

POLICIES FOR MODERNISING AND DIVERSIFYING EXISTING SMEs AND SUPPORTING THEIR INTERNATIONAL COMPETITIVENESS

by David Crichton

This paper draws together the findings and conclusions of a study visit to Croatia undertaken in May 2007 on behalf of the OECD and USAID. The overall purpose of the visit was to review policies for supporting entrepreneurship in Croatia, and to make recommendations on policy at national, regional and local level. The particular component of the review covered in this paper is the issue of modernising, diversifying and internationalising the existing SME base of the country.

The paper is structured into four main sections:

1. Introduction and general impressions
2. Current policy approach in Croatia: strengths and weaknesses
3. Policy recommendations
4. Learning models

Introduction and general impressions

The underlying premise in this part of the review is that a more modern, diversified and internationally competitive SME base will benefit the Croatian economy by improving its growth, employment, investment and balance of trade prospects. Arguments in favour of developing the existing SME base include:

- Established SMEs tend to achieve higher levels of growth than new starts or micro-businesses.
- As they grow, their participation in wider national and international markets increases, generating additional GDP for their local economy.
- A pattern of growth and sustainability makes the attraction of additional finance more likely, thus creating a virtuous circle of growth and investment.
- Growing SMEs generally employ higher levels of management and technical skills, creating higher incomes and building a bigger pool of talent in the local economy.
- They also tend to demonstrate higher levels of product innovation and new technology adoption.

Designing policy interventions that make a meaningful difference to the performance of existing SMEs represents particular challenges. These include:

- *Identifying SMEs with real growth potential.* The public sector is not generally adept in “picking winners”, and must often rely upon such SMEs presenting themselves for advice and support.
- *Designing an appropriate package of support.* As SMEs grow and diversify, their support needs become both more complex and more specific to their particular markets and products. This requires a greater level of sophistication and coordination from public sector support than is the case in new start promotion, for example.
- *Reacting quickly enough.* Higher growth SMEs tend to be more opportunistic and faster moving. The constraints of good public sector governance and accountability make it difficult to provide the speed of response required.
- *Identifying the real impact of policy and support.* As SMEs grow and diversify, their performance becomes dependent on a wider range of factors of which public intervention represents only one, often marginal, element. Evaluating impact and minimising deadweight therefore become increasingly difficult.

Good practice in SME growth policy therefore tends to be characterised by a range of factors:

- A supportive macroeconomic, fiscal and legal context that provides the confidence necessary for SMEs to bear the additional risks associated with growth.
- A clear, detailed understanding of the local SME base which enables identification of where the growth potential lies and what the actual support needs are.
- Careful design and targeting of interventions, tailored to the specific needs of the SMEs involved.
- Delivery by skilled practitioners who understand the dynamics of SME development, and can win the trust and confidence of the entrepreneurs involved.
- Effective coordination of interventions from all of the relevant public agencies involved, providing an efficient, seamless service for SMEs.

These are challenging criteria, and few of even the most developed countries or regions could reasonably claim to meet them all. In the context of Croatia’s recent emergence from state control and regional conflict, they represent especially high hurdles. Any assessment of current policy therefore needs to be sensitive to the country’s recent economic and political history.

The general impressions that emerged from the study visit and that reflect this recent history are:

- An SME sector that is at a very early stage of development, in which the opportunities for growth and internationalisation remain understandably limited.
- A policy environment that is very driven by the EU accession process, generating considerable activity and resource but not necessarily matching the specific needs of high-growth SMEs.

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- A package of policy measures that include most of the interventions generally relevant to SME growth, but not yet operating in a consistent or integrated way.
- A support infrastructure that contains many talented people and impressive agencies, but is similarly not yet operating in a coherent or integrated way.

Current policy approach in Croatia: strengths and weaknesses

The SME sector

The overall scale and contribution of the SME sector in Croatia is relatively well documented. There were around 68 000 registered SMEs in the country in 2006. This represented 99% of all registered companies, and their employment amounted to around 424 000 people: 53% of the employed population. In addition, the crafts sector comprised a further 105 000 people in self-employment, in turn employing an additional 145 000 workers.

Overall, therefore, the small business sector accounted for over 65% of total employment in Croatia in 2006. It contributed 55% of national GDP, 27% of exports and 38% of total assets. SMEs are clearly a significant sector within the national economy and policies to support them are an obvious, legitimate component of national economic strategy.¹⁵

As described in the previous expert's contribution, the results of the 2006 Global Entrepreneurship Monitor revealed some additional features of how the SME sector in Croatia is performing:

- the level of business start-up grew significantly between 2002 and 2006;
- the motivation for setting up in business remains, however, predominantly necessity- rather than opportunity-based;
- the survival rate of new businesses also remains low; and
- the proportion of businesses that exhibit growth potential is also low.

There is therefore evidence of a large and growing SME sector in absolute terms. But the evidence also suggests that the survival and growth potential of the sector remains limited, with insufficient SMEs displaying the characteristics of high growth, modern, diverse and international businesses. The "pipeline" of SMEs from start-up to high growth is a narrow one, with few businesses travelling through it to become genuinely high growth contributors.

SME policy framework

During the study visit, discussions were held with policy makers and practitioners at a number of levels: central government and its agencies, regional and local agencies, and business organisations. A very full range of policies and programmes were identified during those meetings, and an analysis of strengths, weaknesses, opportunities and threats is presented below.

¹⁵ Figures provided by the Croatian Chamber of Economy

Strengths and opportunities

There are many positive aspects of the current situation that provide a good platform for future development. Notable ***strengths*** include:

- A clear recognition amongst policy makers and practitioners of the need for modernisation, diversification and internationalisation. There is no complacency or lack of ambition, and no evidence of cultural or political barriers to growth aspirations.
- An understanding of the range of interventions that is appropriate for SME growth. Policy makers and development agencies have already identified the types of policies that are used in most other developed economies: specialised property infrastructure, managed workspace, strategy and market planning, international collaborations, management and technical skills training, R&D linkages with research and education institutions.
- A wide range of development agencies are already in place and active. At national, regional and local level there are a number of departments and agencies providing support to the SME sector. This is providing many opportunities for contact with SMEs, and for refining the range and quality of support measures.
- Similarly, there is a growing cohort of skilled and talented practitioners working in the field of SME development at national, regional and local level. They have developed good experience in running support programmes and in meeting the accountability requirements of international and government funding sources.

Alongside these strengths, a range of ***opportunities*** are evident:

- There are a number of sectors where the scope for modernisation, diversification and internationalisation is already strong: ICT, tourism and precision metal work for example.
- The range of programmes and interventions already in place provides an evidence base that should enable evaluation of what works most effectively. Initiatives are already under way in areas such as financial support for SMEs, loan and export credit guarantees, innovation support, management training and advice, and export promotion. These can now be reviewed in the light of experience to identify what has worked best.
- Similarly, the range of development agencies already active provides an opportunity to measure the relative impact of national, regional and local interventions and to refine the skills required amongst practitioners for effective delivery.

Weaknesses and threats

The visit also however revealed a number of ***weaknesses*** in the current approach:

- There is insufficient understanding of the structure and dynamics of the SME sector. Whilst national data do exist on broad indicators such as the number of SMEs and their regional and sectoral distribution, this does not enable delivery agencies to identify those SMEs in their areas with the best growth potential. Interventions cannot therefore be targeted in the most cost-effective way.

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- The origins and motivations for setting up in business remain largely related to need rather than opportunity, and local rather than international markets. As a result the “pipeline” of SMEs with genuine growth potential is a narrow one, making it all the more important that those SMEs can be identified more quickly and accurately.
- Interventions in support of SME growth are almost entirely driven by pre-defined programmes, largely funded by international donors such as the EU. Whilst these bring welcome resources and activity, their delivery primarily requires strong administrative skills to meet the governance criteria of the donors. This does not necessarily match the more flexible and entrepreneurial requirements of supporting fast growth SMEs.
- Whilst there is a wide range of both interventions and delivery agencies, the connections between them are not yet well enough developed. As a result, the route into support for SMEs can be confusing, time consuming and bureaucratic. Also, this increases the probability of overlap and inconsistency in how the range of agencies operates.
- Similarly, the scope to link SME growth policies with other economic development interventions is not yet being exploited. Examples of such links are the potential to link FDI attraction with development of the local supply base, or the opportunity to steer more university-based R&D activity to the innovation requirements of progressive SMEs.
- There appears to be very little evaluation of the impact of interventions. Best practice is therefore difficult to identify and to build upon.

Given these weaknesses, a number of *threats* to future SME success are evident:

- Without a proper, detailed understanding of the SME base, SMEs with growth potential may not be identified by support agencies and will not receive the appropriate assistance on a timely basis.
- Without effective integration and consistency in support measures, SMEs may not believe that the delivery agencies are either accessible or relevant to their needs.
- A lack of evaluation will lead to waste and inefficiency in the use of public sector resources for SME support.

Examples of good practices in Croatia

In the course of the visit, a number of good examples were identified. For example, the **BICRO** organisation was founded by the Croatian government in 1998 and has the specific purpose of increasing the competitiveness of SMEs. Its primary focus is on technology development, and it aims to improve links between SMEs and the national research base. Its objectives include commercialisation of research, knowledge transfer from science to business, establishment of knowledge-based companies, promotion of a venture capital industry and improvements in the technology infrastructure. It is a small organisation, operating from Zagreb with 16 staff. Despite its principal focus on technology, BICRO also accepts that growth-oriented SMEs can come from more traditional sectors as well, for example mechanical engineering.

Aspects of its operation that made it stand out as a good example included:

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- its key staff have worked in the commercial sector at home and overseas, and have an impressive grasp of the dynamics of business growth;
- its recognition that success in delivering its objectives requires an inter-disciplinary approach, with strong project management skills;
- its clear criteria for identifying and supporting SMEs with growth potential: quality of management in particular; and
- its recognition of the need to improve the management and impact of technology centres and parks, to make them genuine centres of innovation rather than simply managed workspaces.

A good example with quite different characteristics is the *Azra* local development agency in Varaždin. Azra was established by the county authorities in 2005. It has 31 staff and supports SMEs in a number of ways: business planning advice, market entry, project preparation, meeting EU funding requirements and business networking. Its remit from the local authorities is to take a very broad approach to local economic development, with social and community objectives alongside its business development role. Over time, this breadth may cause dilution of effort but at this relatively early stage it is enabling a mix of approaches to be tested and broad political support to be maintained. Strong aspects of its work to help grow SMEs included:

- a clear underpinning strategy, based on careful analysis of the regional economy;
- clear identification of where best SME growth potential currently lies in the area, for example in organic foods, tourism, skilled metal work, ICT and software;
- an ability to work closely with individual SMEs and groups of SMEs to develop growth opportunities, for example through collaboration on marketing or through helping to establish machinery rings;
- a patient commitment from local politicians and officials, recognising that success will require continued public subsidy over an extended period; and
- energetic and committed staff with a strong, experienced leader.

At national level, there was good evidence of an innovative and increasingly coordinated approach to *tourism development*. A number of organisations are involved in tourism promotion: the national government through the Ministry of the Sea, Tourism, Transport and Development; regional and local development agencies, international donor agencies such as USAID; and private bodies such as the National Association of Small Family Hotels. This diversity runs the risk of a fragmented approach with poor coordination and inconsistent policies. But the Ministry and the other agencies are committed to ensuring a coordinated approach. This is characterised by:

- a clear national strategy, with specific targets, selective priorities and an emphasis on coordinated delivery;
- linkages between national, regional and local strategies;
- recognition of the need to build on existing strengths (coastal tourism), while developing new tourism products (wine trails, upgraded accommodation, FDI attraction);

- well targeted financial support programmes; and
- recognition of the need to improve “soft” skills, such as customer service, alongside the physical tourism product.

Policy recommendations

Based on the analysis of strengths, opportunities, weaknesses and threats, five main policy recommendations are made below, covering:

- analysis of the SME market;
- evaluation of policies and programmes to date;
- improved links with other policy areas;
- outsourcing opportunities; and
- local clustering opportunities.

Analysis of the SME market. One of the main impressions from the visit was of a wide range of activities and interventions made in support of the SME sector. Mostly, these activities appear to be “supply-driven”, i.e. they reflect the knowledge and capacities of those agencies delivering the service. There was much less evidence of “demand-driven” policies, reflective of the identified needs of SMEs themselves and tailored to their individual circumstances. Demand-driven policies are more likely to achieve the results sought and to provide a cost-effective use of public funding.

In order to design more demand-driven interventions, it is necessary to understand the needs and opportunities of the SMEs being targeted. On a quantitative level, there is a reasonable understanding of the SME sector in Croatia in terms of its scale, structure, geographic and sectoral distribution. There is less understanding of the structure of the SME sector in terms of its growth potential, the specific constraints on growth that it faces, and the types of support most likely to mitigate these constraints. Gathering such information requires direct contact with SMEs, and it is recommended that a series of surveys are undertaken at regional and local level.

A similar survey design should be used in each local area, to enable collation and comparison of results at national level. However management of the surveys by appropriate local development agencies would help increase response rates by exploiting affinity with the SMEs local area. It would also help the local agency itself to understand the benefits of a more targeted approach.

The surveys would involve a combination of face to face and telephone interviews and postal questionnaires. Depending on the size of the SME sector in each area, returns from 5-10% of local SMEs should be sufficient to establish the pattern of need and demand for policy support. Questions would include issues such as: market performance and potential; product development; management and workforce skills; growth aspirations; constraints on growth. The information collected can then be used to “segment” the market for SME support, and in particular to identify the types of local SME most likely to achieve growth through modernisation and diversification. It can also be used to help design policies and projects aimed much more specifically at those SMEs, and therefore more likely to be effective in enabling growth. The surveys should also identify how SMEs would prefer to have support delivered, for example through one-to-one support from advisors, through group programmes or through web-based services.

Better information on the requirements of client SMEs will also enable Croatian national and local agencies to influence the design of support available from EU and other donors. It will provide a means by which those donors can tailor their standard programmes to the specific circumstances of the SME sector in Croatia.

Evaluation of programmes and policies to date. The wide range of programmes and policies being delivered to the SME sector has been acknowledged earlier in the report as strength, reflecting a high degree of commitment to the objective of encouraging growth. Over time, however, it is important to become more selective in the programmes being delivered, homing in on those which can be shown to achieve the greater benefits. It is also important to make support as accessible as possible to the SMEs themselves. A plethora of overlapping or inconsistent policies is likely to discourage participation by the SMEs that they are intended to support.

It is recommended therefore that a series of evaluations be undertaken of the range of SME support policies currently being delivered at both national and local level. This will involve measuring outcomes against original objectives, and comparing outcomes across different programmes. In order to identify the impact of policies at the level of individual SMEs, it will generally be necessary to talk directly with client businesses in order to establish how they have benefited from support. In order to avoid “survey overload”, it should be possible to incorporate evaluation questions into the market surveys recommended earlier. SMEs could be asked about their take-up of support so far, what actions they took in response to it, and how those actions improved their growth potential and performance.

The results of the evaluation work can be used to refine the range of support measures, concentrating on those with the highest impact and simplifying access for the SMEs themselves.

Improved links with other policy areas. As the BICRO example has already shown, success in achieving a more innovative and internationally competitive SME sector will require a multi-disciplinary approach. We identified, as did many interviewed partners during the visit, a lack of connection across policy areas. In order to create a more supportive environment for SME growth, better connections across policy areas will be required. Two particular areas where improved links could be effective are with FDI policy and with R&D policy.

Success in attracting FDI to Croatia creates a potential new source of demand for goods and services locally. For example, a major new tourism investment has potential spin-off benefits for local suppliers of food and drink, souvenirs, leisure activities, transport and distribution services, etc. Most global companies investing overseas will have their own well-developed international supply chains with established quality standards. Local suppliers may not be essential to their success. It therefore requires additional effort by local SMEs and enterprise agencies to make those connections. Once successfully made, however, the SMEs can benefit not only from the immediate market potential but from an overall increase in quality and skills that will improve their ability to compete on a wider basis.

A key element in successfully making a productive connection between FDI and local suppliers is to intervene early in the process, as the investment is being considered and made rather than after the event. The international investor needs to have the confidence that local supply capability can be developed, and will need to be directly involved in advising and training local SMEs. Similarly, the SMEs will require time to develop the service levels and skills demanded. If the connection is made only retrospectively, the investor will already have activated their established supply chains and it will be all the more difficult for local SMEs to break into that process. International investors generally expect to be asked to take part in local supplier development as part of their incentive package, so this approach need not put Croatia at a competitive disadvantage in attracting FDI.

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Another key policy connection necessary on behalf of SMEs is with the R&D infrastructure in universities, colleges and research institutions. Small companies with growth aspirations will generally be able to identify for themselves where they need product or process improvements. But they may not have the detailed technical knowledge or time to develop these on their own. Improved connections with sources of technology innovation will be required, along with a greater degree of market and business orientation from the relevant institutions. Policies in this area are covered elsewhere in this report, but it is important to emphasise here just how vital they are to SME policy.

Outsourcing opportunities. The potential for some SMEs to modernise and internationalise through providing an outsourcing service to international companies was highlighted on a number of occasions during the visit. For example, we spoke with a software business operating from the DAN technology park in Varaždin that was providing such a service to a German customer. Similar potential was also identified for other sectors, for example the precision metal casting and die manufacturing sector.

Outsourcing provides an opportunity to work very closely with an overseas customer, improving the quality of local products and services, gaining an entry point into export markets and developing local management and technical skills, while benefiting from a steady revenue stream. There are potential disadvantages of course, in terms of dependence on one or two large customers and over-specialisation on those customers' technical requirements. But on balance, the approach offers a "fast track" to product innovation and exporting.

We therefore recommend that the potential of an outsourcing initiative be examined in more detail through a feasibility assessment. This could initially focus on one or two sectors considered to offer the best potential, such as ICT and metals. The market opportunity should be measured, specific potential customers identified, technical requirements determined and local capacity measured. Any barriers to market entry would be identified, and support provided to address these. Such support may involve help with R&D to enhance technical capacity, financing or guarantees to support market entry costs, management and workforce training towards meeting customer requirements, or legal support to ensure adequate contract protection.

The feasibility work could be undertaken under the auspices of HAMAG in collaboration with relevant local enterprise agencies in areas where the sectoral potential is highest. There may also be a role for the Chamber of Commerce in supporting the initiative through export promotion and trade exhibitions.

Local clustering opportunities. Most development agencies worldwide have adopted clustering as a model for their industry interventions. Most have also identified a similar mix of industries on which to build clusters, for example life sciences, ICT and semiconductors. As a result, the overall concept has been diluted and does not offer the competitive advantage that it was initially intended to.

Nevertheless, it can work well in specific circumstances and this is often the case where the cluster is built upon a well established natural resource or industrial capability. The Scottish forest industries cluster is an example of this, and is presented as a learning model later in this report. In the case of Croatia, there are a number of similar examples that offer potential for a cluster approach at regional or local level. This is already developing with boatbuilding in Istria. Other possibilities identified during the visit were organic food and drink, and bio thermal energy.

These opportunities could be best exploited at regional and local level, beginning with systematic audits of the SME base in the selected sectors and its links with the local education and technical infrastructure.

International learning models in OECD countries

Scottish Forest Industries Cluster (SFIC)

Description of the approach

The SFIC was launched in 2001 by Scottish Enterprise (SE) and Highlands and Islands Enterprise (HIE). It brought together the existing forest industries supply chain (timber growers, primary and secondary processors, contractors and management agents, education and research institutions) with relevant public sector and environmental bodies, including the state forest service, the Forestry Commission. SE initially undertook a cluster analysis, identifying the scale, structure and performance of the forest industries and their development potential. The industries employ around 20 000 people directly in Scotland and another 40-50 000 indirectly. Much of this employment is in rural areas, where alternative employment opportunities are limited.

SE supported the initiative with a significant budget commitment of an average £1mn per annum and an executive team of 4-5 full time equivalents. There is a leadership group chaired by an industry representative, and comprising senior executives from businesses within the industry (predominantly SMEs), from public agencies, environmental bodies and education institutions.

A wide range of activities has been undertaken through the SFIC, including:

- efforts to attract FDI;
- business development support for local SMEs;
- support for R&D activities;
- establishment of centres of research and education;
- market and feasibility studies to explore industry issues;
- conferences, seminars and events; and
- regular newsletter and annual reports.

Rationale

The principal rationale for the approach was that timber planting in Scotland from the mid-20th century onwards had created a huge natural resource that offered potential for exploitation and added value within the country. There was insufficient processing capacity within Scotland to exploit this resource, in which case it would simply go unharvested or be exported for processing elsewhere, with little contribution to Scottish GDP. By building a more vibrant and integrated cluster, the conditions for new processing investment would be improved. A secondary rationale was that the timber resource and much of the existing processing investment was located in rural and remote areas of the country, where the economic base was much more fragile. The forest industries therefore provided an opportunity for additional rural investment and employment.

Relevance to Croatia

Croatia has a significant timber resource base but with only a limited amount of local processing capacity, as was the case in Scotland. There is interest from overseas investors, for example from Italy, in investing in processing. Croatia is already represented in the relevant EU forums for the timber industry, for example the forest technology platform. There are therefore a number of elements in place, including the natural resource base, some local processing capacity and interest from foreign

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investors, which suggest that a more coordinated effort to promote and develop the industry would be worthwhile.

Reasons for success or failure

The SFIC has been subject to independent evaluation which reached positive conclusions on its impact. A number of success factors were identified:

- the long term commitment of significant public sector funding;
- the deployment of a significant, stable executive team over period of years;
- the active engagement of senior industry representatives through the leadership group;
- effective sharing of knowledge and good communication of the cluster's work; and
- demonstrable, practical outcomes in terms of new projects in, for example, R&D, workforce training, e-business, transport logistics.

Obstacles faced and quality of response

The forest industries are of relatively small scale within the Scottish economy, and it was initially difficult to secure full support and attention from political leaders and from the wider public sector. The commitment of resources over a period of 4-5 years, the evidence of practical outcomes, effective communication and a growing interest in climate change and sustainability issues all helped alleviate this.

There was initial scepticism from the industry regarding the value of public sector intervention. This was gradually overcome through giving the industry a leadership role, showing a commitment over the long term, demonstrating practical outcomes and communicating well and regularly.

The forest industries are traditionally fragmented across a complex supply chain, making it difficult to achieve coherent representation and opinion. The SFIC supported the formation of a single industry trade organisation, which helped achieve a stronger voice for the industry and which will in time assume the leadership responsibility for SFIC from the public sector.

Considerations for successful adoption in Croatia

To successfully adapt a similar approach in Croatia will require:

- Central government recognition of the opportunity to increase investment and added value from the country's timber resource.
- The involvement of local development agencies in areas with timber resources, able to work with local growers and processors.
- The involvement of the industry itself in a coherent, active way.
- The setting of clear targets for the initiative, e.g. on FDI attraction, new processing investment, and additional employment creation.

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- The commitment of executive resources to ensure coordination, communication and delivery.

Contact details:

Web-site: www.forestryscotland.com

Nova Scotia Business Inc. (NSBI)

Description of the approach

NSBI is the publicly-funded business development agency for the province of Nova Scotia in Canada. It is an example of a regional agency working within a national policy context set by the federal government of Canada, but also working in collaboration with a number of more locally-based agencies within the province itself.

NSBI was established in 2001, and has an annual budget of around \$Canadian30mn. It is accountable to the provincial government of Nova Scotia, but operates as an arms-length agency with its own staff (many of whom have experience in the commercial sector) and a private sector-led Board. It was set up following publication of an economic growth strategy for the province and its primary focus is very much on attracting and supporting growth-oriented SMEs in the region. Its services include:

- Business advice to SMEs, through a team of in-house business advisors, covering financial and business planning.
- Market intelligence and contacts to increase SMEs' export potential, such as market research, customer searches, exhibitions and missions.
- Funding, including loans and venture capital, to support business expansion.
- Marketing of Nova Scotia as a location for FDI, including administration of investment incentives.

NSBI's reported achievements in 2006 include: over 3 500 jobs created and maintained; \$124 mn additional income for the regional economy; and almost \$60 mn additional export sales.

Rationale

The distinctive feature of NSBI is its very specific focus on supporting growth-oriented SMEs through initiatives to encourage innovation and internationalisation. This clear focus is unusual amongst regional development agencies, which often have a wider remit. Whilst it also has responsibilities for FDI attraction, these are closely linked with NSBI's work in SME growth, encouraging links between the two and a more open approach to development of the SME base.

This concentration of effort was the result of a deliberate decision by the Nova Scotia provincial government to create a highly specialised agency, with private sector leadership and a strong commercial focus. NSBI replaced earlier, more generalised approaches that sat within the provincial government. Whilst NSBI is expected to work with other development agencies, it retains this clear focus and priority.

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Relevance to Croatia

The Nova Scotia region has a population of just over 900 000. Around 30 000 of its 32 000 registered businesses employ less than 50 people, so the SME base is crucial to the regional economy. That economy was traditionally dependent upon natural resource sectors: fishing, forestry, agriculture and mining. As these declined, it became essential to modernise and diversify the economic base, both through encouraging innovation within the traditional sectors and through building a presence in newer sectors such as tourism, technology, media and financial services. This requirement for both modernisation and diversification therefore matches the needs identified within Croatia, at both national and regional levels.

Nova Scotia is also characterised by the range of agencies involved in trying to support SME growth: federal agencies working across Canada, provincial agencies such as NSBI itself, and more local agencies, often with wider social and community objectives. NSBI is an example of establishing a specific role and specialism within a complex overall structure, whilst aiming to work in collaboration with other elements of that structure.

Reasons for success or failure

There are a number of positive features of NSBI that have contributed to its success:

- The private sector has a strong stake in its success, through representation on its Board.
- Its business advisory staff has largely been recruited from the commercial sector, bringing experience and credibility.
- It has a very distinct focus on SME growth with no wider, and potentially conflicting, objectives.
- It has recognised the importance of local knowledge and access, placing its advisors throughout the region, often co-located with more local development agencies.
- It takes a very pragmatic approach to prioritisation: growth is recognised to be possible from traditional sectors as well as from new sectors.
- It takes impact evaluation seriously, monitoring in particular the trend in average income levels from the jobs that it supports.

Obstacles faced and quality of response

The key challenge in establishing NSBI initially was to win political acceptance within the provincial government for devolving budget and responsibility to an arms-length, private sector led agency. This was a controversial issue, and required strong political leadership and a clear, overall economic rationale to resolve it.

Alongside that, difficult decisions had to be taken in terms of staffing NSBI, to ensure that there was sufficient commercial skill and experience in the new agency. This required redeployment of many of the previous government-employed staff, and the recruitment of new people, including a chief executive, from the private sector. Whilst difficult at the time, it has been played a crucial part in building the impact and credibility of NSBI.

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NSBI operates within a complex organisational environment, with a range of more locally based development agencies that also provide business support services. It has resolved this through encouraging those agencies to identify and introduce to NSBI SMEs with growth potential, using their local market knowledge and contacts. Also, NSBI has also co-located many of its business advisors with such agencies to help improve consistency, coordination and local credibility.

Considerations for successful adoption in Croatia

Providing a relevant, effective and credible support service for growth-oriented SMEs requires a very specific focus and a strong commercial understanding. With the exception of the BICRO example, few of the interventions identified during the study visit could demonstrate this. To adapt the NSBI model in Croatia would require a number of issues to be addressed:

- Securing political commitment, at both national and regional level, to a greater degree of specialisation when supporting SMEs to innovate and internationalise.
- Attracting suitably experienced staff to deliver more focused growth support.
- Considering whether an existing organisation, HAMAG or BICRO for example, might provide a basis for adopting this more specialised approach.
- Building effective links between the national or regional provision of specialised SME growth support and the range of more local agencies that cannot deliver the service but can identify and introduce growth prospects.

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The school meals service in Udine, Italy

Description of the approach

Creative use of public procurement expenditure can be a means of developing SMEs both through increasing the overall level of demand for their products and services, and through encouraging product innovation. In Udine, in common with many other public authorities in Italy, public procurement strategies are specifying local and organic foods for the school meals service. As a result, the localisation and enhanced sustainability of the agri-food supply chain is being supported. From the wider social perspective, food consumption habits are also being improved in the process. Udine is particularly noteworthy because it was one of the first Italian cities to supply organic school meals in all its schools. Local agri-food supply chains, including producers, distributors and purchasers, have benefited from expansion and upgrading of the level and nature of local demand. This has enhanced the sector's product mix and development prospects.

Rationale for the policy intervention

Standard forms of public procurement often favour larger scale suppliers rather than SMEs, due to volume and cost requirements. More creative policies, which take a wider view of the potential benefits of public expenditure, can be a means of promoting SME development and innovation. In the Udine school meals example, the local authorities recognised that local and organic sources could yield a multiple dividend. First, more nutritious school food helps reduce diet-related problems including obesity, heart disease and diabetes, and boosts educational attainment through improved student concentration and less sickness and absence. Second, more locally-oriented procurement of school meal ingredients stimulates and supports local markets for local agri-food producers. Last, a more localised food chain delivers economic benefits by reducing reliance upon food imports, environmental benefits from lowering food miles from farm to fork and cultural benefits accrue from the encouragement and sustenance of local food cultures.

Why the approach is relevant to Croatia

In Croatia, in common with many other emerging economies, the size of the state sector is disproportionately large. This creates the potential to use public procurement for wider policy objectives. In addition, Croatia has relatively high levels and proportions of agricultural employment and output. Relatively small scale and formerly collectivised production units, often in family or local community ownership, may provide latent production capacity and innovation potential if stimulated by appropriate public procurement strategies. Given that Croatia has mostly avoided the large scale “industrialisation” of its agricultural sector due to its size and position as a transition and post-conflict society, there is a clear opportunity to establish a short cut straight to organics and localise the agri-food supply chain. Creative public procurement for school meals can then be an experimental policy intervention for more localised and sustainable agri-food chains and a means of modernising and diversifying SMEs and, potentially, supporting their international competitiveness.

Reasons for the success or failure of the approach

The particular context of Italy is important to the success of the approach in Udine. Italy has an embedded food culture that attaches a high premium to seasonality and territoriality. In addition, the Italian school meal system is seen as an educational institution that promotes and protects distinctive food consumption habits and practices. Local public procurement policies in cities like Udine therefore operate in a supportive context and institutional framework that demands, encourages and rewards sustainable food production and consumption.

Obstacles faced in implementation and quality of response

In the context of the Single European Market, EU public procurement regulations operate the principle of “non-discrimination” to prevent biases towards domestic businesses. However, such directives have been interpreted creatively by public authorities in Udine and other Italian cities in contracts that specify product qualities that could only be met by local producers, for example fresh seasonal produce, regionally certified products and organic ingredients. Recent new EU directives have supported this approach by allowing economic, social and environmental considerations to be taken into account under the rubric of sustainable development.

Considerations for successful adoption in Croatia

Exploring the potential of this approach for the Croatian context will require a thorough review of public procurement practices, focusing upon school meals in the first instance, and an assessment of

Policies for modernising and diversifying existing SMEs and supporting their international competitiveness

the extent to which regional and local public authorities can pursue creative procurement strategies of the kind undertaken in Udine. Second, local agri-food supply chains need to be mapped in terms of their capacity and potential to respond to increased local public procurement, especially in organics. Pilot initiatives may then be explored to experiment with and assess the potential of the approach. Last, Croatian agri-food specialities can be reviewed and assessed for their potential for distinctive and higher value added branding activity. Particularly strong agri-foods with quality identities and reputations may have export potential and, in the context of EU membership, may provide the basis for Protected Designation of Origin and Protected Geographical Indication accreditation applications which protect the provenance of high value added regional specialities from cheap imitations.

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