, and impact – we must now identify how to do it. The field covers a wide range of possible interventions, and definitive "best practice" has yet to be formulated and agreed. We need to think about how to **grow from current practice to successful practice**.

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 and the OECD/EBRD/EC Enterprise Policy Performance Assessments. 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 implies a private sector-led, market economy framework.

Traditionally, donors and governments have intervened in BDS markets at the level of the BDS transaction; i.e. directly providing services to SMEs via public BDS providers, or permanently subsidizing services delivered by other BDS providers. Traditional approaches have not succeeded in achieving high outreach (access to services by a large proportion of the target population of SMEs). Institutional sustainability has been low, since programs often cease when public funds are exhausted and services tend to be more developed around centres of population.

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, 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.

Selecting partner institutions

For BDS interventions to be both sustainable and locally owned, they should build on what is already in place 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 those closest to SMEs, geographically and socially.

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.

⁷ 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.

BDS facilitators - often public institutions or donor funded project offices - are usually publicly subsidised short-term entities that should ideally wind down 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 stimulate local, for-profit facilitators.

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 identified⁸. These closely resemble the 10 points outlined in the 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.
- 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. To what extent do existing regional strategies address such issues?
- 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 should 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 should 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.

To what extent should regional development strategies seek to address such issues?

Linkage

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. In particular successful regional strategies demand innovative programmes to foster better linkage especially with international investors both to maximise the benefits of FDI as well as to stimulate and grow stronger domestic companies.

Key Questions:

* Has government, in particular at regional and local levels, demonstrated the necessary commitment to the European Charter for Small Enterprises, particularly with regard to access to

⁸ 2001 Best Procedure Report, European Commission

finance, removal of regulatory barriers, provision of capacity support, etc.? How far should regional government and agencies engage in this area?

* Are regional development agencies adequately resourced to carry out their mandate (in terms of skills, finance, management, institutional cross-cutting, legal environment, etc.)?

* Have the SME development agencies the capacity to identify and work in support of growth companies?

* Are the potential and opportunities for partnership with universities and research institutions been adequately understood and exploited?

* What specific actions and initiatives within regional development strategies (or is this just an issue for action at national level?) are needed to maximise linkage?

4. Dealing with Industrial Change and Restructuring

Dealing with industrial change and restructuring is a complex and multi-dimensional challenge. The notes below highlight some areas for discussion but do not embrace all dimensions.

Traditional Industry in Transition Economies

Generally speaking, a route to industrial growth in transition economies is to move from the constricting influences of factor-driven competitive advantage, where industries are typified by low-wage, low-cost and locational advantages. This is easier said than done. To survive, these industries are often dependant on government supports and protectionist policies. Using scarce cash and other resources in this way is not conducive to longer-term development, though there may be short-term political and social considerations. As market economies and global competition develops many such traditional industries may not survive. How can regional development strategies best address this major issue? How can the employment and social consequences be addressed?

Privatisation

Much of the international investment attracted through privatisation, while highly desirable leads in the short to medium term to reduced employment and a period of 'downsizing' with consequential serious impact on local employment and the local economy. In the longer term more competitive and vibrant companies will re-emerge but this process may take years. To what extent can this process be managed in order to allay the worst features of sinking employment and undermining of local economies?

Need to Build Industrial Clusters?

Clusters can lead to higher growth in a number of ways:

- Raise productivity by allowing access to specialised inputs and employees
- Increase innovation capacity in companies by diffusing knowledge and technology more rapidly
- Stimulate higher rates of new business formation, as employees become entrepreneurs in spin-off ventures, since barriers to entry are lower than elsewhere.
- Encourage an enhanced division of labour among companies offering greater economies of scale for individual enterprises.

For SMEs in particular, clusters can greatly assist smaller companies to reap the benefits from economies of scale and scope. The many examples of affluent regions containing dynamic

clusters of companies have spurred local, regional and national governments to adopt cluster oriented policies in order to offer clusters optimal business conditions (research, education, venture capital etc.), tailored to their specific needs.

Foreign Direct Investment

There are obvious advantages and benefits in attracting FDI (especially 'greenfield' investment), not least of which are the rapid creation of employment, introduction of new skills and technologies, modern management practices, investment capital, etc. But multinationals locate their activities in other regions as part of their own global strategies, not as part of a national or regional strategy. How can regional development strategies be shaped and build to address this fact? A region should ideally have its own SME Development policy aligned within the overall industrial development policy.

The presence of the global company can itself lead to the development of a cluster, where focused government policies can provide the stimulus to SMEs to innovate and upgrade in line with the requirements of the multinational. In time, with the right conditions, local companies will be in a position to themselves compete globally, adding to the region's prosperity.

Key questions:

- * To what extent do regional development strategies set out goals for industrial change and the management of that change?
- * What is successful practice in handling industrial decline or downsizing and how should regional (as well as national) bodies deal with this major challenge both in its economic and social dimensions? Is there a template of good practice based on OECD country experience?
- * What is the role and potential of FDI located in regions in responding to industrial re-structuring?
- * To what extent do potential clusters form part of the industrial re-structuring strategy?