ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS
Private Sector Development Unit

UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION

PRIVATE SECTOR DEVELOPMENT BRANCH

TRANSITION ECONOMIES FORUM ON ENTREPRENEURSHIP AND ENTERPRISE DEVELOPMENT

POLICY GUIDELINES AND RECOMMENDATIONS

Centre For Co-operation With Non-Members, OECD

in Co-operation with

United Nations Industrial Development Organization

Foreword

The OECD has consistently pointed to entrepreneurship as a critical element in creating vibrant market economies. Entrepreneurs -- people who start businesses and make them grow -- are essential agents of change in the process of transition from a centrally planned to a market economy. They are the catalysts of growth, marrying capital, innovation and skilled people. A crucial barometer for economic and social wellbeing is the number of new small firms established in all sectors of the economy by all segments of society. The conditions for entrepreneurship and new firms are still in poor shape in many countries in transition and in particular in the countries of the former Soviet Union. This applies not only to small firms but also to larger ones who should play a stronger role as "seed trees" for entrepreneurial initiatives. The vital dimension of an environment conducive to entrepreneurship needs urgent and continued attention.

Improving the different elements which make up a good entrepreneurial climate is fundamental to achieving functioning market economies and underpinning fledgling democracies and emerging civil societies. The nature of this task demands an integrated horizontal approach, dealing with a number of crucial and inter-related policy areas simultaneously. This challenge is addressed directly by the Forum on Entrepreneurship and Enterprise Development (FEED), jointly established by the OECD in the framework of its Centre for Co-operation with Non-Members and UNIDO.

The FEED brings together the wide range of expertise available in the OECD and UNIDO to support transition countries in stimulating entrepreneurship. The complementary experience and skills of the two organisations in policy development and capacity building, combined with the expert inputs of international and bilateral donors, has helped to create a coherent and co-ordinated response to this policy challenge. The policy guidelines and recommendations presented here are founded on research papers and case studies from transition countries, review and dialogue at FEED meetings as well as the extensive knowledge and expertise of the OECD and UNIDO over many years in this area of entrepreneurship and small business development. They provide a guiding charter for best practice policy development and action on entrepreneurship and enterprise development by transition countries. But they are just one stage in the ongoing work of the FEED. The challenge now is to build on the progress to date and to ensure that these policy guidelines and recommendations are widely disseminated and implemented. The future work of the FEED will monitor progress on this challenging task and use the practical results of the implementation work to extend and develop the guidelines.

It is my great pleasure to express our thanks to UNIDO, the many OECD Member countries and international organisations, the participating transition countries and private sector representatives from various countries for their excellent partnership and contribution to the FEED. OECD and UNIDO are committed to jointly continue and support that partnership process to achieve real and sustained progress in our work with transition countries.

Donald J. Johnston
Secretary-General
OECD

Foreword

Industrialization has historically been a significant driver of modernization, and is the engine providing developing countries and countries in transition with the principal means to increase productivity. This, in turn, provides the foundation for increased standards of living and a corresponding decline in poverty. In recent years, the process of industrialization in developing countries has undergone profound changes. Globalization and new technology have, of course, played important roles, but also important has been the re-definition of the role of the state in economic development and the increased reliance on the private sector for production of goods and services. UNIDO, as the specialized agency of the United Nations dedicated to improving the lives of people in developing countries and countries in transition through sustainable industrial development, makes the development of the private sector, and especially the promotion of Small and Medium Enterprises (SMEs), the focus of its work.

At UNIDO, private sector development is recognized as being a partnership between the private and public sectors, since the competitiveness of an enterprise may depend as much on what government does as what the firm's owners and managers do. As a result, our programmes address not merely the managerial, technological, or informational needs of the private sector, but the needs that governments have in supporting the growth and competitiveness of private firms. We help governments to build their capacity to draft policies that are conducive to business creation and growth, to set up SME data collection systems to monitor the SME sector, to design SME support programmes that use public funds wisely, and to improve their understanding of how best to support private sector development. This is not an easy task because, while some basic principles are generally agreed on, conditions vary so much from country to country, that specific private sector development activities that work in one country may not work in another.

It is in this context that UNIDO has been working with OECD to organize the Forum on Entrepreneurship and Enterprise Development (FEED), which consists of two working group meetings and one high-level plenary session annually. Participants from a variety of transitional economies, and bilateral and multilateral organizations, meet to discuss their experiences with SME promotion, and to distil guidelines for best practice in the field. The guidelines in this book are intended to be a general framework within which private sector development and the promotion of SMEs can be undertaken while at the same time recognizing that different objectives, conditions, and resources in each country require a customized approach.

The guidelines presented here address specific issues that were discussed in the 1998 FEED sessions. It is expected that these guidelines will be expanded to include new issues and new lessons based on the outcomes of the 1999 and subsequent FEED discussions.

UNIDO is pleased to be jointly organizing the FEED with OECD, and we look forward to closer co-operation and exchange of information and experiences with the countries in transition in 1999 and beyond. We expect that FEED will play an important role in establishing basic principles for the design, operation, and monitoring of SME programmes, especially for countries in the earlier stages of transition

Carlos Magariños
Director-General
UNIDO

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INTRODUCTION TO THE POLICY GUIDELINES AND RECOMMENDATIONS

1. Introduction

The last ten years of OECD and UNIDO work in transition countries has shown that fostering entrepreneurship is crucial to successfully managing the structural and social changes in the process of transition from centrally planned to market economies. Most transition countries still have an unfavourable environment and discouraging conditions for entrepreneurs. There is an urgent need for more effective policies to promote small and medium-sized businesses in these countries. The FEED was designed to address this issue using case studies and research papers from transition countries, OECD roundtable discussion methods with wide participation from OECD Member countries, international organisations and private sector representatives, advice from a special FEED Private Sector Consultative Group and subsequent review by OECD and UNIDO directorates.

2. FEED participants and subjects addressed

The Forum for Entrepreneurship and Enterprise Development, launched jointly by the OECD and UNIDO, held two working party meetings, an annual plenary meeting and private sector consultative group meeting at the OECD Centre for Private Sector Development (PSD Centre) in Istanbul in 1998. The OECD PSD Centre is jointly financed by the Turkish International Co-operation Agency (TICA) and by the German Technical Co-operation Agency (GTZ). The purpose of these meetings was to allow policy makers from ministries and state agencies, small business experts and technical specialists from transition and OECD countries to share experiences on enterprise promotion, diagnose problems for transition countries and seek common understandings on how to develop better enterprise policies and programmes. Members of the FEED are those transition countries that have generally participated in the activities of the PSD Centre since its creation in 1997: Albania, Armenia, Azerbaijan, Belarus, Bulgaria, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Mongolia, Romania, Russian Federation, Slovakia, Slovenia, Ukraine and Uzbekistan. OECD Member countries participating in this FEED are: Austria, Canada, Czech Republic, Denmark, Finland, Germany, Hungary, Italy, Japan, the Netherlands, Poland, Sweden, Turkey, United Kingdom, and United States. Some other countries, for example, Israel and South Africa have started to participate in the FEED as its work has proven to be relevant also for non-transition countries. International organisations participating with OECD and UNIDO in the FEED were EBRD, European Union, UNCTAD, UNDP, UNECE, USAID and World Bank. Six topics were addressed at the meetings:

<u>Institutional Framework for Entrepreneurship</u>

(1.) Tax Policy for Small Business

(2.) Institutionalisation of Enterprise Development Policy

(3.) Rule of Law and Regulation

<u>Support Services and Financial Instruments for Entrepreneurship</u>

(4.) Financial Instruments for New and Small Businesses

(5.) Advisory Services for New and Small Business

(6.) Business Incubators

3. Outcome of the FEED meetings

The outcome of these meetings and review work described above has lead to the codifying of policy guidelines and recommendations on enterprise development in transition countries. Each of the guidelines has a short introduction outlining the main discussion at the Working Party meeting on this subject and illustrating some of the progress achieved and difficulties faced by transition countries as they endeavour to develop new policies and move to market economy structures. This is followed by a series of best practice policy guidelines and recommendations on the subjects referred to above.

4. Entrepreneurship policy and promotion - finding solutions to meet country needs

When it comes to enterprise development policy and promotion it is easier to identify the problems than the solutions. This is common in all countries. FEED delegates at the Working Party meetings agreed that there are no easy, quick or single-model solutions to these problems. Transition countries are faced with the challenge of developing coherent and creative policies, which match their environment and their needs.

Each country needs to find its own solution, which focuses specifically on that country's needs and environment. The continuing FEED workshops provide a learning network for policy makers to share and exchange views on key issues and assist the search for solutions. They also enable focused guidelines to be developed which can help to shape and underpin policies to promote and foster new enterprise in the countries participating in the FEED.

The policy guidelines and recommendations are an aid in that challenging task and can potentially play an important role for each FEED member:

- In evaluating its own enterprise development policies and promotion organisations and in identifying where there is a need for improvement;
- As a policy mechanism in setting objectives and procedures to apply best practice;
- As an important information source on the experience gained by transition and OECD Member countries in developing policies and programmes.

As experience in adopting and applying the guidelines is acquired future FEED meetings will review progress and new editions of the guidelines will be developed. The FEED process in the future will address other important subjects for enterprise development, for example, expanding tax policy treatment, regional policy on small business development, venture capital policy, etc.

In response to demand the FEED process has been extended to other regions and new FEED programmes established: a Baltic FEED focusing on Estonia, Latvia, Lithuania, and the Russian Federation regions of Kaliningrad and Saint Petersburg in 1998; a country-specific FEED for the Russian Federation, aimed at promoting entrepreneurship in the regions of Russia; and a South East Europe FEED in 1999. In all the FEED programmes a similar broad process of dialogue, exchange of experience and development of policy guidelines is being pursued.

The guidelines are intended to assist Governments and policy makers in transition and emerging market economy countries to create the environment to stimulate and promote new enterprise.

Private Sector Development Unit
Directorate for Financial, Fiscal and Enterprise Affairs

Private Sector Development Branch
UNIDO

INSTITUTIONAL FRAMEWORK FOR ENTREPRENEURSHIP

TAX POLICY FOR SMALL BUSINESS

1. Overview

At the Working Party 1 meeting held in Istanbul in March 1998 and the Annual FEED meeting in December 1998 the subject of tax policy for small business was considered. The notes here outline the main points of discussion at these meetings and they are followed by the more detailed policy guidelines and recommendations. There was consensus that small businesses have an important role to play in the transition to a market economy. However a picture was painted of heavy tax burdens for small business, frequent changes in policies and institutions and limited encouragement to start a business in many transition countries. In OECD countries small businesses have generated significant employment growth. For example, in North America the small business sector has contributed much of the employment growth in recent years. Small and medium-sized businesses were described by an Austrian delegate at the FEED working party meeting as “the spirit and heart of the economy in the European Union”. Small business entrepreneurs have traditionally played an important role in strengthening local communities and contributing to regional development. Accordingly FEED delegates sought to identify the features of a tax system which can stimulate and foster the growth of the small business sector.

2. Establishing the objectives of support through the tax system to small and medium-sized businesses

Any discussion of assistance to the small business sector through the tax system must take as its starting point an evaluation of the need for and objectives of the assistance. Small businesses share many of the same needs as other businesses. If tax burdens are excessive, then desirable activity will be stifled and firms will be driven to the underground economy with negative results for tax collection and the open functioning of the market. Therefore taxation burdens, taking into account all types of taxes faced by businesses, should be reasonable. In this regard both the Uzbekistan and Moldovan FEED delegates referred to the need for better dialogue at an early stage between governments and entrepreneurs to shape tax law and discuss tax policy changes. A view expressed by many delegates was that small businesses are in need of predictable taxation and appear to bear a heavy compliance burden when compared to larger businesses.

At the FEED meetings it was emphasised that there is no ideal model of taxation for small businesses. Experience and taxation systems in developed countries are diverse and by no means wholly successful. In addition, as pointed out by a Russian delegate, transition countries differ from OECD countries -- in many cases transition countries are talking about the start-up of market systems and not just the refinement of systems. Nonetheless, FEED delegates concluded that there are many useful good practices and guidelines that can be pointed to in both developed and transition countries.

3. Examining the potential role and use of tax incentives.

Countries may wish to introduce special incentives for small business for a variety of reasons. Small firms enable economies to be more adaptable to changing economic circumstances. All OECD countries apply special measures, including tax measures, intended to improve the economic and technological environment of small enterprises, and to facilitate their establishment and growth. The most important reasons cited for having such policies were that small and medium-sized businesses face proportionately higher costs; that there are market imperfections; that there are broader benefits to society going beyond the economic benefits; and that there are important social goals involved. Expert delegates at the FEED meetings warned that special tax incentives for small businesses had frequently not been cost effective in achieving their goals. They were often directed at activity that would have occurred in any event, were a major source of complexity in the tax system and were subject to significant tax avoidance possibilities. In many OECD countries the tax system is used to support the development of the small and medium-sized business sector but the potential downside of this approach was also discussed. It was recommended that in most cases it may be more appropriate for transition economies to focus primarily on changes which remove impediments to the growth of the small business sector, rather than targeting special tax incentives at the sector.

4. Needs of small business

In an increasingly global and competitive world small and medium-sized businesses, similar to other businesses, face many challenges. A wide range of viewpoints and arguments were advanced by FEED delegates to the effect that small businesses face special disadvantages:

- In economies of scale compared to larger businesses,
- In access to seed and development finance and in the costs of raising funds,
- In the lack of information or capability to apply new technologies, and
- In resources and expertise to deal with complex tax and regulatory systems.

In particular, small and medium-sized businesses have special vulnerability to compliance procedures and costs. The sector is also typically fragmented and not well organised into representative groups. All of these factors call for special measures, according to FEED delegates, if small and medium-sized businesses are to start up, to survive, to prosper and grow.

The Polish Foundation for SME development has found that the three things that entrepreneurs want, in conjunction with fair and equitable rates, in a tax code are:

- **Simplification** for easier compliance and less loss of time in dealing with tax matters,
- **Clarity** to promote transparency and to avoid discriminatory interpretation,
- **Stability** so that tax liabilities can be planned for.

In similar vein the Bulgarian delegate stated that the small and medium-sized business promotion strategy being developed in Bulgaria will call for transparent legislation which is predictable, non-contradictory and avoids discriminatory interpretation.

5. Importance of implementing the guidelines

The guidelines presented here are an important framework for Governments and policy makers in developing their small business and associated taxation policies. There was a strong consensus by all FEED delegates that the implementation of these guidelines was crucial to entrepreneurship in transition countries and that future FEED meetings should monitor progress on this.

POLICY GUIDELINES AND RECOMMENDATIONS ON TAX POLICY FOR SMALL BUSINESS

1. Create a positive and enabling business environment for small and medium-sized business and recognise that tax policy plays a fundamental role in that process.

1.1 Use tax policy to create a pro-business environment, namely, an environment that responds to business needs, encourages new businesses to start and helps existing businesses to expand.

1.2 Have a clear definition of what businesses come under the SME heading (see 3.4.1).
The small and medium-sized business sector encompasses micro, small and medium-sized businesses. It is important to ensure that all these sub-sectors are promoted and fostered.

1.3 Ensure that these guidelines are widely distributed to policy makers, parliamentary groups and those who influence tax policy. FEED delegates considered that this recommendation was important for all guidelines and particularly for the tax policy guidelines and recommendations.

2. Develop tax policies on the basis of a partnership between small and medium-sized businesses and the government, recognising that government will collect more revenue if the enterprise sector succeeds and flourishes.

2.1 Recognise that government will collect more revenue when the small and medium-sized business sector succeeds and grows. This basic principle needs to be central to all tax policy planning and design of tax systems.

2.2 Governments and tax authorities need to see small and medium-sized businesses as an important part of the solution to economic progress and growth, creation of jobs and regional development as well as a source of tax revenues.

2.3 Recognise that the small and medium-sized business sector has a legal responsibility to comply voluntarily with the tax laws. This is the responsibility of the SME sector in the first instance.

2.4 Governments/policy makers have corresponding responsibilities to ensure an equitable system, which does not penalise small business, is in place and facilitates compliance.

2.5 Recognise that both parties have an obligation to work together to achieve their mutually reinforcing goals. This calls for constructive dialogue and mutual acceptance of the respective roles of tax authorities and small business in national economic development.

3. Provide a fiscal climate that promotes the small and medium-sized business enterprise sector by simplifying the rules applied to these businesses, reducing the compliance burden, and promoting transparency and stability in the tax regime.

3.1 Simplify tax rules applying to the small and medium-sized business sector and reduce the compliance burden.

3.1.1 Reduce the number of taxes. Some transition countries described over 30 separate taxes that applied to small and medium-sized enterprises in their countries. The general view was that the appropriate number should be no more than five taxes.

3.1.2 Eliminate small taxes that often cost more to collect than they raise in revenue.

3.1.3 Calculate the overall tax burden on small and medium-sized businesses. If this burden is more than 50 percent of annual net profit for the average small and medium-sized business then reduce tax rates and/or eliminate categories of taxes.

3.1.4 Recognise that excessive tax rates and over-complex procedures imposed on small business force enterprises into the shadow economy and may lead to a reduction in total tax revenue from the small business sector.

3.1.5 Avoid complex rules and schemes to benefit certain businesses that may be ineffective and inefficient. Subsidies cause a loss of tax revenue and give recipient businesses an unfair competitive advantage over other businesses without such privileges. Taxes are made higher for all other taxpayers in the country as a result of such incentives.

3.1.6 Note that countries wishing to adhere to OECD international tax norms or join the European Union should be aware that tax incentives for particular businesses should be consistent with OECD guidelines on "Harmful Tax Competition", the EU Code of Conduct and the EU rules governing state aid (EC Treaty Arts. 92-93).

3.1.7 Calculate the average compliance burden each year in terms of how many hours must be spent each year by the typical small and medium-sized business on complying with its tax obligations. If the burden is excessive or is growing each year, then reduce the burden by making procedures more efficient.

3.2 Ensure that tax rules are transparent and accessible to the small and medium-sized business sector.

3.2.1 Publish all laws and interpretative guidance.

3.2.2 Distribute for free all tax forms -- for example, the registration form, all tax returns and tax exemption forms.

3.2.3 Develop and distribute, for free, handbooks that describe tax obligations of those opening or operating small and medium-sized businesses.

3.2.4 Ensure that up to date handbooks are available at all times.

3.3 Promote stability of the tax system by resisting frequent changes to laws.

3.3.1 Recognise that constant changes to the tax system are the greatest source of complexity and burden on small and medium-sized businesses.

3.3.2 Recognise that the small and medium-sized business sector generally lacks the financial and human resources needed to master new tax laws.

3.3.3 Recognise that tax administrations do not have the time to develop new regulatory guidance, forms and instruction manuals for small and medium-sized businesses each year.

3.3.4 Recognise that constant change will result in a drop in compliance.

3.4 Focus on efforts to develop administrative rules to achieve a simple, transparent and stable tax regime for small and medium-sized businesses.

3.4.1 Create a clear definition of small and medium-sized businesses for tax and other purposes. In addition there should be consistent definitions of assets, liabilities, sales, gross income and net income.

3.4.2 Create a single, one-page registration form that is applicable for business registration, tax and all other government purposes.

3.4.3 Adopt less frequent reporting and payment obligations, for example, quarterly rather than monthly.

3.4.4 Provide clear and timely taxpayer assistance. For example, establish a telephone help-line or tax offices, where tax advice can be obtained easily and free of charge.

3.4.5 Adopt appropriate penalty regimes that distinguish between mistakes and intentional evasion of tax.

3.4.6 Consider exempting small enterprises from certain taxes; for example, VAT below a certain threshold.

3.4.7 Allow SMEs to use cash accounting rather than accrual accounting.

3.4.8 Allow small enterprises to use income statements rather than double-entry bookkeeping.

3.5 Interact and communicate with the small and medium-sized business sector in the development and implementation of tax rules.

3.5.1 Consult regularly with the small and medium-sized business sector when developing or reviewing tax laws that affect the sector, and ensure that the consultation itself is transparent. Consultation should ideally take place before tax laws are enacted.

3.5.2 Ensure that reform goals and strategies are articulated clearly to the small and medium-sized business sector.

3.5.3 Prepare background materials for distribution on possible changes to the rules.

3.5.4 Provide drafts of laws to the small and medium-sized business sector for comments.

3.5.5 Consider the use of panels of business people to comment and provide feedback on draft legislation.

3.5.6 Institute formal mechanisms for regular briefing and consultation with small business representative bodies to ensure that relevant interest groups are kept up to date with new tax code changes and can give views which will assist in the eventual implementation.

3.5.7 Create a panel of entrepreneurs to give comments and advice on tax legislation.

3.5.8 Train tax officials on the substance of tax rules and procedures in order to assist small and medium-sized businesses to comply with the rules and to ensure familiarity and common interpretation across regions.

4. Promote tax compliance by the small and medium-sized business sector by encouraging and supporting the organisation of the sector to better represent its viewpoint and by facilitating participation by the sector on a regular basis in the government's consultative process on tax legislation.

4.1 Encourage and support the organisation of the small and medium-sized business sector at a political level to enable it to better interact with the government on relevant policy issues. This will help to achieve better mutual understanding of the aims of tax codes and practical inputs to the shaping of more effective codes.

4.2 Emphasise timely payment of tax liabilities as a priority for small and medium-sized business.

4.3 The private sector should participate in government's consultative process and data collection.

4.4 Business associations should educate small and medium-sized business owners on their tax obligations.

4.5 Business associations should provide forums for business owners and tax officials to exchange views on a regular basis.

5. Review tax incentives to ensure each incentive is cost-effective, fair, and properly targeted.

5.1 Be aware of OECD and transition countries' experience with tax incentives which suggests that these incentives are often (i) inefficient because they are given to those who would have operated a small business without the subsidy or given to those outside the purpose of the incentive; (ii) unfair because they are given only to businesses with profits whereas start-ups often only have losses in the initial years; (iii) complicated and encourage abuses; (iv) distortionary as they create pressure for more incentives; (v) hard to remove; (vi) result in loss of predictability of tax revenues; (vii) result in revenue loss substantially exceeding the amount of new investment.

5.2 Moreover, recognise that in a desire to attract foreign direct investment, countries in transition have engaged in outbidding each other with increasingly generous tax incentives. This practice among the countries erodes the national tax base of each country, distorts trade and investment in the region, and undermines the fairness and neutrality of the tax system.

5.3 Improve the effectiveness of existing tax incentives.

5.3.1 Make sure that the intended beneficiaries are the actual beneficiaries. For example, ensure that the small business tax rate does not apply to large companies that form separate small companies in order to avail themselves of tax incentives.

5.3.2 Make sure that intended activities are the actual subsidised activities. For example, ensure that specific tax subsidies for agriculture do not benefit industrial processing.

5.4 Monitor the effectiveness of each tax incentive by regular surveys or other methods to identify the impact of the incentive and compare the estimated cost of the incentive with its actual cost.

5.5 Ensure that policy-makers understand that tax incentives are equivalent to direct spending programmes in that both result in a loss of budget resources.

5.6 Resist tax incentives targeted only at foreigners because this:

- Hampers the competitiveness of domestic small and medium-sized businesses.
- Leads to certain domestic small and medium-sized businesses creating foreign parent companies to take advantage of incentives.

5.7 Consider lower rates rather than targeted tax relief because (i) lower rates are fairer, since they do not discriminate by rewarding only certain small and medium-sized businesses; and (ii) they encourage the overall small and medium-sized business sector to work and invest more, since it keeps more of what it earns.

6. Consider the use of presumptive taxation (tax base inferred from simple indicators) for the smallest businesses.

6.1 Consider the use of presumptive taxation for domestic small businesses, i.e. the desired base for taxation is not itself measured but is inferred from simple indicators which are more easily measured than the base itself.

6.2 Analyse benefits of presumptive method including (i) simplification and lower compliance burdens for small and medium-sized businesses and tax administrators; (ii) combating tax evasion if indicators are more difficult to hide then true tax base; (iii) potentially more equitable system if it impedes corruption and is easier to comply with; (iv) if rebuttable, a presumptive system can encourage small and medium-sized businesses to keep books and pay less tax; (v) more tax revenue from each taxpayer if enforced properly.

7. Co-ordinate small and medium-sized business tax policies with other small and medium-sized business government policies to ensure internal consistency and minimise burdens for such businesses.

7.1 Review other public policies that affect small and medium-sized businesses to ensure a rational overall government policy to promote small and medium-sized business development.

7.2 Identify non-tax mechanisms to assist small and medium-sized business such as training, information, loan guarantees or grants (see Policy Guidelines and Recommendations on Financial Instruments and Support Services for Entrepreneurship).

8. Develop a system to monitor implementation of recommendations.

8.1 Recognise that the value of these policy guidelines is heavily dependent on the implementation process.

8.2 Implement a process to discuss the guidelines, to develop action on how they will be implemented, and to monitor progress.

INSTITUTIONAL FRAMEWORK FOR ENTREPRENEURSHIP

INSTITUTIONALISATION OF ENTERPRISE DEVELOPMENT POLICY

1. Overview

In introducing the discussion on this subject delegates at the March 1998 Working Party 1 meeting and December 1998 Annual FEED Meeting in Istanbul set the background of a growing general awareness in transition countries of the role of small and medium-sized businesses in:

- Creating new jobs,
- Fostering regional, local and social development,
- Introducing new leaders of industry,
- Developing an entrepreneurial spirit and a new business culture,
- Accessing new markets.

In this context the FEED meetings concluded that the subject of institutionalising small and medium-sized business policy within national development policy and small and medium-sized business representation in that process was crucial to the growth of the sector. Developing effective institutional arrangements for the governance and support of small and medium-sized businesses in the economy is a challenge shared by all transition countries.

What is meant by institutionalising of small and medium-sized business development policy?
In summary, the key elements were seen to be:

1.1 Governments having a coherent and focused small business development policy, usually within the framework of a national enterprise development policy;

1.2 Having specific policies and plans to identify and remove obstacles to entrepreneurship and to improve the wider environment in order to foster new enterprise;

1.3 Assigning clear institutional responsibility and roles within government and regional structures for small business policy and ensuring that there is common acceptance and understanding of these roles in implementing policies;

1.4 Providing for the effective participation of small business sector representatives in the dialogue on policy formulation, implementation and evaluation;

1.5 Providing for mechanisms to assess the environment for business and to monitor and measure the impact of different policy tools.

1.6 Ensuring that adequate attention is given to formalising and managing the process and structures as well as the objectives.

2. Importance of the sector and of institutionalising the policy framework

Expectations for the small and medium-sized business sector are high in many transition countries. This underlines the necessity of ensuring that small and medium-sized business policy is seen as central to national enterprise strategies. It was reported that, for example, in Kazakhstan 52,200 small and medium-sized businesses have created 900,000 jobs. In the strategy for the development of the country in “Kazakhstan 2030” it is envisaged that the small and medium-sized business contribution will rise from 7.7% of GDP in 1998 to 50% over the period of the plan. This ambitious target highlights the need for proper institutionalisation of small and medium-sized business policy and adequate regional and private sector representation in policy dialogue. In Romania the development of small and medium-sized businesses was similarly described as one of the main priorities of the Romanian government. Other FEED delegates confirmed this increasing and wider awareness at government level of the importance and potential contribution of small and medium-sized business. This again underscores the desirability of institutionalising small and medium-sized business policy. Flowing from the research papers, case studies and FEED meetings therefore was the clear view that to enable the small and medium-sized business sectors to achieve the optimal economic and social contribution to national and regional development, it is essential that in each of the transition countries:

- A small and medium-sized business policy framework be developed and widely disseminated.
- A clear institutional framework on small and medium-sized business policies, with specific responsibilities designated, be established.
- Urgent action be taken on removing obstacles to enterprise and business development.
- The private sector be properly represented in the dialogue on small and medium- sized business policies and promotion programmes.

3. Identification of constraints for development

The policy framework for small and medium-sized business development should be directed in particular at constraints to entrepreneurship and enterprise development. For example, a survey undertaken in Armenia identified key constraints for small and medium-sized businesses as:

- Imperfect legal framework,
- Lack of infrastructure supporting small and medium-sized businesses and helping them to survive under market economy conditions,
- Lack of financial resources as well as complex procedures in obtaining loans,
- Artificial barriers to small business start-ups and development created by informal groups,
- Absence of social protection and safety for businessmen.

Similarly the Bulgarian experience referred to small and medium-sized businesses suffering more severely from slow bureaucratic procedures and corruption and from lack of accurate and timely information. In the Ukraine the regulatory compliance costs borne by Ukrainian enterprises each year was estimated to be 2.9% of GDP in 1997. FEED delegates cited some progress and initiatives taken to institutionalise small and medium-sized business policy in individual countries. However an overall picture was presented at the FEED meetings of very serious deficiencies in the institutional framework for small and medium-sized business policies and inadequate small and medium-sized business involvement in the development of policies and programmes in transition countries.

4. Need for action

The guidelines that follow represent the considered views of FEED delegates in OECD and transition countries with many years of practical experience in dealing with small businesses and based on FEED research papers and case study material. To enable the ambitious targets for the small business sector in transition countries to be met it was considered essential that urgent action be taken in implementing the guidelines.

POLICY GUIDELINES AND RECOMMENDATIONS ON INSTITUTIONALISATION OF ENTERPRISE DEVELOPMENT POLICY

1. Recognise the need to develop the wider policy environment to encourage entrepreneurship and pursue a practical development policy that is conducive to promoting and supporting the small and medium-sized business sector.

1.1 Prepare the environment for small and medium-sized businesses in the first instance through macro policies and regulatory reform. Macro and regulatory reform policies across the political, economic and social spectrum should be cognisant of the specific needs and affirm the crucial role of the small and medium-sized business sector.

1.2 Remove obstacles to small and medium-sized businesses -- this policy is often the most cost-effective action for governments to take.

1.3 Pinpointing and removing all forms of obstacles should form a core part of the thinking in formulating the whole policy framework on the small and medium-sized business sector and be seen as a priority area for action.

1.4 Seek stability in rules and regulations applying to the sector, and continuity of institutions dealing with the development of small and medium-sized businesses.

1.5 Implement a practical development strategy for small and medium-sized businesses that complements macro policies. The main elements of this strategy should:

1.5.1 Ensure that a small and medium-sized business sector policy is established, publicised and implemented.

1.5.2 Have an overall organisation to galvanise efforts for small and medium-sized business development and co-ordinate the delegation of tasks to agencies, etc.

1.5.3 Ensure clarity as to where regulation is required and where the market should be left on its own.

1.5.4 Ensure that small business policy addresses local and regional development of the sector.

1.5.5 Require interaction and instigate where necessary consultation procedures between Ministries and state agencies to ensure that each is not pursuing its own separate agenda on small and medium-sized business development.

1.5.6 Establish mechanisms so that relevant small and medium-sized business interest groups' views on the formulation of policies and plans to support the sector can be heard.

1.5.7 Maintain good statistics on the small business sector and provide for research that will assist in developing and modifying policy.

2. Establish transparency and consistency in the institutional environment dealing with small business with a clear division between the organs of the state, and between respective government departments at national, regional and local levels.

2.1 Transparency and consistency in government intervention in the small and medium-sized business sector are often mentioned by entrepreneurs as being critical to the growth of the sector.

- In general, better small and medium-sized business policy and better small and medium-sized business outcomes are strongly influenced by the degree to which state responsibilities are clear and state behaviour is predictable.

- Good institutional practice can be judged by taking all aspects of institutional framework into account; the legislature, the executive, the judiciary, the intermediaries and by assessing how they interact together and whether there is clear interpretation and consistent enforcement of laws and regulations.

3. Establish clear objectives for the small and medium-sized business sector within national development plans.

3.1 Establish clear objectives for the small and medium-sized business sector within national development plans and ensure that small and medium-sized business policy is seen as central to national policies.

3.1.1 Set quantified and qualitative targets for the small and medium-sized business sector, which accord with broader overall goals of economic, social and regional development.

3.1.2 Recognise that the effectiveness of specific plans to support entrepreneurship and small business development is strongly influenced by the clarity of national, regional and sectoral objectives, the determination of institutional responsibilities and interaction between different institutions/departments.

4. Assign clear advocacy and institutional responsibilities within the government and regional and local authorities for the policy development and promotion of the small and medium-sized business sector.

4.1 Designate clear institutional responsibility for small and medium-sized business policy. This is an important step for transition economies. Possible approaches are described below.

4.1.1 Recognise that there is no single best practice model that can be adopted by all countries. The key principles unanimously recommended by FEED delegates here are to: (i) establish clear roles and responsibilities in the institutional structures and (ii) provide the essential mandate and resources to the relevant institutions.

4.1.2 Establish where main responsibility for small business policy fundamentally resides.

4.1.3 Assign a strong role of advocacy for small and medium-sized business to a Ministry/department within the government at a sufficiently high level to ensure synergy among various activities of different government departments/ministries.

4.1.4 Consider the establishment of a major autonomous agency of government that acts as an advocacy department on policies and strategy recommendations, finding synergy for individual departmental ideas, and implementing core support programmes. Such an agency can:

- Analyse and formulate policy for approval, co-ordinate action and focus efforts.
- Facilitate the learning process and interaction between government and the private sector.

4.1.5 Ensure that adequate budget allocation is matched with a clear mandate for the organisation, if such an agency is to have the desired impact.

4.1.6 Consider the use of an inter-departmental group (including the agency) to review, co-ordinate and harmonise small and medium-sized business policy activities and to share views on various policies that may impact upon small and medium-sized business. This forum could complement and add value to the above structure.

5. Clarify the policy rationale for intervention by government department and agencies and provide directions on how support should be provided and delivered to the small and medium-sized business sector.

5.1 Establish intervention and sustainability criteria for policy initiatives -- this is a key issue. There is a clear need for a policy position to be explicit and sustained over time.

5.1.1 Follow the general principle that intervention policies should be based on market deficiencies and the identified need for public sector action.

5.1.2 Specify the objectives and criteria for intervention. For example: What will require public or other forms of subsidy on a temporary or continuous basis; what are the expected outcomes and how will performance be monitored and measured.

5.1.3 Ensure clarity and common understanding on the definition of small and medium-sized businesses for the purposes of such policies i.e. which groups of businesses are the target.

5.2 Agree policy directives for relevant government departments and agencies on when and how to intervene and to what degree.

5.2.1 Use established policy and agreed policy directives to co-ordinate and focus external bi- and multi-lateral offers of assistance for small and medium-sized business development. Offers of assistance through different ministries may often not be complementary or co-ordinated (e.g. several types of overlapping or competitive small business centres being set up and funded by different bilateral and multilateral agencies).

5.2.2 Bring better focus and co-ordination to SME development initiatives through the institutionalisation of the policy and support agency framework in transition economies.

6. Empower the local and regional government to promote and develop small and medium-sized enterprises based on different regional and local needs.

6.1 Provide local and regional governments with the mandate and resources to create different strategies and programmes in response to different local needs.

6.1.1 Contribute to the institutional framework of small business policy by giving regional governments the mandate to promote and develop small and medium-sized businesses based on regional plans and local need.

6.1.2 Introduce innovative solutions to leverage government money for small and medium-sized business development by promoting the system of local partnerships. This is closely related to the development of a regional and local network of support to small and medium sized businesses.

6.1.3 Take action to improve the policy formulation capabilities of local and regional authorities. The local and regional bottom-up strategic assessment of needs, and in response, programme development, requires a competence within the local authorities to be able to come up with coherent sectoral or local strategies.

7. Establish close and regular communication with small and medium-sized businesses to ensure their practical advice and guidance on policies and programmes and help private sector organisations to self-organise and present their viewpoints.

7.1 Gain better understanding of SMEs by establishing good channels of communication.

7.2 Create regular contact and dialogue between such private sector organisations and public bodies on small and medium-sized business policy and in particular in communicating the goals for the small and medium sized business sector. This is an important task for business policy makers.

7.3 Provide a mechanism for pro-active and early participation of small and medium-sized business representative organisations in the formulation of policies.

7.3.1 Establish good consultative procedures and communication between government departments and relevant pressure groups. This should be a regular activity between public and private sector representatives.

7.3.2 Facilitate early consultation on proposed legislation affecting the sector in order to lead to more effective policy and implementation in the long run. In many transition countries it was reported that adequate consultations with the sector do not exist or allow only for post-facto comment on policy.

7.3.3 Recognise that such consultation can assist in instigating essential legislation and acting as a barrier to too frequent changes in policy and institutional structures.

7.4 Focus on practical steps to strengthen the private sector representative organisations and their involvement in the process of policy formulation. They must have competence, at the local level as well, to contribute to the development of sectoral and local strategies.

7.5 Establish transparent criteria to select and involve relevant business and trade associations to provide inputs on small and medium-sized policy and advise on how new initiatives and policies should be best developed. The criteria might include the record of contribution on such issues in the past; the level of representation of membership; self-supporting structure of the organisations; and provide for rotation for periods in their participation on policy consultative groups.

7.6 Establish public and private partnerships between associations of entrepreneurs, chambers of commerce, industry and trade associations, local government, educational institutions, consultancy groups, etc.

8. Monitor the structure, performance and needs of the small and medium sized business sector through (i) the collection of comprehensive statistics and (ii) research on the sector, and use this information to adapt policies and programmes.

8.1 Establish a comprehensive statistical database on small and medium-sized businesses.

8.1.1 Monitor the targeting and effectiveness of policies. The collection and analysis of such performance data is crucial for policy making.

8.1.2 Adequate research and information flow on the small and medium-sized business sector needs to be developed and distributed.

8.2 Monitor the health of the very diverse small and medium-sized business sector.

8.2.1 Use studies by public and private research institutes, regular surveys, needs assessments, pilot testing of individual policy initiatives and feedback on the impact of particular policies on small and medium-sized businesses.

8.2.2 Establish this work as a core responsibility of the Ministry or agency with designated responsibility for the development of the small and medium-sized business sector.

8.3 Create mechanisms and structures to adapt policies/programmes to the continually changing conditions and requirements of the dynamic small and medium-sized business sector.

9. Take action to ensure that the progress of the small business sector is properly and regularly reviewed and ensure implementation of enterprise development policies by monitoring and measuring implementation of policies against specific targets.

9.1 Establish mechanisms to review progress continuously and to monitor and measure implementation of policies against agreed targets.

9.2 Consider the need to provide training for the bureaucracy in dealing with entrepreneurs and in implementing policies.

9.2.1 Provide training which will enable public officials to better understand small and medium-sized business development policy and their role and potential contribution to such policy.

9.2.2 Consider the use of, for example, practical role-playing on dealing with entrepreneurs. In some countries it was reported that such training has been found to be very effective.

INSTITUTIONAL FRAMEWORK FOR ENTREPRENEURSHIP

RULE OF LAW AND REGULATION

1. Overview

The topic of "Rule of Law and Regulation" was considered at the March 1998 Working Party meeting and December 1998 annual meeting in Istanbul. One of the strongest points of consensus among Working Party participants during 1998 was the over-riding importance of removing constraints and obstacles to business formation and enterprise development. This can have a greater impact in the long run than the specialised support services often provided to help small businesses, at least in those countries where the rule of law is under-developed. It is also a more effective strategy for governments with limited resources.

Considerable progress in creating legislation and institutions designed to lower the bureaucratic barriers for small and medium-sized businesses was reported by FEED delegates but there was widespread agreement that there is substantial further work that needs to be undertaken in this area by transition countries. Market economies by definition have a necessary minimum of state regulation. Numerous surveys and OECD and UNIDO research and experience have shown that removing needless laws and regulations, administrative barriers and other constraints is deemed to be a priority for entrepreneurs. Such action can have a powerful impact by stimulating and promoting new enterprise.

2. Action being taken by transition countries to simplify laws and regulations.

While parts of governments engage in proactive and even subsidised programmes of assistance to new and small businesses, other parts of governments in transition countries may actively discourage the same through the introduction or application of laws and regulations. For example, the former business registration procedure in Romania was described as time-consuming, complex, costly and included some steps that were not necessary. The Romanian example of undertaking a study on the registration process for companies and implementing substantial changes was described. A new process, based on the recommendations of the study, created a one-stop-shop system in Romania and eliminated some of the requirements. The Romanian delegate reported that the system now operates well. In addition new legislative provisions were approved to give effect to the changes including harmonisation of commercial company law with European Union directives.

The action outlined above is a good example of how one transition country tackled the company registration problems and obstacles that hinder the development of the small and medium-sized business sector. In the Ukraine, business centres (supported by USAID) play a useful support role by assisting companies with registration. The Armenian delegate described a situation where the legislation is quite transparent but there are problems sometimes in finding the appropriate offices and officials to get permits and licenses and there may also be conflict between ministries as to who actually controls licenses. Other examples of such administrative problems were cited by FEED delegates.

Company registration, consumer protection, labour regulation, environmental protection, etc. are all essential legal and regulatory aspects of any market economy but there are often many unnecessary barriers and unduly bureaucratic procedures associated with such areas. Small and medium-sized businesses are usually less able to present their needs to government and lobby for them as effectively as larger businesses. They are rarely consulted at the design stage of new policies and reforms. These factors need to be recognised in developing small business policy.

3. Informal economy

Informal and shadow economy businesses deprive governments of needed tax resources and put undue burden on those companies that are legally incorporated. Cumbersome laws and procedures unwittingly encourage the shadow economy by forcing some entrepreneurs to avoid proper legal procedures and then use bribes or fines to deal with the consequences that arise. This is clearly unsatisfactory in the long run for governments and entrepreneurs. Governments now place high priority on new and small business development as critical to economic growth and employment generation, yet practical and clearly identifiable barriers often remain.

FEED delegates made extensive presentations on bureaucracy and obstacles to entrepreneurs. For example, from survey data it was revealed that entrepreneurs have to pay local officials in Russia for:

- Issuing licenses and permissions,
- Providing premises,
- Giving access to loans,
- Ensuring business security.

It was estimated that the informal economy amounts to 20% - 30% of Russian GDP. In Georgia it was suggested that the shadow economy is greater than that of the official economy.

Therefore, from both the small and medium-sized business and government standpoint, it is important to remove the obstacles to legal business formation and regulation and to the general conduct of business in the formal economy.

4. Anti-corruption measures

Extensive discussion on this subject took place at FEED meetings. There was a strong consensus on the need for combined and paralell action on a number of fronts if success in small business policy was to be achieved. There is wide analysis available on many aspects of corruption and what should be done to combat it. FEED delegates strongly emphasised the urgent need for action in implementing anti-corruption measures and for ensuring that regular review and action are taken in a systematic and continuing programme.

There was agreement on the need to make greater distinction between different segments of the informal economy in implementing enforcement of regulations. Participants talked about three broad categories of business in the informal economy (see paragraph 5 of these guidelines). Policy makers were encouraged to seek distinction where possible between these categories but at the same time it was recognised that there was no simple definition of each. The key point recommended was that all businesses in the informal economy should not be treated in the same fashion and policy makers should recognise this and strive to develop different approaches to these different segments as they formulate and shape policy and regulations affecting small and medium-sized businesses.

POLICY GUIDELINES AND RECOMMENDATIONS ON RULE OF LAW AND REGULATION

1. Seek to improve the legal and regulatory environment for small and medium-sized businesses by focusing awareness and action on improvements in key areas where the State has direct responsibility.

1.1 Simplify red tape and increase transparency and availability of information regarding government procedures. This will have greater relative benefits to small and medium-sized businesses than many support programmes.

1.2 Ensure good public access to information on legislative proposals affecting small and medium-sized businesses.

1.3 Multiple tax and licensing authorities can create confusion and be counter-productive; therefore having fewer authorities and more fairly enforced taxing mechanisms is recommended.

1.4 Eliminate laws and regulations that give too much discretion and interpretation authority to the enforcing officials. This usually leads to increased bureaucracy and corruption.

1.5 All Ministries and state agencies dealing with small business should pay attention to regulation and ideally have a regulatory reform plan to reduce regulatory procedures or to deregulate.

1.6 Undertake effective enforcement of anti-trust legislation.

1.7 Improve administrative procedures, in particular secondary regulations/ordinances.

1.8 Continually monitor and take action to address new barriers and obstacles that may emerge both in the introduction and implementation of laws and regulations.

- Rationalising the administrative process is an ongoing process that is not resolved by one reform.
- Problems may arise with the application of the law and this needs to be monitored.

1.9 Effective implementation of laws and regulations should be underpinned by judicial and commercial expertise and appropriate penalties for non-compliance.

2. Implement measures to improve small business registration, licensing and administrative procedures where the existing procedures are identified as unduly bureaucratic and an obstacle to entrepreneurship.

2.1 Undertake a systematic and professional study to identify and alleviate the major constraints to registration (and licensing where relevant) of new companies. This type of study can provide a good basis for action to improve systems.

2.2 Reduce needlessly complicated and time-consuming business registration, licensing and administrative procedures relating to business-start ups.

2.2.1 Consider the use of one-stop-shops, facilitating entrepreneurs by reducing the number of offices where they must go to undertake registration or similar procedures.

2.2.2 Enterprise registration should be simplified and preferably reduced to the entry of requisite data in a unified register of legal entities. It should be of a notification nature.

2.2.3 Follow the example of the steps on company registration procedures taken (or seek similar simplification of procedures) by Romania, as follows:

- Establish a special office at each Chamber of Commerce (alternatively use other organisations which have wide geographic presence) for registration formalities (one-stop-shop)
- Complete all registration procedures within 10 working days
- Avoid the confusion between registration and operation (registration is the process of making a company a legal entity; operation is ensuring it develops activities related to the registration itself)
- Update laws to eliminate unnecessary consultative approval from other bodies;
- Shorten the period of 15 days to 5 days for a court decision to become effective;
- Enact a law that enables public notaries to practice.

2.2.4 In similar fashion seek to reduce the number of licenses required by small and medium-sized businesses and the time needed for issue of licenses.

2.3 Establish new licensing procedures and standards where necessary and a minimal list of activities subject to regulation.

2.3.1 Recognise that the absence of definite licensing procedures and uniform licensing standards can, for example, (referred to by the representative of the Russian Association for Small Business), lead to the chaotic and uncontrolled expansion of licensing requirements at both federal/local levels.

2.3.2 Be alert to the fact that in some cases licensing restrictions may have been reduced but have then been replaced by other restrictions such as local trade patent fees. This type of scenario needs to be countered by new procedures and standards.

2.4 Examine not just the regulations but the compliance costs and ensure that they are not an obstacle to new companies. These are often more burdensome for small firms.

3. Seek a change of attitudes by the bureaucracy in dealing with small and medium-sized businesses through demonstrated good standards at government level and through training of public officials.

3.1 Seek to change the attitudes of civil servants towards small business by providing an example from the very top of government -- one of the most important ingredients in bringing about such change will be the direct role and leadership played at the highest political level.

3.2 Provide more training to public officials dealing with small and medium-sized businesses.

3.2.1 Introduce more training for civil servants to help them to understand better the role of the businessman.

3.2.2 Training and attitude change should be endorsed and underpinned by leadership from the top.

4. Provide small and medium-sized business representatives with an opportunity to express their views on relevant draft legislation and regulations.

4.1 See small and medium-sized businesses and their representative organisations as partners who have the potential to assist in policy development and to encourage compliance by members. Effective laws and regulations require the active participation of the small and medium-sized business sector.

4.1.1 Involve the business sector at the design stage of new laws and regulations affecting small and medium-sized businesses. No involvement at this stage can lead to deficient new laws and procedures emerging.

4.1.2 Involvement should be open, that is, not restricted to select groups only and not just in a ‘post facto’ manner.

4.1.3 Establish procedures for listening to small and medium-sized businesses in regard to the impact of laws and regulations on their businesses and setting priorities for action.

4.2 Conduct annual surveys of perceived constraints to growth by small and medium-sized businesses and periodic surveys on specific issues.

4.2.1 Information and data received can be valuable to policy makers and small and medium-sized business associations in developing policy dialogue and action plans to address issues.

4.2.2 Statistical information can be gathered from company registration data but surveys can provide qualitative information on opinions, perceptions, problems, etc.

4.2.3 Encourage and listen to small and medium-sized business research and advocacy groups. These can give insights that may not be evident from general surveys.

4.3 Strengthen small and medium-sized business agencies so that they can contribute to voicing the needs of small and medium-sized businesses and improve the legal and regulatory infrastructure for small and medium-sized businesses.

4.4 Private associations of entrepreneurs, employers organisations, chambers of commerce, etc. have an important role to play in this process in creating awareness of difficulties and obstacles presented by legislation and regulations or hostile bureaucracy. Mechanisms should be established by governments to gather the views of these bodies at the design stage of regulations.

5. Distinguish between broad segments of the informal economy (ranging from businesses committing minor misdemeanours to businesses involved in serious criminal offences) when designing policies and programmes for small and medium-sized businesses.

5.1 Recognise that the informal economy is made up of different segments and there is a need for policy makers to take account of these when designing policies. The three segments described below are not watertight in their definition but for the purposes of developing policy they provide a useful categorisation to determine different policy approaches and different action strategies which should be taken with the various segments of the informal economy.

5.1.1 First segment - the informal economy segment where businesses operate generally within the law but may not have been properly registered at start-up or are in breach of minor administrative regulations.

5.1.2 Second segment - the 'shadow' or 'grey' segment where the business activity is legal but where there is some non-compliance with the law or regulations and some systematic infringement of the legal system (for example, evasion of tax). Bureaucratic and inefficient administrative pressures within the state system may be forcing such businesses into breaches of the law.

5.1.3 Third segment - the "black" economy segment which is illegal or criminal business which can never be legitimate and where the promoters have no intention of ever creating a legal business.

5.2 Recognise that it is vital to understand what is happening in the various segments of the overall informal economy.

5.2.1 Instigate systematic research and professionally conducted surveys, where necessary, to establish more clearly what is going on in each segment of the informal economy. In general transition country policy makers should allocate much more effort and resources to this task.

5.2.2 Analyse, what a FEED delegate described as, "the sea of analysis" already available on the subject of corrupt practices and use it to draw conclusions on policy design and initiate action to deal with corruption. There is much useful information already available.

5.2.3 Be aware of the existence of the "OECD Convention on Bribery of Foreign Officials in International Business Transactions" which could provide useful guidance to transition country policy makers as they develop their policies in this area.

6. Instigate and develop a systematic and continuing programme to deal with corruption, especially in its impact on small and medium-sized businesses.

6.1 Take action to change administrative systems and specific procedures, which may be a significant cause of companies moving into the informal economy and adopting corrupt practices.

6.1.1 Recognise that this requires political leadership and the will to reform rules and institutions and work with actors in the informal economy to understand key constraints, which promote corruption.

6.1.2 Recognise that it is important not to suppress the informal economy, except for the "black" economy segment, but to seek to create the environment where legitimate business people are facilitated to become part of the formal economy.

6.1.3 Remove or change administrative restrictions that are burdensome and time consuming. Such restrictions are negative for the state. They force businesses to evade them and use informal economy service suppliers.

6.1.4 Establish a system to review, in an objective manner, proposals for new laws and regulations and their impact on small and medium-sized business before they become formalised.

6.1.5 Consider the use of approval by positive-administrative silence in certain circumstances, i.e. if no decision is given by a certain date it means that automatic approval applies.

6.2 Strengthen judicial systems to allow quicker and better dealing of court cases.

6.2.1 Speed up case handling in the judicial system. In some transition countries cases take too long to go through the legal process.

6.2.2 Institute open and transparent methods of case tracking to see where cases "bottleneck".

6.2.3 Institute more pre-court practices or legal system substitutes such as arbitration and other out-of-court dispute resolution procedures.

6.2.4 Consider the use of "ombudsman" roles to resolve commercial disagreement.

6.3 Use open procedures in public procurement contracts, sale of commodities, dealing in real estate, etc. These systems should be open (e.g. open tendering) and transparent and based on objective criteria. There should be clear procedures on the bidding method, solicitations for bids, choice of contractor and the terms of contracts should be non-exclusionary.

6.4 Undertake participatory and publicised campaigns of anti-corruption measures (such as Transparency International's integrity systems or national plans as in Latvia and Estonia) to deal with corruption both in the public and private sectors.

6.4.1 Involve small and medium-sized business representative organisations in this process. Seek wide and active co-operation from the private sector.

6.4.2 Pursue the general principle of trying to retain and encourage the initiative and enterprise of the informal economy while at the same time taking specific action that will facilitate its actors to become part of the formal economy.

6.4.3 Establish internal and integrated audit functions in Ministries and state agencies dealing with businesses, giving them the authority to investigate misdeeds or pass cases to the appropriate authorities. It should be recognised that such audit functions are only as good as the power given to them.

6.4.4 Select public officials based on their integrity and provide periodic training in detecting and preventing corrupt practices.

6.4.5 Require officials, as part of their employment contract, to work in a lawful manner.

6.4.6 Establish "whistle-blowing" rules protecting officials from unfair treatment where they draw attention to corrupt practices.

6.4.7 Legislate so that bribes paid (for example, by domestic businesses operating in foreign countries) are not tax deductible.

6.5 Participate in international networks, for example, the OECD Anti-Corruption Network for Transition Economies dealing with anti-corruption measures.

6.5.1 Sharing concrete policy change and project data (such as judicial reforms, procurement reform, integrated financial systems, civil service reform, deregulation, etc.) facilitates anti-corruption programme design and implementation.

6.5.2 Sharing survey data and contact information involves important actors in the reform process and allows countries to engage in “action learning” with partners to address complex and changing corruption issues.

SUPPORT SERVICES AND FINANCIAL INSTRUMENTS FOR ENTREPRENEURSHIP

FINANCIAL INSTRUMENTS FOR NEW AND SMALL BUSINESSES

1. Overview

In establishing new firms or undertaking business expansion small and medium-sized business entrepreneurs in transition countries face a number of problems. Major constraints can be categorised as structural, technical, managerial and financial. Among the most frequently cited constraints are financial problems. Credit and financial support for small and medium-sized businesses are typically very poor. Banks are reluctant to lend to small and medium-sized businesses because of the perceived high risk and the administrative costs per loan. This was the status of affairs in most transition countries, as reported by delegates at the Working Party II meeting in Istanbul in June 1998 and at the subsequent annual FEED meeting in Istanbul in December 1998. While many examples of new small and medium-sized business enterprises emerging in some transition countries were described, the rate of growth in other transition countries has slowed. On the one hand, the liberalisation of the Albanian economy has led to many new entrepreneurs establishing their own firms but turbulence in the region has greatly hindered this progress. Small and medium-sized businesses have been the only growing sector of the economy in Moldova; Poland has created 1.6 million new firms in just 7 years; most of the real growth in Georgia has derived from the emergence of newly privatised and newly established small businesses. On the other hand, Russia reported a decline in the number of new small and medium-sized businesses being formed.

Macro reforms in transition economies need to be complemented by measures that strengthen the financial institutions, facilitate the provision of appropriate financial instruments, and foster relationships between lending institutions and entrepreneurs. These measures can help to provide sound, responsive financial services to the majority of enterprises. Fundamental changes in the credit and financial support system are very important together with simplification of registration and licensing procedures and tax reduction. What is needed here, according to the Romanian delegate, and this is relevant to all transition countries, is a system that “serves the entrepreneurial spirit”.

2. Access to finance in transition economies

All delegates referred to the lack of financial instruments and poor access to finance for business development. It is a key issue for all transition countries. Russian delegates noted the reluctance of banks to lend to small and medium-sized businesses. New small and medium-sized businesses are typically undercapitalised. Lack of sufficient loan collateral was cited as the major problem for financing small business in Georgia. Lack of financing limits the scale of activities and capital intensity of newly emerging companies. Shirakinvest Bank in Armenia referred to the absence of medium to long term resources; the main deposits of Armenian banks are short-term deposits of citizens. The shadow economy is a serious problem in many countries. Non-official small and medium-sized businesses were estimated to account for 30-35% of the Ukrainian workforce. An argument for supplying credits to start-ups, suggested by Bulgaria, is that contractual obligations with financial institutions may discourage companies from entering the shadow economy and also help to build up mutual working experience. It was suggested that in Mongolia the establishment of a venture capital fund with foreign investment could be a tangible contribution to the development of the private sector as many small and medium-sized businesses and entrepreneurs with new ideas are restricted because of the lack of capital.

3. Range of financial instruments used

Among the various instruments being used and described by different country delegates were:

- Micro loans; micro-credit schemes at commercial interest rates -- short term (less than 1 year), medium term (less than 3 years) and long term (3-7 years);

- Bank loans for households used for business purposes;

- Targeted credits with specific repayment conditions and sanctions if credits not paid in time;

- Local loan guarantees;

- Lower tax rates;

- Exemption from tax on profits in the early years;

- Leasing companies are very important according to the Polish and Moldovan delegates. They may represent the only possibility for business expansion for many small and medium-sized businesses.

- Personal and family capital and retained earnings are the principal source of growth financing, and tax systems should encourage such private investment;

- Venture capital; venture loans (patient loan and participating loan).

4. Reasons why access to finance is inadequate

Various reasons why access to finance is inadequate were described by the Working Party. The main reasons cited were as follows:

- Lack of sufficient loan collateral;
- High real interest rates;
- Unwillingness of banks to extend 2 - 3 year loans;
- Lack of guarantees and mortgages;
- Lack of qualified personnel in both companies and financial institutions;
- Generally low level of qualifications of small business managers;
- Low quality of business plans;
- Lack of market feasibility;
- Low efficiency of projects.

The danger of unreal expectations being placed on the banking systems in transition countries was referred to. Banks need to curtail the volume of risk loans and ensure good management of their own affairs. Therefore they should not be seen as the only provider of solutions to the lack of credit for small and medium-sized businesses. The overall point emerging here was the need for wide-ranging action including new funding policy initiatives in many transition countries. FEED delegates elaborated policy guidelines and recommendations on this subject.

POLICY GUIDELINES AND RECOMMENDATIONS ON FINANCIAL INSTRUMENTS FOR NEW AND SMALL BUSINESSES

1. Focus on key policies and actions that will build the financial services sector and improve access to funding for small and medium-sized businesses.

1.1 Create and build long-term and sustainable financial institutions and infrastructures rather than implementing short-run measures. Governments and policy-makers should play the central role in establishing the priority of this principle and ensuring appropriate action.

1.2 Strengthen the banking system to make it competitive, as this is the basic institution for small and medium-sized business financing.

1.3 Concentrate on reducing barriers to access to finance by entrepreneurs.

1.3.1 Recognise that access to financing is generally more important than the cost of the financing.

1.3.2 Put priority on Government programmes that improve access to finance rather than subsidise interest rates

1.4 Establish essential legal conditions and well-functioning implementation systems addressing bankruptcy, registration, collateral systems, leasing regulations, etc. Measures to improve the legal framework of commercial credit transactions can have benefits that are as important as targeted credit programmes.

1.5 Keep this link between improved legal and regulatory framework conditions and targeted credit/subvention programmes in mind in order to obtain the optimal policy mix.

1.6 Recognise the importance of mechanisms that improve the financial environment for small and medium-sized businesses.

1.6.1 Ensure that suitable mechanisms and procedures for good implementation of laws and regulations are established in conjunction with the introduction of such laws/regulations.

1.6.2 Take focused action to address such issues. An example here: banks are reluctant to lend without collateral in a situation where there are still problems with land titles and land collateral. This requires priority action by policy makers and governments.

1.7 Set standards for paying small business suppliers on a timely basis for work done for the State and thereby provide good example to other institutions and businesses.

2. Provide public funding schemes for small and medium-sized businesses where market deficiencies demonstrate the need.

2.1 Demonstrate a positive stance towards financing start-ups and small business immediately and in a concrete manner where suitable financial intermediaries do not exist.

2.2 Ensure that public sector/state financial assistance programmes complement rather than compete with or replace private sector financing that could be available on commercial terms.

2.3 Help to strengthen financial systems (e.g. banks, credit institutions, etc.) which provide resources to the sector by using these channels insofar as possible rather than state agencies for providing funds directly to small and medium-sized businesses.

2.4 Assess state financial assistance programmes not just by their direct impact on firms but also by the degree to which they contribute to improving and changing the banking and financial services infrastructure for small and medium-sized businesses.

2.4.1 The long-term goal should be to facilitate private sector financial institutions to be involved in supporting SMEs and therefore understand better the needs of the small business and to make them more efficient in such work.

2.4.2 Similarly, encouraging a well functioning capital market at all levels through policy initiatives can contribute to the improvement of financial conditions generally and especially for new and small enterprises.

3. Follow good business practice in evaluating and selecting projects for funding from public sources and involve business people in the decision-making process through representation on boards, credit committees, etc. which consider projects.

3.1 Establish good assessment and selection criteria on projects supported by public funds.

3.2 Link credit decisions to risk. Decisions on selection of projects should take full account of risk factors; otherwise it will lead to poor repayment rates.

3.3 Avoid the practice of granting credits and guarantees without economically justified and independent project evaluation and conditions applied in good commercial bank credit practice. This applies to public and private sector funding schemes for SMEs.

3.4 Establish clear conditions and policies on the level of private funding required in projects and how public funds should be used to leverage such private funding. As a general rule the matching principle on sharing risk was recommended, i.e. do not provide from public funds more than the amount, which the private sector person is willing to contribute.

3.5 Appoint a board with experienced business people to make decisions on projects on the basis of business merits.

4. Put in place and develop other key components of the financial services sector infrastructure for business such as credit reference sources, venture capital, leasing, training of bank personnel in dealing with small business, etc.

4.1 Strengthen credit bureaux and other mechanisms to provide credit references. This has been an effective way of strengthening overall financial systems.

4.2 Encourage the development of a credit reference industry. This helps to lower the risk of lending to small business and results in the expansion of access to credit by small business.

4.3 Recognise the necessity and role of venture capital and the need to develop the venture capital sector.

4.3.1 Be aware that venture capital is a very important tool for small and medium-sized business development, although most appropriate in later stages of the transition process.

4.3.2 Take action through policy initiatives to introduce such funding where it is not available.

4.3.3 Examine the possibility that venture capital funds in OECD countries may provide models that can be emulated or adapted. The creation of such new funds may attract local investors in transition countries.

4.3.4 Start with small-ticket equity funds to gain experience in venture capital, to identify bottlenecks in the general framework conditions and to prepare for a broader use of venture capital at a later stage.

4.4 Promote a small and medium-sized business culture in the banks through, for example:

- Better understanding of small and medium-sized business needs,
- Training of bank staff to deal with entrepreneurs,
- An internal bank policy on working with the small and medium-sized business sector,
- Initiatives by the banks to encourage new enterprise at a local and national level.

4.5 Encourage the provision of leasing facilities where necessary and recognise that:

- Leasing may be the only source of start-up capital in some locations.
- The availability of leasing has been a crucial factor in assisting the growth of small and medium-sized businesses in some transition countries.

5. Provide training and advice for small and medium-sized business entrepreneurs in dealing with financial institutions and devote resources to training staff in their enterprises on business planning and appraisal.

5.1 Provide training and advice to entrepreneurs in dealing with financial institutions and funding agencies. This is essential to help them qualify for loans.

5.2 Devote resources to training staff in small and medium-sized businesses on, for example:

- Preparing good business plans and business plan appraisal.
- Legal regulations and obligations (e.g. company law, audit practices).
- Coaching and training in practical aspects such as forecasting needs and raising capital.

5.3 Consider the use of retired business people managers who would act as advisors/mentors to provide coaching and technical assistance.

6. Respond to the need for financial instruments at local and regional levels.

6.1 Ensure that local level funding needs are adequately recognised and provided for in policies and programmes to support small and medium-sized businesses.

6.2 Establish local support schemes. For example, credit guarantee schemes are crucial at times to facilitate access to credit.

6.2.1 Recognise that lack of finance is particularly severe outside the capital cities, as bank branches frequently only function to provide local cash and do not have authority to make loans. The work of these branches needs to extend to loan assessment and provision.

6.2.2 Be aware that the initiatives to establish local support schemes can contribute to changing the capability and attitude of local banks in dealing with small business.

6.3 Anchor policies to local reality. Local factors and conditions need to be adequately considered in devising financial instruments.

6.4 Avoid copying models of credit development and loans for small and medium-sized businesses from the developed countries without first identifying clearly the needs of transition economies and considering the specific needs and circumstances of the local private sector and banking system.

7. Ensure that funding is available for SMEs in key industry sectors and new technology projects.

7.1 Recognise that the transition process entails moving also to providing funding for the development of higher value-added and more capital-intensive enterprises (e.g., food processing, vertical integration in textiles). This becomes essential to keep the economy competitive and to ensure a sustainable process of job creation and sectoral development.

7.2 Small business policy and programmes need to facilitate and promote funding support to different categories of projects.

- The difficulty in accessing external finance may force most entrepreneurs to enter low capital-intensive sectors which means mostly services. Policies need to encourage balanced development and a spread of projects.

- Small and medium-sized businesses are mainly in the trade sector and not in production using innovative technology but funding for all categories of project is important.

7.3 Encourage banks to seek outlets for loans in capital-intensive projects rather than retaining funds in state securities, bonds, and stocks of higher liquidity companies. This issue needs to be tackled by policy makers and banks alike if the small and medium-sized business sector is to develop and grow.

8. Establish micro-credit organisations and policies based on long term and business-like structures with the objective of achieving self-sufficiency.

8.1 Plan micro-credit structures and policies.

8.1.1 Recognise that access to micro-credit has particular importance due to the potential job-creation and poverty-alleviation effects that micro-enterprises offer.

8.1.2 Recognise that provision of very small amounts of money by commercial banks is so costly that some appropriate private/public structures may be necessary to overcome this financial gap.

The following specific guidelines for micro-finance policy were suggested by the FEED delegates:

8.2 Build permanent funding institutions:

- Micro-credit organisations need to have a strategy for long-term sustainability with long-term capitalisation and institutional development, as well as effective products and services.

- Entrepreneurs need ongoing and sustained funding sources rather than temporary programmes for their financing needs,

- Dependence on one-off public, donor or philantrophic funding alone was seen as short-sighted.

8.3 Seek financial self-sufficiency. Many micro-credit organisations in developing countries have reached financial viability by achieving scale in their operations. They usually operate in high-density markets with a high demand for micro-credit, and have relatively low operating costs.

8.4 Justify the subsidy costs per beneficiary where subsidy is necessary. Those programmes that can not reach a large scale and achieve financial self-sufficiency (for example, in thinly populated rural areas) have to be able to clearly demonstrate their development results.

8.5 Subsidies, if used at all, should be explicit and should have a cut-off deadline.

8.6 Run a micro-credit organisation like a business:

- Small-scale entrepreneurs are drawn to and better served by organisations that they perceive as businesses rather than government programmes or charities.

- The lending institution has more credibility as a reliable business partner and can speak more convincingly about business planning and financial management if it operates in a business-like way.

SUPPORT SERVICES AND FINANCIAL INSTRUMENTS FOR ENTREPRENEURSHIP

ADVISORY SERVICES FOR NEW AND SMALL BUSINESSES

1. Overview

At the Working Party II meeting on "Support Services and Financial Instruments for Entrepreneurship" in June 1998 and the subsequent Annual FEED meeting in December 1998 held in Istanbul delegates addressed the subject of business advisory services for small and medium-sized businesses. There was a general consensus on the importance of these services for stimulating entrepreneurship and guiding entrepreneurs. In a market economy, the market should provide most business advisory services but there is an absence of such market-driven services in many transition countries. The key policy issues were therefore seen to be:

- Whether donors and governments should intervene or not?
- If intervening, to what extent and how to do this efficiently?
- Private sector involvement in providing services.
- Sustainability, subsidies and the charging of fees.
- Scope of services to be provided.

On the overall issue of whether intervention should take place there was general agreement that Governments and donors should intervene, when the problems confronting entrepreneurs and small businesses are not being addressed or adequately serviced by existing market suppliers. However, in doing that FEED delegates asserted that it is important not to suppress the natural emergence of a market-driven consulting and business advisory service industry in the private sector. Small business policy makers need to meet the twin challenge of providing essential services to SMEs and simultaneously fostering the private sector role in that work.

2. Expectations of small and medium-sized businesses in transition economies

The central role of small and medium-sized businesses in the transition process and the need for adequate small and medium-sized business advisory services was outlined by FEED delegates. Given the role and contribution of the small and medium-sized business sector expected by many transition countries it is essential that the necessary infrastructure and support services for small and medium-sized businesses be provided. The small and medium-sized business sector is perceived as potentially the major catalyst for required economic and political change, according to the delegate from Kyrgyzstan. Also as privatisation moves forward and small and medium-sized businesses establish more business links with larger companies there is more demand for a full range of business advisory services from small businesses. This trend is supportive of larger companies as well as potential export customers who want, for example, more reliable quality, delivery and competitive costs from their small business suppliers.

Entrepreneurs and small and medium-sized businesses, because of their size, isolation, and inexperience, often lack adequate access to important information and inputs (finance and technology were referred to in particular). Important main categories of advisory service identified were:

- Training in business strategy and operations,
- Legal services,
- Consultancy on technical issues, marketing, production systems and practices, etc.,
- Financing: accessing, managing, financial systems.

The availability of adequate services to small and medium-sized businesses is less developed in transition economies since there is relatively little recent experience with entrepreneurship and business ownership.

A study of entrepreneurs by the Kazakhstan Centre for Entrepreneurship Support illustrated the need for various kinds of training services. Overall 78% of those surveyed reported a need for training. For example, over 50% need new ideas on how to access and apply technology, 46% need training in marketing. There is a shortage of skilled entrepreneurs and business managers and of the institutions that can provide them with access to good information. The Kazakh experience, similar to the experience related by other countries, showed that the business advisory infrastructure is very important for small and medium-sized businesses and frequently it falls to the Government and its constituent organisations to provide or instigate the provision of these services.

3. Services provided to small and medium-sized businesses

Over the past 10 years there has been a significant change in the supply of services to small and medium-sized businesses in transition countries. A wide range of business advisory services is provided to entrepreneurs, potential entrepreneurs, or managers of businesses to stimulate the creation, expansion, or improvement of small and medium-sized enterprises. The services offered by state organisations, regional authorities, public/private partnerships, subsidised private agencies and companies, etc. typically fall under the following broad headings, according to FEED research material and delegates:

- Information services.
- General business counselling and consulting.
- Entrepreneurship or management training.
- Specialised advisory services.

Some FEED delegates, particularly private sector representatives, highlighted the fact that entrepreneurs in most transition countries expect advisory services to be provided free of charge. The point was made that information and general advisory services might be free but should be distinguished from consultancy services that help a company gain new business or improve its competitive position. The latter services should normally be charged for.

More detail on the range of services that should be considered is outlined in the policy guidelines and recommendations on business advisory services which were derived from the existing policies and practical experience reported by FEED delegates from transition and OECD Member countries and international institutions.

POLICY GUIDELINES AND RECOMMENDATIONS ON ADVISORY SERVICES FOR NEW AND SMALL BUSINESSES

1. Design and provide business advisory services to small and medium-sized businesses where market gaps exist in the provision of such services and spell out a policy that specifies why and how this will be done.

1.1 Intervene where there is a deficiency in the market in the provision of business advisory services to small and medium-sized businesses. This is a basic principle which Governments and regional authorities should follow in the provision of business advisory services.

1.1.1 Weigh carefully the decision to intervene.

1.1.2 Specify the objectives to be achieved and monitor the cost-effectiveness of the intervention.

1.2 Design and implement business advisory services with clear links to support infrastructure:

1.2.1 Link business advisory services with business incubators, small and medium-sized business funding and credit schemes, etc.

1.2.2 Provide business advisory services and other support mechanisms ‘under one roof’ where possible in order to maximise and co-ordinate their delivery to small businesses.

2. Manage and operate business advisory service programmes like commercial entities.

2.1 Establish business advisory service programmes as independent corporate entities, so that they are operated more like businesses than like donor or government organisations.

2.1.1 Position programmes to have lower overhead costs by establishing them as independent entities. Programmes established by governments and donors usually have higher relative cost structures compared to the lower overhead of a private firm.

2.1.2 Encourage programme managers to operate advisory services in a business-like manner. This can provide a firmer basis for credibility with companies.

2.1.3 Make subsidies in support of business advisory services explicit -- in addition, subsidies by donors or governments for business advisory service programmes should have a definite time-span and provide for targeted and measurable objectives.

2.2 Recognise that fees for services, which at least recover costs, are almost always desirable.

2.2.1 Distinguish clearly between information/general advisory services, which may be provided free (or for a modest fee) to selected clients and business consultancy services, which are more costly to provide.

2.2.2 Charge for valuable business improvement techniques and/or market intelligence that enable a company to gain sales and grow.

2.2.3 Make people understand that fees provide support for sustainability of the overall business advisory service.

2.2.4 Recognise that fees provide important information about the perceived value of the services being provided.

2.2.5 Target subsidies to certain groups if necessary where they may be excluded from participation in the business advisory services as a result of fees being charged.

2.2.6 Ensure that any surplus earned is re-invested in the business advisory service programme.

3. Build business advisory service programmes based on clear identification of the needs of small and medium-sized businesses and ensure that a flexible range of services, adaptable to changing needs, is provided in all regions.

3.1 Undertake objective surveys to identify the needs and priorities of small businesses and design and provide business advisory services based on this objective feedback from the intended clients.

3.2 Be aware of the extensive experience of other transition countries/regions in identifying SME needs, e.g. a survey undertaken in 1997 by the Tomsk Region Administration, Russia, of small and medium-sized business needs revealed that entrepreneurs wanted advisory services on:

- Business planning.
- Partner searching.
- Know-how consulting.
- Marketing.
- Legal expertise.
- Sources of finance.
- Specialist training.

3.3 Conduct regular surveys of the actual use of business advisory services by small and medium-sized businesses and their needs in order to:

3.3.1 Determine the suitability and satisfaction levels with the delivery of the services,

3.3.2 Be aware of changing needs and ensure that services are meeting the real needs of entrepreneurs and that services are adapted to meet changing needs.

3.4 Provide a flexible range of business advisory services. There is a growing demand, for example, for information and advice on new services such as:

- Special services for women entrepreneurs.
- Leasing services.
- Franchising services.
- Innovative technology and marketing related services.
- Establishing business linkage between domestic and foreign partners.

The last service is important for both small and medium-sized business and FDI policies and should be a clear part of policy and action in each of these areas.

3.5 Consider how the business advisory services can be extended on a regional basis in the design of such programmes. Most business advisory services are based in major centres of population.

3.6 Business advisory service programmes are one of the important components of regional development plans and should be seen as such.

4. Involve the private sector, as early as possible, in the provision of business advisory services and aim in the long run to have these services fully provided by the private sector.

4.1 Establish programmes that lead to the eventual provision of business advisory services by the private sector. The initial design of the programmes, then, should provide a strategy that:

- Actively encourages private sector provision of the services as quickly as possible and
- Provides for cessation of government and donor intervention as early as possible.

4.2 Where government and donor intervention are warranted, private sector provision of some elements of this intervention, through subcontracting, concession, or other modality, should be considered.

4.3 Consider capacity building of private sector organisations to enable such organisations to supply services direct to entrepreneurs before deciding to establish state programmes. Both Governments and donors should adopt this approach through, for example,

4.3.1 Encouragement of new service providers through incentive schemes to attract them from other geographic or sectoral areas, or strengthening of existing service providers in a region through technical assistance.

4.3.2 Vouchers being provided to small businesses which then decide who to hire, thus stimulating a market for business services.

4.4 Seek maximum support and participation from local organisations in the provision of services.

4.4.1 Where organisations such as local governments, local trade associations, and local enterprises are seen to support the programme it can endorse the acceptance and credibility of these services.

4.4.2 Seek to use and develop local expertise where possible in undertaking this work.

5. Aim for sustainability in the design and funding plans for business advisory services and seek multiple sources of funding including local sources.

5.1 Plan for sustainability of services in the design of the programme (unless the programme addresses an identified temporary need). Avoid the problem of programmes having to close because a subsidy is removed.

5.1.1 Seek sponsorship (cash or in-kind) by multiple organisations, both public and private, which will improve the prospects for sustainability.

5.1.2 Offer various kinds of services relevant to small businesses, which will diversify sources of fee income.

5.2 Provide subsidies up-front.

5.2.1 Subsidies provided by donors or by central governments should preferably be up-front, in starting a programme, rather than funding its day-to-day operations over extended periods.

5.2.2 This up-front subsidy can emphasise from the beginning that continuation of the programme depends on the quality and relevance of the services provided and that the services should be in demand by SMEs.

6. Manage the selection, training and supervision of staff to deliver business advisory services.

6.1 Manage carefully the delivery of the advisory services. The success of business advisory services depends on the rigorous selection, training, and supervision of staff.

6.2 Ensure that business advisors have the experience and ongoing training required to effectively deliver the level of advice they provide. Key issues here for action, identified by the FEED delegates, are the need to:

6.2.1 Undertake objective analysis of the existing needs of trainers.

6.2.2 Provide good forecasts of the supply of trainers needed.

6.2.3 Ensure that trainers are motivated and trained to deliver quality services.

6.2.4 Provide trainers/counsellors with a firm grasp of basic business functions, such as accounting and finance, marketing, personnel, and production, in addition to counselling skills.

6.2.5 Provide adequate equipment to support the delivery of business advisory services

6.3 Set standards for the quality of services to be delivered and ensure that good feedback from clients is monitored and used to develop the service provision.

7. Plan a full range of business advisory services based on identified needs of the small business sector and aimed at targeted entrepreneurs and companies.

7.1 Establish criteria to select entrepreneurs for help and advice.

7.2 Establish criteria for choosing the scope of services to be offered and recognise the practical limitations in terms of human resources and equipment.

7.3 Consider the following illustrative selection of services:

7.3.1 Information (by direct contact or through publications, library services, etc.) and referral,

- Access to Internet and commercial databases.

- Information on various regions/countries.
- Information on market characteristics.
- Information on international companies.

7.3.2 General business counselling and consulting

- Mentoring, i.e. general business advice by experienced business people.
- Consulting services where specific tasks in support of entrepreneurs are provided.
- Business plan development and related advisory services (for a fee).

7.3.3 Entrepreneurship or management training

- Centralised training for companies (e.g., how to manage personnel, perform accounting, marketing, etc.) including possible training for trainers.
- Management development.
- Courses on computer related topics, applying management information systems.

7.3.4 Specialised advisory/consultancy services

- Financial assessment services.
- Market services (market information, market research, sales contacts, advice or contacts on distribution, etc.).
- Legal services, for example, assistance in preparing statutory agreements, contracts, documents to work abroad, other legal/juridical services.
- Facilitating registration of joint stock companies for established companies.
- Partner selection, foreign partner participation (companies may be screened and ranked).
- Technology transfer, negotiation and acquisition.

This is not a complete listing of the services being provided by various agencies and organisations but it illustrates the type and scope of support now being made available to small and medium-sized businesses in many countries. It serves as a guide to policy makers in transition countries in planning the range of business advisory services that could be provided. The eventual range of services to be provided should be determined by the identified needs of small and medium-sized businesses and the resources available.

SUPPORT SERVICES AND FINANCIAL INSTRUMENTS FOR ENTREPRENEURSHIP

BUSINESS INCUBATORS

1. Overview

In the movement to a market economy the stimulation of indigenous enterprise is a major challenge for transition countries. Policies and programmes that can assist in the establishment of new enterprises, help to build strong domestic companies and promote an enterprise culture need to be created and widely employed. Participants at the FEED Working Party meeting in Istanbul in June 1998 and Annual Meeting in December 1998 examined the role and potential of business incubators in that regard and reached a broad consensus that incubators could be a useful and very beneficial tool in promoting and fostering small and medium-sized businesses.

The successful use of business incubators as part of national industrial development policies is common throughout OECD countries. They are especially important in areas of poor or anti-entrepreneurial culture. In transition economies, incubators can help in changing attitudes towards personal initiative, innovation, risk-taking and entrepreneurship, and hence contribute to the transition towards an entrepreneurial culture.

2. Experience of business incubators in transition countries

Delegates at the Working Parties outlined their experiences of business incubators. While there were mixed views on the cost effectiveness of incubators they concluded, in line with results in developed countries, that incubators could respond directly to the needs of entrepreneurs and improve the survival and growth prospects of start-up businesses. Increasingly they are being established in transition countries. For example, in Ukraine the demand for incubator training and services is high although the incubator network only began in 1996; delegates from Uzbekistan reported that there are now 23 business incubators which have spawned 200 new enterprises, generated 2,500 jobs and resulted in US$ 100 million in sales. The Romanian experience pointed to the impact of incubators in creating a market for more realistic prices for business space in the wider locality, in diversifying local economies and in creating new jobs in response to plant closures. The successful example of an incubator in a relatively remote area in Bulgaria where many engineers had been out of work was also noted. The gradual emergence of science parks with incubator facilities in Hungary and Slovenia was cited. In Armenia there are plans to develop incubators specific to agricultural industries. The delegate from Moldova observed that a legal and policy framework for incubators was needed, as many are still confused about the definition of business incubators. Azerbaijani participants noted the special business incubator needs of an economy built around petroleum. Other observers noted the importance of incubators in forming clusters of businesses and promoting networking.

3. Defining what is meant by business incubators

FEED delegates referred to the lack of understanding sometimes about what exactly a business incubator is. Business incubators were generally defined by the FEED delegates as special areas for new and young developing businesses that provide these businesses with premises, infrastructure, a comprehensive range of services and convenience that can improve their ability to initiate and run their operations during the early developmental period. The combined features of efficient physical facilities; focus on start-ups and small and medium-sized enterprises;

collaborative links fostered between companies within the incubator and in the region; and ‘soft’ advisory and support services provided are what distinguish business incubators from other industrial centres or industrial estates.

The delegates differentiated between small business incubators, industrial parks and free trade zones. Each of these has different objectives although they may all share certain common elements and goals such as providing basic infrastructure, business services and a focal point for entrepreneurs to establish a cluster of businesses. It was concluded that there is no simple or single business incubator model, which can be adopted but, what emerged from FEED discussions was (i) a broad definition of the distinguishing features of business incubators based on world-wide experience, (ii) a charting of their strengths and weaknesses and (iii) some principles and recommendations that might guide transition countries in considering their own approach to business incubators.

4. Strengths and weaknesses of business incubators

Studies suggest that incubators can reduce the failure rate of start-up companies. The presentations by various countries represented at the Working Party described positive features. They contribute to the formation of entrepreneurial culture and networking amongst entrepreneurs who are at the same site. When attached to strong centres of learning and research, these sites may also create specialised knowledge or production centres as a source of a regional competitive advantage, attracting additional local and even international investment. They are visible signs of progress and commitment to entrepreneurship, and it was noted that this sometimes makes them attractive to local political leaders who can assist support for the incubator. Incubators may be targeted towards specialised areas such as high-tech, research, export-oriented industries or manufacturing start-ups. When well managed and integrated into the regional business community, an incubator can contribute to entrepreneurial development and become a role model for the wider region or nationally. Unlike business advisory service centres, incubators provide daily coaching, strong networking possibilities and a convenient business site.

Business incubators were criticised by some delegates for only helping a handful of firms. If incubators do not fully cover their initial or operational costs, they may be seen as a form of subsidy to a handful of enterprises. Some FEED delegates argued that the goal of policy should be to improve the environment for all enterprises, making it less necessary to have special programmes. This was seen as a valid long-term aim and business incubators should ideally aim to eventually service companies outside the incubator as well. Sustainability issues emerge when there are outside subsidies by government or donors. Among the pitfalls to be avoided according to some speakers are inappropriate prices and operational procedures. There needs to be transparent admission criteria, exit criteria and internal management procedures. It was suggested that incubators should not be seen as a panacea and can be expensive. They may not have the resources necessary to provide a full range of services to entrepreneurs.

5. Conclusions

The broad conclusion arising from the overall discussion was the need for policy makers and business incubator managers to be aware of the above features and to consider how to take account of them in their strategies and plans to promote small and medium-sized enterprises. Building on the practical experience of various transition countries outlined above, the policy guidelines and recommendations were recommended by the FEED delegates.

POLICY GUIDELINES AND RECOMMENDATIONS ON BUSINESS INCUBATORS

1. Recognise the role of business incubators in fostering entrepreneurship and realise their potential to support regional/sectoral development.

1.1 Gain from the lessons and experience of existing incubators in various countries.

1.2 Recognise and be aware of the extensive practical experience of other countries -- both transition and OECD member countries -- that show that business incubators:

- Help networking amongst entrepreneurs and help in improving attitudes to entrepreneurship.
- Are visible signs of progress and commitment to entrepreneurship and thereby influence the wider population and environment for enterprise.
- Become a role model for the wider region in which they are located and even nationally when they are well managed and integrated into the regional business community.
- Offer a safer environment for small and medium-sized businesses in those areas where organised crime is present.

1.3 Plan for successful business incubators**.** Take into account all of the above factors as well as the range of services and potential strengths and weaknesses in developing policies and programmes to provide business incubators.

2. Ensure good business-like governance structures and clarify the status and mandate of business incubators.

2.1 Establish suitable governance and mandate for the business incubator.

2.1.1 Establish an independent not-for-profit organisation or corporation. This is seen as having advantages over being run directly by a government or donor contractor.

2.1.2 Appoint an independent and qualified board of directors (for example, ideally people with practical experience of starting or running a business are on the governing board).

2.1.3 Closely associate and link business incubators with business development or advisory centres where these exist.

2.2 Aim for self-sustaining status:

2.2.1 Arrange that the local or national government ideally donate the initial site.

2.2.2 Seek some initial funding from the government or from international project finance.

2.2.3 Generate own income. Self-financing or a significant contribution to that goal is vital to sustainability and to prepare for the eventual expiry of subsidy (through rental income, service income and training income, etc.)

2.2.4 Offer some services and training to entrepreneurs outside the incubator, thereby generating additional income.

2.2.5 Re-invest any surplus earned in the operations back into the business incubator.

2.3 Clarify the mandate of the business incubator; prepare the corporate mission and strategic plan:

2.3.1 Ensure that the business incubator mandate allows for support to manufacturing, processing and service companies and takes local needs into account.

2.3.2 Follow best business practice in managing business incubators:

(i) Business incubators should have a full corporate plan with quantified objectives set out, similar to a well-run private company.

(ii) Performance should be measured regularly and at least annually.

2.3.3 Attract a complementary mixture of companies, which can be mutually supportive of each other, to the business incubator.

3. Seek to involve good support partners at local and international level and focus the activity of the business incubator on local entrepreneurs and local needs.

3.1 Establish good support partners for the business incubator:

3.1.1 Have a strong local partner to assist in the start-up and development of the business incubator: for example, big companies, the local university and the municipal authority, all of which will ideally play a patron role in sponsoring and advising the centre.

3.1.2 Organise and foster partnerships with international agencies and donors, chambers of commerce, international companies and associations, etc. which will help the incubator in its management and operations.

3.2 Focus the business incubator on local business people and local needs:

3.2.1 Focus the operations of the business incubator so that it responds to the specific needs of local business entrepreneurs.

3.2.2 Take into account the economy of the region and future potential for growth and diversification by local companies in the corporate plan and operations of the business incubator.

3.3 Manage the introduction of the range of services to be provided by the business incubator and ensure linkage with other regional or local services:

3.3.1 Move gradually to providing a full range of services at reasonable prices to companies.

3.3.2 Do not create unrealistic expectations for business incubators. Although a vital mechanism in promoting entrepreneurship, they can not substitute for the wider reform of SME promotion policies needed in many areas.

3.3.3 Ideally business incubators should be closely integrated with small business advisory centres.

4. Choose the location and select the site carefully and ensure that suitable infrastructure and facilities can be provided.

4.1 Assess all relevant factors in choosing a location:

4.1.1 Take care in the selection of a location to ensure suitable infrastructure for the business incubator. An objective evaluation of the suitability of sites should be undertaken in advance.

4.1.2 Ensure that telecommunications, roads, water, power, etc. are available or will be accessible.

4.2 Balance regional policy demands and the essential requirements for success of business incubators:

4.2.1 Select regions with both high and low investment potential but where the latter is done it needs to be realistically balanced against the need for adequate infrastructure and for access to "networks".

4.2.2 The business incubator's local sponsors and governing body should be involved in ensuring that the business incubator has adequate infrastructure and access to networks.

4.2.3 Recognise that incubators in transition countries can respond effectively to the acute need of suitable business premises, and eventually contribute to setting more commercial market prices for business space.

4.3 Use site selection criteria:

4.3.1 Establish clear criteria and conditions in choosing locations for business incubators. For example, a local free contribution of premises; a local financial contribution; the legal adoption of the non-profit constitution, described above, by local participants.

4.3.2 Adhere to the underlying principle of local contribution and local legal commitment to the constitution/mandate. These principles may vary in implementation from one location to another but the underlying principle of obtaining tangible local commitment and support is recommended.

4.4 Provide modern and competitive communications infrastructure:

4.4.1 Install good communications facilities (telephone, fax, Internet, Email, video conferencing, etc.), which will facilitate companies.

4.5 Plan a full range of services, which will meet the needs of entrepreneurs. These facilities/services may be introduced on a gradual basis and could encompass, for example, the following:

- Incubator space: offices, workshop or production space on a flexible and affordable basis.

- Common services such as secretarial/administrative support, information and library services, shared offices and use of office or other equipment at reasonable cost.

- Access to modern telecommunications and information technology services: Internet, Email, ISDN, video conferencing and advice on hardware, software applications, etc.

- Counselling services: general business development advice and information or access to accounting, legal, computer, advertising and marketing services, technical and R&D guidance, introduction to funding and venture capital sources.

- Training services (e.g. market economy principles, business strategy, business development, professional and technical skills) are often features of incubators, and these services are generally made available to entrepreneurs "outside the walls" as well.

- Networking and linkage activities which will link companies within the incubator to external advisors, component or raw material suppliers, business partners, potential investors, distributors, service providers, etc.

- Aftercare and outreach services to companies graduated from the centre and to other companies in the region.

5. Recruit good management and apply business-like operational practices so that a positive view of entrepreneurship can be fostered as well as helping to promote a new enterprise culture and networking.

5.1 Select suitable management.

5.1.1 Recognise that selecting suitable management is critical to success. The business incubator manager has a key central role in the success or failure of the incubator.

5.1.2 Considerable care therefore should be taken in selecting suitable management.

5.2 Adopt business-like management procedures in the management of the business incubator.

5.2.1 Ensure that the management style and detail of incubator operations reflect a quality and business-like approach. Business incubators have the potential not just to create positive views of entrepreneurship but can stimulate a new enterprise culture in a region.

5.2.2 The management should be continuously alert to the incubator role in creating a new image.

5.3 Set targets and measure performance:

5.3.1 Set goals to graduate a specific number of companies each year. This should be part of the strategy and plan for the incubator.

5.3.2 Ensure the success of the first clients. This target is critical for the eventual success of the incubator. It will set the image for the business incubator.

5.3.3 Measure and monitor the cost per job and effectiveness at job creation within the business incubator as well as the contribution/value added within those regional/sectoral areas where they operate.

- Business incubators are emerging in many countries as a most effective tool for job creation and economic development.

- The cost effectiveness of incubators per job created is still the subject of divergent views in some countries. It needs to be continually investigated and monitored.

5.3.4 Undertake effective and regular evaluations of business incubators' performance through feedback from client entrepreneurs both within the incubator and outside.

5.4 Use successful companies to support the incubator:

5.4.1 Use successful companies (in the incubator and after they have left) as role models of new enterprise which will encourage other entrepreneurs.

5.4.2 Demand the active co-operation of all companies coming into the incubator as part of the entrance conditions.

5.5 Help companies in the incubators through the use of networking:

5.5.1 Recognise that business incubators have a high potential especially in providing services to clusters of enterprises and fostering networking between enterprises.

5.5.2 Facilitate the needs of companies by establishing good networks.

- Incubators can not deliver all the services demanded by small and medium-sized businesses.

- Networking with external providers of goods and services is an important activity for business incubators.

5.5.3 Donor-supported centres should actively seek to develop private service suppliers and take account of this in establishing their charges or determining which services might be provided free of charge.

5.5.4 Consider the opportunity to develop networking through 'twinning' with other business incubators, which might help to identify business opportunities between networks and/or clusters of companies located in different types of business incubators.

6. Make the business incubator operating conditions, services and charges/costs clear and transparent to companies.

6.1 Establish clear policies in advance on entrance/exit criteria and charges:

6.1.1 Establish transparent entrance/exit criteria for companies coming into and leaving the incubator. Realistic exit periods should be set.

6.1.2 Set down clear charges for companies, entering the business incubator and/or using the various services provided, so that entrepreneurs are aware at all times of costs.

6.2 Prepare companies for exit from the business incubator:

6.2.1 The incubator management should see this as an important task to undertake and work with companies to smooth the exit process.

6.2.2 Ensure continuity of the business outside the incubator by continuing liaison and advice. This is in the interests of the business incubator, as the eventual success of graduates of the incubator will provide role models for the incubator management.

6.3 Provide aftercare and outreach services:

6.3.1 Some incubators continue to provide services to graduated companies, thereby providing continuity, follow-up and monitoring of long-term success after companies have left the incubator.

6.3.2 Business incubators should serve not just the tenants of the incubator but a wider clientele of small and medium-sized businesses outside the centre. In this way they can spread the benefits outside and generate additional sources of income.

7. Learn from the extensive international experience with business incubators and communicate and distribute guidelines widely to ensure their implementation.

7.1.1 Feed delegates stressed the importance of learning from each other and setting up Internet-based communications on this subject between countries and agencies participating in the FEED.

7.1.2 Delegates also stressed the importance of communicating these guidelines to policy makers to ensure proper recognition of important policy issues and to obtain implementation of the policy guidelines and recommendations.

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