Review of the International Best Practice in SME State Support
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Introduction

Small and medium-enterprises (SMEs) are often praised as the economic and employment backbone of thriving economies as well as the driving force for innovation and value added production. In OECD countries the competitiveness of SMEs and the emergence of new start-ups are often valued as an indicator for future economic growth potentials and as the prerequisite for healthy structural change processes, in which traditional sectors are declining and new, more knowledge-intensive sectors are emerging.

During the last 2-3 decades many OECD countries went through different generations of promotion policies to strengthen the role of SMEs. It has contributed to a laboratory of experiences in which many different approaches, tools and methodologies have been tested. During these years a certain wisdom was commonly accepted: that there are very different (un)successful ways of promoting SMEs and that SME development strategies need to fit to the local and national socio-political context. There is no one-fits-all solution. Many countries had success with decentralized SME strategies, others, especially smaller countries, were able to promote competitive SMEs through rather centralized approaches. Some countries focused rather on the promotion of large enterprises in which SMEs became the followers rather than leaders of growth. Others again focused mainly on SME promotion and created a highly competitive entrepreneurial class (e.g. like the German Mittelstand with its famous “hidden champions”, SMEs with a highly specialized and export orientation).

Despite these differences in SME strategies and promotion policies, there are common learning experiences and certain success criteria which have emerged out of the SME promotion laboratory. In the following chapters these common success aspects should be presented. Its key objective is to provide important principles for the SME promotion strategy in Armenia.

This introductory chapter of the Armenian SME strategy is structured into different subchapters. The first sub chapter will provide a short overview of the role of SMEs in OECD countries and about basic similarities and differences of SME realities in OECD and developing countries (DC). The second sub chapter provides an overview of development paths and common good practices from experiences in OECD and EU countries. Before analysing these experiences, a systemic competitiveness perspective is presented. It points out certain institutional and stakeholder criteria for successful policies and support programs. In many DC these criteria are still very weak and have to been taken into consideration when designing SME policies. The 3rd subchapter points out the importance of following a systemic step-wise approach to promote SMEs according to the respective national capacities of the stakeholders involved. General suggestions of rather small interventions with a high outreach are provided to start the strategy process.
The role of SMEs in OECD countries and DC: Similarities and Differences

The growing importance of SME policies since the 1990s
Since the end of the 1980s SME promotion became an important focus in private sector development policies in OECD countries. The discovery of industrial districts in countries like e.g. Italy, the start of the cluster promotion approach through analysis by Michael Porter and the increasing role of more knowledge-intensive and growth-oriented businesses has also given more attention to the promotion of SMEs. Whereas in many industrialized countries (IC) former support approaches based on the welfare state model in the 1970s and 1980s rather focused on the support of larger enterprises or a more isolated and individual support of SMEs, the liberalization efforts in the 1990s and the breakdown of socialistic and import substitution development models in East Europe and Latin America contributed internationally to an increasing awareness about the importance of SMEs for the discovery of new business opportunities, innovation, employment promotion and value added production.

Since then a wide range of studies and country reports on SME development and entrepreneurship have been published, many SME promotion approaches have been tested and the reflection on successful SME policies and programs has gained importance. There is still an ongoing debate about the question in how far SMEs in developing and industrialised countries are rather a result or a driver of growth. This paper argues that it is necessary to distinguish between different kinds of SMEs. Some of them are rather the drivers, others the followers of growth. In difference to many international policy approaches, who try to tackle different SMEs with one-fits-all approaches, it is necessary to differentiate, e.g. between entrepreneurial-oriented SMEs and survival-oriented SMEs, high-tech or innovation-driven SMEs and “hidden champions, average industry-oriented SMEs and small handicraft or trade oriented businesses. These distinctions also needs to be made when analysing successful policies. Different SMEs require different policies and tools to overcome their specific bottlenecks.

Having said that it is internationally widely accepted that SME promotion is of crucial importance to increase the competitiveness and value addition of products as well as to develop national and local competitive advantages. Nonetheless it also became clear in the last two decades that just the set-up of SME policies is not enough to strengthen the competitiveness of a nation or region. Much more a healthy mix of differentiated SME-, cluster and innovation promotion activities, selective industrial policy initiatives, bottom-up and top-down approaches as well as competitiveness enabling factors like organizational and institutional prerequisites are necessary to encourage sustainable growth and value added production.

Thus SME policies in Armenia as well as in many OECD countries have to been interpreted as highly important. Nonetheless their success depends on the embeddedness of the promotion programs into a wider systemic competitiveness context.

The role of SMEs in OECD countries
In the OECD countries (2010, 7), 99% of all firms are SMEs, and they add 50-75% of value addition. SMEs play an important role in employment (between 40 to 80% according to different countries and statistics). In OECD countries main arguments to promote SMEs are the following:

- Their capacity to substitute for jobs lost due to downsizing of large enterprises;
- Their innovation potential due to specialization potentials;
- Their flexibility to adopt to new market conditions which becomes especially important during structural change processes
- Their potential to become the root of new emerging sectors with radical innovation tendencies (like e.g. new ICT companies like Microsoft and Apple since the 1970s)
Their ability to identify new markets due to their export and expansion potential (see JMS/Waeltring, 2000).

Especially in the end of the 1980s different research disciplines focused on the analysis of industrial districts especially in Italy with the identification of competitive advantages of locations where the agglomeration of SMEs had contributed to certain knowledge and social capital advantages. The term "small is beautiful (Schuhmacher, 1989) came a common phrase emphasizing the flexible potentials of SMEs to adopt to new markets and to quickly change production processes. It also became a synonym for the promotion of all different kinds of SMEs. SMEs are in many OECD countries seen as the innovation-agents of change, introducing new products and reacting on new production processes and market demands in a globalised world. Nonetheless it also became clear during the 1990s that is necessary to differentiate between the challenges and potentials of SMEs in developing-, transformation and industrialized countries. In OECD countries newest studies demonstrate that SMEs are in general not the innovation force per se. in general they innovate, but not as much as large firms. They are also on average less involved in collaboration networks to identify new products or new process innovations. The innovation force of SMEs in OECD countries is rather concentrated in some knowledge-intensive enterprises, including new firms with rapid growth. OECD figures state that in 11 OECD countries high growth enterprises account for only 2 to 8% of all enterprises beyond 10 employees whereas innovative small enterprises (below 10 employees) account for only 1% (OECD 2010, 24). This does not mean that the large bulk of other SMEs do not innovative, but to a lesser extent.

In general it is necessary to distinguish between different kinds of SMEs and their potential to innovate. In the OECD countries SMEs are often differentiated between

- high-potential enterprises in knowledge intensive sectors e.g. biotechnology, ICT etc.
- hidden champions (e.g. in Germany) as specialized medium-sized businesses with a high export potential for supplier products e.g. in machine engineering, electro-technical production or e.g. in the automobile sector
- average industry SMEs who produce certain supplier products or end products for the local and national market e.g. in the textile and garment sector or in different production areas
- local service and handicraft businesses like e.g. supermarkets, shops, plumbers, carpentries etc, who satisfy local and national consumer demand of day to day products

Also in DC these distinctions between SME groups can be made although the competitiveness gaps are in general larger. This goes back to much weaker framework conditions for these SMEs in regard to access to knowledge, education, market access and finance. The institutional and physical infrastructure as well as the political and societal circumstances are also more fragile. This makes it more difficult for SMEs to grow. In this context and in regard to the classification of SMEs it is important to mention in DC a group of enterprises that can also be defined as survival businesses. Most of these survival entrepreneurs became not businesses by choice but by emergency. Many producers and self-employed people in the production and service sector can be defined as survival entrepreneurs. They in general lack basic assets to be an entrepreneur like market orientation, entrepreneurship, search for business opportunities. They often lack prerequisites for growth like a business strategy or basic management skills. These enterprises will rarely become competitive businesses. Nonetheless it will be necessary to provide them with support structures and an business environment that supports and secures their economic situation. This does not only include access to finance but also the promotion of new employment opportunities, skills development as well as market knowledge and market information. When we reflect about growth promoting SMEs, we would rather need different approaches. The following chapters will focus on these latter enterprises with higher potentials.
**Similarities and differences between SMEs in OECD and DC**

In OECD and DC many similar but also very different barriers to SME competitiveness and innovation can be identified.

**Similarities**

Most of the similarities go back to general market and government failures. Government failures refer to 1) bureaucratic obstacles, corruption and regulatory disadvantages for SMEs, 2) lack of the provision of the necessary institutional and physical infrastructure that supports SMEs in their growth, 3) missing policies that overcome these government failures, and 4) the non-provision of certain public goods and policies to overcome market failures. Market failures refer to the lack of provision of certain goods that are not provided by market relations themselves but which require certain support structures. Otherwise it would especially affect SMEs. These market failures include e.g. lack of same access to information, investments in R&D and trainings, access to certain services etc. (source,...)

In general it can be said that in OECD countries and in many governments in DC, institutions and businesses try to overcome government failures as well as market failures through certain interventions. Here we can identify similar challenges in general. These are e.g.

- lack of access to finance for longer-term investments
- lack of linkages between SMEs and technology institutes and R&D institutions
- lack of transparency of information and linkages between SMEs, buyers and suppliers
- lack of access to market information and the elaboration of market knowledge
- lack of service and demand-oriented business organisations and public support institutions
- bureaucratic and business environmental obstacles

**Differences**

Despite these similarities, most of the challenges above are much stronger in DC than in industrialized countries. This goes mainly back to different systemic competitiveness challenges which finally lead to the misuse of potentials for knowledge and expertise creation. Whereas many IC have set up a wide range of support mechanisms and institutions, many DC lack these stable institutional and policy structures. It often includes

- a lack of competitiveness orientation in existing SME policies. Especially informal and small businesses are often rather approached with social support mechanisms than with entrepreneurship-oriented ones
- a lack of generic and targeted SME policies focusing on the improvement of the competitiveness of SMEs and the SME enabling environment
- institutional and professional weaknesses of business development services and support organisations
- a lack of linkages between top-down and bottom up, decentralized supporting measures

From the perspective of SMEs in DC this results into

- a lack of knowledge intensive businesses
- weak business networks between suppliers and buyers,
- and a lack of access to technology and market as well as to production knowledge.

OECD countries have in the last decades set up a wide range of policies and programs to overcome the challenges of SMEs. To understand the reason of good SME policies and the difference between weaker and stronger implementation success, it is necessary to have a closer look into the different systemic elements which are relevant for success.
Systemic good SME policy practices in OECD countries

The OECD and especially EU countries have their different approaches as well as a multitude of different funding schemes at the local, regional, national and EU level. Despite these funding schemes most of the success of certain programs do not go back to the funds themselves but to the existing structures in place that provide, deliver and use these funds. SME support measures depend on many stakeholders, on institutionalized structures, on a certain governance capacity of the private and public sector as well as on networking activities between the different stakeholders to finally encourage market-oriented, knowledge-intensive and innovative product solutions. This means also that good policies do no need a lot of finance in the first place.

General requirements for systemic interventions

To better understand the success in SME development of some IC it is necessary to take a systemic perspective before presenting good practices of programs and policies. The systemic competitiveness approach provides this framework of a deeper understanding (see graphic).

Determinants of systemic competitiveness

Successful SME competitiveness requires certain prerequisites and interlinked interventions. The experience of SME promotion during the last two decades have provided the following insights:

At the business level (micro level) it is important

- to promote competition between businesses and encourage them to improve their products and their processes on a continuous basis
- to focus on that businesses and potential individuals with entrepreneurship skills or potential, motivation and growth potential
to promote the self-organization of and the linkages between businesses, their suppliers, buyers and knowledge providers (like BDS, R&D institutions, economic development and export agencies)

Although SMEs have (to a certain degree) their own responsibility to stay competitive, they require institutional support (meso level) and supporting policies (macro level). At the meso level professional (and learning-oriented) institutions are necessary which provide the support necessary for SMEs. These involve

- market-oriented business organizations or cooperatives instead of socially oriented business networks. The latter provide businesses with access to certain services that goes beyond lobby function. It rather entails market information, skills, technology, finance and/or access to new markets. In several OECD countries (e.g. in Germany) chambers and certain business organisations take over a strong role in the provision of some of these services or in the development and quality assurance of apprenticeship programs and exams.
- Training, education and R&D institutions that provide skills and capacity building which is related to the need of the SMEs and that encourage knowledge flows and innovation in knowledge intensive and less intensive businesses to improve their competitiveness in the market
- local and regional economic development agencies that understand the local business needs and sector potentials and supports these competitive advantages and potentials through network management activities, promotion initiatives and support measures

Successful linkages between businesses (micro) and support institutions (meso level) will only be possible if policies (macro level) are in place which

- provide an SME enabling framework in which property laws and macro-economic stability as well as competition orientation is assured
- support the institutional (see above) and physical infrastructure (roads, access to public utilities, business estates etc.)
- promote programs that strengthen (and pressure) institutions and businesses to take over a responsible role
- provide political enabling conditions that enable these businesses to overcome market- and government failures

All these stakeholders involved at the business-, institutional- and policy level will only cooperate with each other at the local or national level if they follow common strategies and directions. The latter depends very much on the national socio-cultural value system which needs to be oriented towards continuous learning and change. This “meta level” includes e.g.

- the capacity of these actors to define common strategies
- the societal appreciation of entrepreneurship, SMEs, economic success and market orientation
- the societal capacity and openness for networking and for taking over own business and institutional responsibilities. This is also often called “social capital” and “trust building relationships in a society. The higher it is the more it contributes to joint knowledge creation
- the ability to deal with flexible circumstances and to adjust continuously

Systemic policies in OECD countries: general trends
SMEs play an increasing role for trade, investment, and competitiveness in many OECD countries. To address the challenges of SMEs in a more systemic way, many OECD countries have increased the coherence of policies in regard to SMEs. SME promotion became a cross-cutting issue in several policy fields. Science, Technology and innovation strategies, economic, sector and structural policy approaches, trade and investment and education strategies are more and more interlinked and address entrepreneurship creation, human capacity development for SMEs, innovation and competitiveness policies with an emphasis on SMEs.

According to OECD country reports IC focus their SME promotion activities more and more on the
following four areas:

- The promotion of entrepreneurship cultures and the improvement of macroeconomic framework conditions for new start-ups, existing businesses and for potential new investors.
- The increase of knowledge flows between SMEs and between SMEs, large enterprises and knowledge institutions. In this regard intervention strategies often differentiate between high-growth-or knowledge intensive firms to encourage radical innovations and traditional SMEs with incremental innovation potentials like e.g. improving products, processes of production, or the quality and value addition of products.
- Strengthening entrepreneurial human capital and access to finance through the improvement of skills development programs and better access to financial and non-financial business development services. This also involves the creation of entrepreneurship skills in schools and universities.
- Encouraging local and decentralized network approaches and innovation systems as well as integrating networks of SMEs and local knowledge institutions into global knowledge networks on the other hand.

Concrete policy areas as examples of good practice

There are several examples of SME policies that focus on the improvement of strengthening the stakeholders at the macro, meso and micro level as well as to encourage the diffusion of relationships between them. Certain policies focus on the improvement of the enabling environment of businesses (macro level), others are more directly targeting businesses and business networks. The third group of policies follow the objective to strengthen the network relation between several supporting institutions and SMEs (meso and micro level).

Policies to improve the enabling environment for businesses

During the last decade a lot of emphasis was given to the reduction of bureaucratic obstacles of governments for SMEs. This can also be interpreted as the result of the Washington Consensus by World Bank and the International Monetary Fund in the 1990s to liberalise markets and to draw back direct interventions of governments in private sector promotion. This emphasis was promoted in IC as well as by many donors and national governments in DC. Several country reports in the OECD and from international donors identify the costs of bureaucratic obstacles. Several rating systems were introduced since the 1990s to motivate the design of several regulatory reforms in regard to private sector development. The annual “Doing business” rating report from the World Bank Group has become one of the most influential rating schemes of 183 countries to measure their business-friendly orientation in regard to business registration procedures and business friendly property and contract rights regulation schemes (World Bank 2011). In these rankings OECD countries show a stronger position in regard to the business environment than other DC (see figure, World Bank 2011, 3).
The latest 2012 report states that during the last 6 years Eastern European and Central Asian countries have strengthened their legal institutions and the protection of property rights but less so their regulatory processes in place. Armenia has improved its rating from position 61 in 2010 to 55 in 2011. These improvements go back to the introduction of a one-stop-shop, credit information systems and complicated tax compliance procedures (World Bank 2011, 66).

The OECD has developed certain policies to strengthen legal institutions and procedures for SMEs. The following can be mentioned in this respect:

- **SMEs as the centre of attention:** Most of the EU countries have started to develop innovation strategies in which SMEs are seen as an important driver for future innovations and economic development. Providing SMEs with this innovation role also provides them with a higher social status. Other ministries started to consider SMEs in their own strategies as an important target group.

- **Ease of procedures in SMEs life cycle:** In the past many OECD countries have mainly focused on the reduction of registration and permit costs for SMEs. Introducing One-stop shops became an important instrument that was also introduced in many DC (like in Armenia). Nonetheless new approaches focus not only on the reduction of transaction costs for businesses in the start-up phase but in the whole company’s life cycle which includes also the ease of procedures in case of insolvency or handing over the business to followers who take on the firm.

- **Regulatory exemptions** especially for small enterprises: Many OECD countries have provided exemption for SMEs to comply with certain regulations. SMEs are disproportionately affected by regulation. The regulatory and administrative costs for smaller businesses can be up to ten times higher than for large companies. The introduced exemption include e.g. total, partial or temporal exemptions of small businesses from regulation, simplified rules, special information and assistance, electronic services and a privileged treatment of small businesses by public administrations (EU 2007).

- **Ease of tax burdens** and accounting regulations for SMEs has become an important part of improving the enabling environment of SMEs in OECD countries. This is often done through the introduction of SME relief laws that decrease the tax and information burden especially for small formal businesses.
• **Increase of number of decentralized public supporting organisations:** SME support structures have been decentralized as well as the number of economic development agencies have been increased during the last two decades. Especially municipalities and regional governments took over a stronger role. Bottom-up approaches in the context of local and regional economic development initiatives (LRED) and the local support of competitive sectors with a high SME participation increased importance.

• **Increase of quality and market orientation of public supporting institutions:** Since the 1990s many municipalities and regional governments have outsourced their economic development- or export promotion departments into privately managed agencies. This has increased market orientation as well as organizational efficiency of these entities. Although these organisations often have a basic public funding, they have to additionally apply for further project funds on a contest basis with other supporting institutions. This contest approach has also encouraged a competition on ideas for better solutions and support approaches.

• **Improvement of local business development services:** especially in many locations municipalities have improved their services for start-up promotion, and created information and matching platforms between existing information providers and SMEs to increase the transparency about existing structures.

• **Improvement of evaluation and monitoring procedures:** Although the evaluation procedures e.g. in the EU can still been interpreted as very bureaucratic and not very impact oriented, many governments have started to increase impact monitoring as an important aspect of learning form past experiences and mistakes.

• **Improvement of SME infrastructure:** many cities in the EU have improved their supply of real business estates for SMEs. Business parks, technology centers, incubators and Science parks have increased in numbers. Many old industrial estates have been restructured as attractive business parks especially for small businesses from the creative economic sector.

These national and local enabling environment policies have had a direct impact on the transaction costs of SMEs.

**Policies to improve market orientation and market access of businesses at the micro level**

Whereas enabling environment policies for SMEs have mainly been oriented to overcome red tape and bureaucratic burdens for SMEs, there are also many support policies that provide direct access for individual SMEs in certain areas. In EU countries several new funding schemes have been promoted in this way and are allocated at local, national and EU level. Examples are mentioned in the following bullet points:

• **Access to finance:** Policies have been put into place in many EU countries to overcome the lack of access to finance for SMEs. These activities entail programs for collateral insurances, cooperation and research between SMEs and R&D institutions, as well as specific credit lines for longer-term investments. Access to risk and venture capital has been increased especially for smaller enterprises in knowledge- and research-intensive sectors, most of the time with private sector participation. Local and regional banks play an important role as intermediary to channel these regional, national and EU funds to local SMEs. This increases transparency of information as well as easier access of SMEs to the available credit lines.

• **Access to market information and consultancy services:** Several OECD countries took specific emphasis on promoting programs in which SMEs have a better access to financial and non-financial business development services. Incentives and certain grants are provided to businesses to make use of professional consultancy services. This often includes services for market information, product and process improvement, the introduction of quality assurance systems (like e.g. ISO management standards), technology advise, counselling or coaching as well as management, book keeping and leadership trainings. Apart from private BDS these services are often also supported by local economic development agencies who provide
consultancy to start-ups and existing businesses. These agencies also play an important role to match demand and supply for certain services. Often they manage matching programs between business services and SMEs.

- **Promoting access to new markets:** especially for more competitive SMEs, access to foreign markets as well as the identification of investment opportunities in emerging markets becomes a source for increasing their outreach and growth potentials. Several programs and services support SMEs in the participation of national and international fairs, in professional marketing of their products as well as in the establishment of business contacts in other countries.

- **Promoting access to skills at all stages of a business cycle:** Whereas in the past years many OECD countries focused especially on the provision of further capacity building opportunities for start-ups, it becomes more and more important to support the access to skills for SMEs in their different stages of development. This includes programs to support SMEs in situation of financial crises (organizational management improvements), in structural change processes (change of production process, new product development) or in the access to further basic skills (business planning and accounting), strategic skills (decision making, management), or entrepreneurial traits (leadership and creativity). Some IC also introduced promotion programs for highly experienced employees who want to start their own business.

- **Resource efficiency and cleaner productions** that reduces running SME costs: SMEs in the EU are responsible for around 60% of industrial air pollution. Several countries provide SMEs support to reduce their environmental costs and to increase resource efficiency in their production processes. This contributes not only to the reduction of running costs and expenditures but often also involves the introduction of technological and organizational innovations.

Most of these support policies and programs are directly offered to SMEs although meso institutions often play an important role as intermediators of these support measures as well as direct providers of these respective services. In conjunction with the enabling environment activities at the policy level (macro level), these initiatives provide even better prerequisites for SMEs in many countries.

**Policies to increase the diffusion of knowledge and knowledge networks at the meso level**

Competitiveness of SMEs will be more and more based on their capacity to develop more knowledge intensive products. This requires the promotion of knowledge diffusion through networking between applied oriented universities, technology institutes, BDS and businesses. In most of the OECD countries the promotion of clusters, value chains and LRED have become an integral part of SME promotion. In this context the promotion of local, sectoral and national innovation systems increased its relevance especially for countries that compete rather in knowledge-intensive sectors than in labour-intensive ones. In many EU countries SME promotion policies have more and more been using network approaches to channel their funds instead of individual support. It goes back to the learning that the large bulk of SMEs innovate and learn mostly through the direct contact with their business partners and via their employees. The latter also provides vocational institutes and formal as well as embedded BDS with a high responsibility. This is the case in IC as well as DC (see graphic, fill in 2nd OECD graphic).
Additionally, especially knowledge-intensive SMEs require also capacity building and access to professional applied-oriented R&D institutes that are cooperating in the development of new product solutions. In the following some of the most interesting network approaches are highlighted:

- **Increasing support for bottom up and local innovation networks**: SMEs in general lack the access to R&D knowledge, information transparency about other suppliers and buyers as well as exchange of experiences with similar businesses. During the last decades many EU countries have increased the importance of LRED to identify local competitive advantages and networks between businesses, suppliers, and support agencies. Like stated above, the responsibilities of municipalities and regional governments in the improvement of business infrastructure and the identification of competitive sectors and respective support mechanisms as well as stronger cooperation of local technical colleges, universities, training institutes and services have gained importance. These new intervention approaches are often referred to as bottom-up approaches in which public stakeholders have to increase their demand or orientation according to market and SME requirements. It also became clear that these bottom-up approaches require top-down support in regard to strategies, organizational development, and the support of new professional institutions and services. It involves a decentralization of responsibilities to local businesses, government bodies and institutions and a change of traditional behaviours of the respective stakeholders.

- **Cluster promotion**: Cluster promotion became more relevant since the beginning of the 1990s. It is based on the assumptions that rather territories and less so nations compete globally with each other. Specific regions have demonstrated that close cooperation between scientific and knowledge-based institutions, training providers and local governments can make a difference. Clusters or the agglomeration of certain businesses in specific and related sectors and related knowledge institutions can make a big difference in the promotion of competitiveness when they are closely cooperating with each other. Although failed attempts to develop clusters by governments show that it is not possible to develop clusters, it became clear that existing clusters can be supported to strengthen their linkages.

- **Value chain promotion**: To produce a certain product from its resources to its final shape, it in general integrates several businesses. These are normally input suppliers, producers,
further processors, transporters, traders and buyers who channel the products to the end markets. Often certain value added steps in these value chains are based locally, but the whole value chain is rather linking businesses at the national level or even globally. The promotion of SMEs in their potential to upgrade in local, national and global value chains became one important approach in EU countries. It is about identifying the position of local and national SMEs in value chains and their weaknesses to then intervene with specific support services that contribute to strengthen SMEs upgrading potentials. In general it also encourages a better self-organization of certain businesses in the chains as well as stronger linkages with the locally and nationally available support institutions who provide knowledge inputs (e.g. on standard compliance, product and technology improvements, etc.)

- **Support of Cross-border alliances of clusters and innovation networks:** Apart form strengthening local knowledge networks through cluster or value chain approaches many OECD countries also became aware about the need to source knowledge and experiences from outside. Supporting the exchange and relations with other international clusters and value chains became one important approach to increase the internationalization of SMEs. EU cluster observatories, platforms and many exchange programs have been established between SMEs, RuD and export institutions across countries (see EU cluster observatory etc.)

All of these approaches can also been interpreted as systemic approaches which in general do not provide isolated interventions to individual businesses. They rather follow a network approach in which interventions are designed to improve the system of interaction between the different stakeholders relevant for innovation and value added production. There are additional approaches in many OECD countries that support more specific relations:

- **Programs to support the linkages between large enterprises and SME suppliers:** SME promotion should not only focus on SMEs but especially also on the improvement of supplier-and buyer linkages. Large enterprises often provide certain embedded services to their suppliers. Additionally larger enterprises often have better knowledge about market trends, product requirements and innovation potentials. Several support programs encourage the “learning from larger buyers”. They entail the identification of spin-off-, outsourcing- and subcontracting opportunities, the more efficient use of the embedded services provided by the buyers, as well as the support of SMEs to upgrade their business processes and thus improve their supplier capabilities and relations with buyers

- **Promotion of academic spin-offs:** especially for the promotion of knowledge-intensive start-ups it became common in many EU countries to promote Academic spin-offs. Several programs are set up to promote innovation centers, business incubators and science and technology parks at universities or research centers which focus on the promotion of new start-ups with entrepreneurial oriented students in knowledge intensive areas. Often certain services like e.g. access to finance, patenting, the provision of research facilities, coaching and counseling activities etc. are integrated into these programs to provide the new businesses with a full package of support. The spin-off programs often also promote larger local and international learning networks with similar start-ups and additional research institutes

- **entrepreneurship education in higher education institutions, in vocational training institutes and schools** has become more important in advanced OECD countries. This goes back to the experience that entrepreneurship education, market orientation and the search for creative business solutions involves a certain culture of learning which has to been promoted already in young kids and students. It means that new stakeholders like schools, training institutes and universities have been integrated into economic development promotion approaches.

The above presented good practice policies can only provide an overview about trends in certain and also not all OECD and EU countries. Nonetheless it is obvious that policy interventions have increased their systemic character. The policy laboratory in many EU countries has contributed to intensive learning processes how to use public and private funds in a more efficient and impact driven way.
This learning is a continuous process and each country has to walk through its own learning curves. Nonetheless the experiences and common trends can also contribute to the design of implementation driven SME strategies e.g. in Armenia. It will be important to take over a step-by-step learning approach which is based on the systemic competitiveness capacities of the Armenian stakeholders.

Promotion of SMEs along a step-wise approach

Systemic challenges of DC in the promotion of SMEs
Like it was already mentioned above, the prerequisites in DC and IC are very different to promote SME policies. These aspects have to been taken into account when designing an SME strategy in countries like Armenia. Some of these weaknesses are mentioned in the following, structured along the systemic competitiveness levels:

Enabling environment and political challenges at the macro level
- **Capacity requirements of governments to intervene in markets**: Many DC have been able to improve their macro-political regulatory framework conditions and managed to keep non-inflationary fiscal policies. This has already improved the framework conditions for businesses in general. Nonetheless more complex interventions of governments e.g. in regard to the promotion of SMEs require also more complex governmental capacities to manage these interventions in a non-market distorting way. This capacity in many countries is just emerging. Every additional policies and their design have to fit thus to the existing governmental capacities to not lead to badly managed and market-distortive or wishful-thinking policies.
- **Systemic SME support experience is rather weak**: Policies in many DC to support SMEs are rather isolated. Especially support activities to small enterprises often follow a rather socially-driven (e.g. the provision of certain input products) than an entrepreneurship- and competitiveness-driven approach. It will be of crucial importance to understand competitiveness and its incentive structures for SME support measures.
- **Centralized procedures**: Support mechanisms are in general very much centralized in DC. Although in many countries local and regional governments are taking over more responsibilities in the promotion of SMEs, they often lack experience, skills and authority from national governments to improve local enabling environment and regulation procedures. In general decision competence is still centralized. Additionally local and regional governments still miss in many cases the capacity to identify local competitive advantages and the support of local business institutions.
- **Red tape and corruption**: many governments in DC at the national and local level often miss institutionalized and efficient regulatory procedures which then leave space for red tape and corruption structures.
- **Lack of data**: SME support policies require certain information about data like the competitiveness of certain sectors as well as concrete economic of SMEs to improve their position in the market. This data often does only exist insufficiently which also makes it difficult to define sustainable interventions.
- **Planning of policies instead of implementation**: many governments have designed SME and innovation strategies with the support of external consultants which then have never been implemented. It demonstrates rather a focus on the design of plans than on the implementation of realistic learning initiatives.
• **Public-private sector relationships are rather weak**: In many countries the private sector is still weakly organized and the public sector representatives see themselves still as the main driver of development. Joint cooperation structures are often still at the early stages.

### Competition challenges of businesses at the micro level

In the above sub chapters some of the similar and different challenges of SMEs in industrialized and DC have been mentioned. There are several additional aspects that challenge SMEs in DC:

- **High informality of the SME sector**: in many DC especially small businesses are informal. They are not registered and often act as micro enterprises under the radar screen of governments. Although a certain percentage of these businesses might have potential to grow it is difficult to reach and identify them.

- **High number of survival businesses** with weak entrepreneurship skills: like it was mentioned above, many small businesses in DC have decided to become self-employed due to a lack of other employment opportunities. These self-employed individuals lack basic business and market skills and in general are mainly working in the trading and service sector (selling and buying with small margins). It would be necessary to address these businesses with rather educational and social approaches to support them in their situation and in regard to small business improvements. These are rather social support approaches. Growth-oriented SME support measures need focus on more entrepreneurial driven businesses.

- **Lack of access to finance**: Many SMEs in DC lack access to investment credits. Although many donors and national governments have introduced micro finance schemes in many countries, this often does 1) only cover a small number of businesses, and 2) not match the credit demands for larger investments. The lack of collateral programs as well a lack of strategic and accounting skills in the enterprises makes it in many cases more difficult to provide sustainable financial credit schemes.

- **Weak market information and market orientation**: Especially in rural areas SMEs often miss the access to market information and product innovations. In general many products are produced in the same way and copying locally produced products is often the main innovative approach.

- **Weak organization of SMEs**: SMEs in many DC rather act in an isolated manner. Often they are not organized in business associations or cooperatives. The existing organisations normally lack a real service orientation towards their members and rather understands itself as a lobby group than a driver of competitiveness.

- **Weak transparency and linkages to other suppliers, buyers and further market channels**: often the lack of market information also leads to a lack of transparency of information about available suppliers and buyers. Often SMEs stay in traditional business relations and do not discover new ones that provide also new upgrading opportunities.

- **Weak access to capacity building and knowledge intensive learning processes**: The supply of trainings for SMEs does not always match the specialized demand of the entrepreneurs. It is in general rather focused on generic trainings in regard e.g. to business management instead of capacity building in the production processes.

Many of these weaknesses of the SMEs can be traced back to their lower entrepreneurial capabilities. But to a large extent it also is the reason of the mentioned unfavourable enabling environment conditions as well as the lack of access to supporting institutions and business development services.

### Challenges at the institutional level (meso level)

In OECD countries many SME support measures emphasized the support of knowledge networks. But the institutional prerequisites in many developing have to been improved to encourage these networks. Certain institutional weaknesses can be identified:
• **Non-existence of decentralized supporting institutes:** Like it was stated above, many professional agencies are rather located in the main cities and less so in the rural areas.

• **Many development agencies focus on the provision of basic services like business planning or accounting services.** They often lack the skills and the support to analyse the local competitive advantages of the respective territories or to provide network management for certain business networks.

• Although many DC have promoted the set-up of vocational training institutes, in general these training institutes are rather supply- than demand oriented. At the same time they lack the involvement of the private sector in the design of the respective curricula or in the participation of apprenticeship programs.

• **Universities focus on teaching, less on research and innovation:** Many universities in DC rather focus on teaching students rather then having sufficient for deeper R&D activities. If they do R&D they rather focus on international research than on local SME innovations. In many cases university professors gain a high social status and universities normally gained long-term support from government. Increasing their orientation towards the private sector and SMEs is rather which made them also reluctant to deal

• **Lack of access to demand oriented services:** SMEs often lack the access to professional BDS. Public BDS often miss an entrepreneurial orientation although this is changing after many donors have put emphasis on the improvement of public business services and a change in their management structure. Often private businesses services exist in the market but with a weak transparency of their businesses.

• **Lack of cluster and value chain promotion approaches:** Many donors and first governments in DC have started to support cluster and value chain approaches. But these approaches and the knowledge about how to promote these approaches are still unknown.

### Intervention promotion in a step-wise approach

The long list of challenges stated above goes hand in hand with a long list of many opportunities to start with systemic interventions to promote SMEs and to design respective policies. But how to promote SME policies based on own and OECD learnings without running into the risk of failure? In the longer run SMEs and governments in DC must design, plan and implement firm-level changes, enabling institutions, decentralized structures at the federal and local level, and the continuous improvement of regulatory barriers. To be able to do this, they need to work closely with the private sector to unleash entrepreneurship and innovation. Nonetheless this is not possible in a short period of time. DC have to go through their own learning cycles. Like the SME policy laboratory in OECD countries demonstrates, it is necessary to test different approaches and to learn from failures and successes. But this requires a step-wise approach in which own failures and learning are registered and used for further policy- and implementation improvements. A step-wise approach has to been promoted in which

- the promotion activities have to comply with the capacities of the respective stakeholders and need to create cooperation potentials
- concrete measures and activities have to been identified that are also put into practice
- small interventions are promoted that have a high outreach
- activities are promoted that encourage the coordination of forces of the private and public actors involved in the system
- there is space for a laboratory of learning by experiencing and learning by doing

Many DC have made successful experiences with such step-wise approaches. Systemic interventions and the implementation of concrete initiatives have contributed to further learnings and trust building processes. Based on these learnings next steps were promoted that further increased experiences and knowledge creation through practice and readjustments.

What could be approaches that focus on small systemic interventions with a wide outreach? The following overview provides some first suggestions for such interventions:
• **Promotion of network management initiatives:** through the promotion of projects in which support organisations are able to finance a professional network managers, learning networks of motivated businesses and training or R&D institutions can be rapidly promoted. The finance of the network managers of such networks has had in most of the countries a high outreach. It did lead to increasing linkages between different businesses and local and regional supporting institutions

• **Support of pilot value chains** with a high potential for value added production in a relatively short period of time: First value chain interventions can have an outreach and get increasing respect from other stakeholders if they can make a difference in a relatively short period of time. This will be important in the initial phase when starting with the value chain approach

• **Promotion of local business networks instead of whole clusters:** Before encouraging the support of whole clusters in a relatively weak institutional environment, it makes sense to identify local competitive advantages in several localities and regions and encourage market oriented businesses to increase their cooperation with certain knowledge providers or BDS. This can be more specialised services or research institutes that support the business network in the realization of concrete incremental innovations in their production processes or services.

• **Focus on growth-oriented businesses:** First promotion programs should especially focus on growth- and market-oriented businesses. It does not mean to “pick” the most potential ones. It rather means working with the ones who show a willingness to change and learn

• **Publishing success model businesses and supporting institutions** that demonstrate a clear market and service orientation

• **Starting with entrepreneurship culture trainings** in vocational training institutes and in schools to encourage business creativity and entrepreneurship orientation from early years onwards

• **Promotion of integrative approaches to improve the access to finance for SMEs:** Collateral programs and longer-term investment credits combined with the provision of basic skills (e.g. business plan, accounting) and counselling or coaching programs assures the feasibility of repayments. The access to further financial credit opportunities for SMEs has in many OECD approaches also been related to value chain-, technology transfer- or cluster projects. SMEs actively involved in such projects, were given additional access to certain investment credits due to their obvious motivation and capacity to further upgrade specific products or processes

• **Promotion of export alliances and exposure tours:** Although several support mechanisms for the participation in fairs already exist in many countries, the creation of export alliances puts special emphasis on the preparation of businesses for such fairs as well as the follow-up of learnings with the businesses after the visits and contact-making procedures

• **Improvement of physical infrastructure:** In several local communities and regions physical infrastructure improvements are rather promoted without a clear analysis of real economic infrastructure needs and priorities. Instead of building new real business estates for businesses or designing and building new technology centres and incubators, old existing and non-used infrastructure (e.g. old state factories in many former East European countries) could be reconverted for SMEs. Additionally more focus should be given to the management of the relevant networks and less so on the construction itself

• **Matching programs of demand and supply of services:** During the last decade donors in many countries supported the matching of demand and supply of services for SMEs. This has strengthened the play of market forces, increased awareness in businesses about their demand, as well as their skills. These matching schemes might require support of certain BDS to become more efficient and more demand oriented. On the other side it also requires in many cases counselling of business groups to identify with them their specific knowledge gaps and service demands.

• **Promotion of technology and knowledge transfer between larger businesses and SMEs:** cooperation projects between suppliers and buyers have in many cases contributed to intensive learning processes of SMEs and increasing knowledge creation. Analysing the market requirements and promoting improvements of e.g. standards or product design, and the use of
more innovative technologies and production processes has contributed in many countries to intensive learning processes.

- **Tackling local and regional red tape procedures:** Despite bureaucratical improvements of many DC in regard to the registration procedures for new start ups, bottlenecks become obvious when looking at government procedures from the local or regional perspective. With red tape workshops it is possible to identify business environmental bottlenecks of SMEs who are mainly based in rural areas. Important is then the implementation of concrete initiatives to increase the trust between the local private and public sector.

Stimulate local, national and international knowledge flows in and with SMEs in a systemic way will be one of the main tasks for future SME strategies. SMEs need to become integrated into local and global knowledge networks and learning alliances.

The following chapters will provide a deeper analysis of challenges and opportunities for the improvement of SME policies in Armenia. The strategy considers a step-wise approach and takes the learning experiences and innovative policy approaches of several OECD countries into consideration.
Literature


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