LEED Programme

LOCAL ECONOMIC AND EMPLOYMENT DEVELOPMENT

Promoting Entrepreneurship in South East Europe

POLICIES AND TOOLS

Edited by

Jonathan Potter and Alessandra Proto

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

FOREWORD

I am very pleased to introduce this new publication from the OECD LEED Programme. Entrepreneurship, recognised as one of the most important drivers of local economic development, is a key element in the process of social and economic transformation. South East European countries have faced many changes in recent years and have undergone important processes of transformation in their political, economic and social systems. The core element of the political and economic transformation of any country in transition is the creation of a vibrant private sector, further development of small and medium-sized enterprises (SMEs) and entrepreneurship. In order to assist transformation, intervention to encourage more entrepreneurial attitudes, support for training, improving access to finance, promoting exports and internationalisation, supporting innovation and developing business networks and clusters, may all be useful.

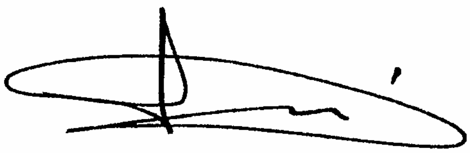
This publication aims to inform national, regional and local policy makers in South East Europe about policies to encourage entrepreneurship, which involve removing the barriers that too often persist and putting in place the conditions that encourage entrepreneurs to grow.

Since its foundation in 1982, the OECD Local Economic and Employment Development (LEED) Programme has played a critical role in identifying and disseminating information on international innovations and best practices in local economic and employment development. It has also been active for many years in the promotion of entrepreneurship and SME development in Central and East Europe. An important step was taken to reinforce this work in 2003, with the creation of the OECD LEED Trento Centre for Local Development. The Trento Centre conducts policy analysis and facilitates the exchange of information and capacity building activities to promote entrepreneurship, local governance and social cohesion, with a special focus on Central, East and South East European Countries.

The papers presented in this publication were commissioned by the LEED Trento Centre in order to assist policy makers in South East Europe to assess how to face key challenges in the area of entrepreneurship policy development. They investigate the themes of: i) financing entrepreneurship, improving SME access to finance; ii) promoting SME internationalisation; strengthening local clusters; iii) promoting SME innovation iv) developing entrepreneurial attitudes and skills; and, v) encouraging youth entrepreneurship. The publication aims to become a valuable aid, offering practical insights on policies options to national and local governments, and local development practitioners.

I am particularly thankful to the Autonomous Province of Trento and to the Italian Government, in the framework of the Italian participation in the stabilisation, reconstruction and development of the Balkans (Italian law n. 84/01), that strongly believed in the value of an OECD Centre for Local Development and supported the development and implementation of our activities in this field.

I would also like to thank Jon Potter, Senior Economist at the OECD LEED Programme, and Alessandra Proto, Policy Analyst at the OECD LEED Trento Centre for Local Development, for taking forward this work and editing this publication. Further helpful assistance was provided by Roberto Chizzali, Emma Clarence, Lucy Clarke, Laura Nardelli and Ekaterina Travkina, all of the LEED Programme.



Sergio Arzeni
Director, OECD Centre for Entrepreneurship
Head, OECD LEED Programme

LIST OF ABBREVIATIONS

AIM	London Stock Exchange's International Market for Smaller Growing Companies
BCI	Business Competitiveness Index
BCR	Romanian Commercial Bank
BCYF	Balkan Children and Youth Foundation
BEEPS	Business Environment and Enterprise Performance Survey
BGL	Bulgarian Lev
BID	Banco Interamericano de Desarrollo
BiH	Bosnia and Herzegovina
CARDS	Community Assistance for Reconstruction, Development and Stabilisation
CDFIs	Community Development Financial Institutions
CEE	Central and Eastern Europe
CEED	Center for Entrepreneurship and Economic Development in Serbia And Montenegro
CEO	Chief Executive Officer
CEPAL	Comisión Económica para América Latina y el Caribe
CGFPR	Romanian Credit Guarantee Fund for Private Entrepreneurs
CHF	Community Habitat Finance International
CIADT	Comité Interministériel d'Aménagement et de Développement du Territoire
COM	Commission of the European Communities
COTEC	Council of Occupational Therapists of the European Countries
EBAN	European Business Angel Network
EBRD	European Bank for Reconstruction and Development
ENSR	European Network for Social and Economic Research
EPPA	Enterprise Performance Policy Assessment
ERDF	European Regional Development Fund
ETF	European Training Foundation

EU	European Union
EUR	Euro
EURADA	European Association of Development Agencies
FDI	Foreign Direct Investment
FNGCF	(Romanian) National Credit Guarantee Fund for SMEs
FYR	Former Yugoslav Republic
GBP	British Pound
GCI	Global Competitiveness Index
GDP	Gross Domestic Production
GEM	Global Entrepreneurship Monitor
GTZ	Deutsche Gesellshaft für Technische Zusammenarbeit
HAMAG	Croatian Agency for Small Business
HP	Hire Purchase
IASP	International Association for Science Parks
IBLF	The Prince of Wales International Business Forum
IFC	International Finance Corporation
INFYDE	Información y Desarrollo S L
IP	Intellectual Property
IPO	Initial Public Offerings
IT	Information Technology
JOBS	Job Opportunities through Business Support Programme
LEED	Local Economic and Employment Development Programme
LEGITE	La Excelencia y la Generalización de la Innovación en las Empresas de Castilla y León (Excellence and Generalisation of Innovation in Companies in Castilla y León)
M&A	Mergers and Acquisitions
MBA	Montenegro Business Alliance
MFI	Micro Finance institutions
MIT	Massachusetts Institute of Technology
MNCs	Multinational Corporations
NBIA	National Business Incubation Association

NES	National Employment Service
NGOs	Non-Governmental Organisations
NOP	National Opinion Pool
OFEX	Off Exchange
OTRI	Officina de Transferencia de Resultados de Investigación (Spanish Research Results Offices Network)
PASARP	Program of Activities in Support of Albanian Regions and Prefectures
PPC	Process Performance Change Programme
R&D	Research and Development
R&D&I	Research and Development and Innovation
RCGF	(Romanian) Rural Credit Guarantee Fund
RDA	Regional Development Agency
SBRC	Small Business Research Centre
SEE	South East Europe
SERT	Small Enterprise Research Team
SFLG	Small Firms Loan Guarantee
SMECA	Serbia and Montenegro Export Credit Agency
SME	Small and Medium-sized Enterprise
TEA	Total Entrepreneurial Activity
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNECE	United Nations Economic Commission for Europe
UNHCR	United Nations High Commissioner for Refugees
UNIDO	United Nations Industrial Development Organisation
UNOPS	United Nations Office for Project Services
USAID	United States Agency for International Development
USD	United States Dollar
YBA	Youth Business Albania
YBI	Youth Business International

EXECUTIVE SUMMARY

The importance of entrepreneurship and small and medium-sized enterprises (SMEs) to economic growth, innovation and job creation is well-documented. For the countries of South East Europe the need to stimulate, facilitate and enhance entrepreneurial activities is critical to their continued economic development. However, creating the appropriate environment in which entrepreneurship can occur requires a complex mix of policies that address a wide-range of interlinking economic, legal and social issues. These interactions take place at the local, regional and national levels, leading to the need to develop policy responses that take account of more general factors as well as the specific local and regional ones which may hinder, or help, entrepreneurial activities. Whilst public policy has an important role to play in encouraging entrepreneurial activity through the actions of actors such as central and local governments, development agencies and other public bodies, there is also a crucial role for non-state actors.

There are a range of actors, including national, regional and local governments, development agencies, chambers of commerce, research institutions, etc. who may be involved in the development and implementation of entrepreneurship policies and support policies for SMEs. However it is important to recognise that there is no single policy which can produce the desired effects of enhancing entrepreneurship and SME activity. Rather, the many instruments which are available need to be utilised with explicit consideration of local, regional and national needs leading to different types of measures in different combinations being implemented. What is evident, not only from the discussions in this publication but also from experience from OECD countries, is that meaningful partnership working and effective co-ordination is essential if local areas, regions or countries are to reap the benefits of entrepreneurial and SME activity.

This publication provides an overview of the key issues and policy challenges surrounding entrepreneurship and SME development with particular reference to South East European (SEE) countries, focusing on five main areas: (i) financing entrepreneurship; (ii) SME internationalisation; (iii) SME innovation, (iv) the role of culture, attitudes and skills in entrepreneurship; and, (v) youth entrepreneurship. It should be acknowledged that these issues are not unique to SEE countries; they are challenges that all countries confront as they seek to stimulate and facilitate entrepreneurship. For this reason this publication should have resonance for all countries which seek to improve entrepreneurial activity.

Chapter 1 reviews mechanisms for financing entrepreneurship and new, emerging businesses at the regional and local level and assesses the current position in SEE countries. SMEs are recognised as one of the principal driving forces in economic development. They stimulate private ownership and entrepreneurial skills, they are flexible and can quickly adapt to changes in the market, they usually represent the largest share of employment, support the diversification of activity and make a significant contribution to exports and trade. Transitional economies have acknowledged that SMEs are crucial for industrial restructuring and have formulated national SME development policies and programmes. The growth of SMEs in the region suggests that there is significant potential for further expansion. This can only happen if it becomes easier for entrepreneurs to raise the finance that they need. The major source of finance in all SEE countries is the banking sector, assisted considerably by the injection of support from the European Bank of Reconstruction and Development (EBRD). But banks are unlikely to support every business. To keep their arrears and defaults down they still require high levels of collateral, which implies a need for other mechanisms. Some countries, such as Croatia, Serbia and Romania have launched guarantee funds. Most countries have micro-loan funds managed by NGOs, alongside the provision of microfinance by banks. They tend to take a softer view on the need for collateral, replacing it with advice and support to ensure that borrowers succeed and so are able to repay their loans. The use of venture capital is still rare in the region; there are a small number of venture capital funds, doing a limited number of deals, and are therefore unlikely to make a significant difference in the short term. Leasing, or asset finance, could make an impact quickly, and its availability appears to be growing, although it is still not universally available. The chapter highlights the need for work in three key areas: firstly, on the demand side, by building the capacity of entrepreneurs to manage their businesses effectively so that they can secure credit more easily; secondly, on the supply side, by combining new instruments and more enlightened banks; and, thirdly, through mediation, by matching supply and demand with good business support agencies, business angel networks and regional stock exchanges, for example.

Chapter 2 tackles the issue of encouraging the internationalisation of SMEs. Internationalisation has become increasingly important to the competitiveness of enterprises of all sizes. In today's environment, SMEs that start with a global strategy can move quickly to take advantage of cross-border activities, which provides opportunities not only for revenue growth but also the exchange of knowledge and the enhancement of capabilities, thereby strengthening the firm's long-term competitiveness. This chapter analyses the details of different approaches to SME internationalisation and associated implementation strategies. Traditionally, internationalisation has been described as a gradual, sequential process with various identifiable stages starting from intermittent exports, followed by exports via agents, overseas sales through licensing or franchising and foreign direct investment in the overseas market. However, more recent research shows that firms do not necessarily follow any consistent pattern in their internationalisation. Particularly in knowledge-intensive industries, the role of entrepreneurial vision and leadership and the initial resource endowment of the firm are crucial to the commencement of international activities. Despite the common understanding of the importance of internationalisation, there are still many internal and external barriers that impede the internationalisation of SMEs. External barriers include national and international administrative rules and regulations, as well as formal and informal trade barriers. Internal barriers can include cultural differences, lack of information or skills, insufficient networks, language barriers and a lack of access to necessary finance. The chapter identifies specific policy actions that could overcome market gaps and encourage the internationalisation of SMEs, including: building networks; fostering openness to internationalisation; making information about international trade and business readily available; encouraging the provision of targeted, quality business support services; reforming education; providing financial incentives and assistance; cutting the administrative burden of cross border activities; encouraging trade and investment; and, reinforcing the legal framework. In SEE countries some efforts should still be devoted to strengthening the basic framework for the development of SMEs and their internationalisation activities.

Chapter 3 analyses the role of innovation and its connections with technology and entrepreneurship. Continuous innovation is central to economic prosperity; how such innovation is to be achieved in the globally competitive marketplace is therefore of the utmost importance. Policies which reflect and respond to the needs of specific localities or regions are required if they are to be effective in encouraging innovation rather than simply importing successful policies from other areas. Such responsiveness does not preclude, however, the recognition of a number of key factors to the development of policies which encourage innovation to occur. SME innovation policy instruments are similar in most countries. What differentiates them is the way these instruments, such as the promotion of innovation culture, information, financing, support infrastructures and the like, are actually utilised. It has to be acknowledged that there has been a shift from purely investment-related financial measures to ones which complement financial support with a process of support for the introduction of new, more innovative behaviour patterns. Direct subsidies for R&D, plus supporting essential innovation infrastructure such as research bodies, are now accompanied by new measures where the parameters for success have to do with innovative activity. This chapter explores those factors and the various tools that can be utilised so as to encourage innovation.

Chapter 4 explores wider questions around the role of culture, attitudes and skills in relation to their influence on entrepreneurship and SME business birth and growth in SEE. It analyses strengths and weaknesses in attitudes and skills for promoting entrepreneurship, and the opportunities and barriers faced by individuals when thinking about starting their own business. Hindrances to entrepreneurial activities have been identified as structural/formal barriers, process-related/informal barriers and skill-based and environmental barriers. Policy instruments should take these barriers into consideration. Statistics show that in most SEE economies entrepreneurial activities are based on job-intensive rather than capital-intensive activities; that is, the large-scale manufacturing sector is nationally concentrated, and value-added activities still need development. The challenge for local and regional level policies is to ensure co-ordination between activities. Inter-organisational collaboration is needed if new innovative business ideas and development are to be seen within the more traditional manufacturing sectors. Other policy options outlined include: integrating entrepreneurship into the basic education system; promoting success stories and best practice to change attitudes; developing tailored educational programmes that focus on skills and attitudes and provide basic knowledge of various business activities; supporting in-house training and education for those already in business; and increasing the number of training institutions offering entrepreneurial, vocational and skills related training.

Chapter 5 outlines key elements of the issues surrounding youth entrepreneurship and analyses a number of programmes designed to support and encourage it in SEE countries. The importance of entrepreneurship and the role of SMEs in the development of a country or a region are well acknowledged. However, while attention to entrepreneurship in general has been considerable, youth entrepreneurship has never been high in the agendas of countries due to the incorrect assumption that activities and programmes which aim to boost entrepreneurship also include youth entrepreneurship. Recently, high levels of unemployment amongst some groups of young people have raised the interest in youth entrepreneurship, by seeing it as a possible solution to the risk of social exclusion. Moreover, entrepreneurship is seen as an outlet for the talents of many highly educated young people in areas such as information technology, biotechnology and other modern industries. Nevertheless, more than ten years after the collapse of communist regimes in the region, and despite obvious signs of economic recovery in most SEE economies, the average youth unemployment rate in SEE remains 2.5 times higher than the EU average and three times higher than the adult unemployment rate. The chapter analyses various initiatives at different levels, including governmental, international and/or NGO level, to address youth entrepreneurship, including the European Youth Pact, which devotes its attention to indirect measures that aim to facilitate and encourage a culture of entrepreneurship in Europe, the single initiatives run by each country in SEE which offer start-up and business development assistance, as well as the provision of training outside the formal education system. The chapter concludes with a review of three good practice examples from Albania, Slovenia and Serbia, which highlight the involvement of the international community, the government, and the civil society organisations.

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CHAPTER 1:

FINANCING ENTREPRENEURSHIP AT THE REGIONAL AND LOCAL LEVEL IN SOUTH EAST EUROPE

by
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Transitional economies have acknowledged that SMEs are crucial for industrial restructuring and have formulated national SME development policies and programmes. The growth of SMEs in the region suggests that there is significant potential for further expansion. This can only happen if it becomes easier for entrepreneurs to raise the finance that they need. The major source of finance in all SEE countries is the banking sector, assisted considerably by the injection of support from the European Bank of Reconstruction and Development (EBRD). But banks are unlikely to support every business. To keep their arrears and defaults down they still require high levels of collateral, which implies a need for other mechanisms. This chapter reviews mechanisms for financing entrepreneurship at the regional and local levels, such as: informal capital, microfinance, bank finance, guaranteed loans, business angels, asset finance, factoring and invoice discounting, venture capital and flotation. It also describes the various methods adopted by entrepreneurs for the provision of finance to new, emerging businesses and by assessing the current position in SEE countries.

INTRODUCTION

The OECD's Local Economic & Employment Development Programme (LEED) organised a conference in Sofia on 16 March 2007 to review mechanisms for financing entrepreneurship at regional and local level in Bulgaria and other countries in South East Europe. This report has been prepared following that conference.

The objectives are:

- To describe methods of providing finance to new and emerging businesses.
- To review the current position in the countries of South East Europe.
- To offer recommendations for policy.

BACKGROUND

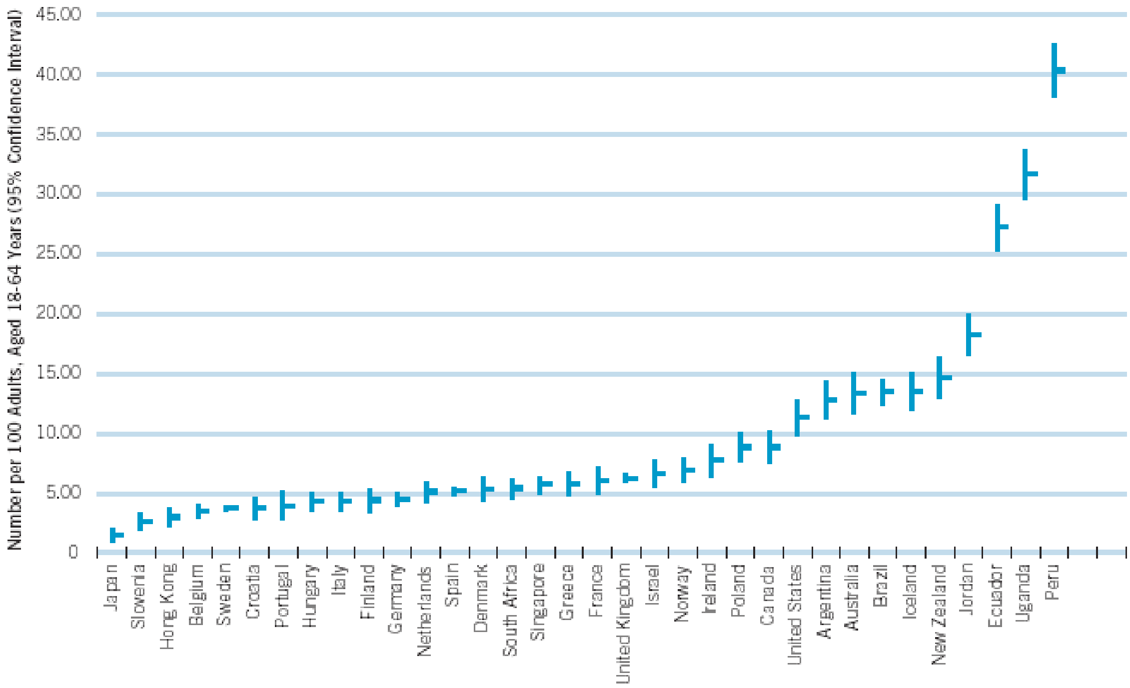
Importance of SME formation and growth

The World Bank, in common with other international donors, asserts that a vibrant private sector – with firms making investments, improving productivity and creating jobs – promotes economic growth and increases opportunities for poor people (World Bank, 2004). Specifically, entrepreneurship is seen as one of the most important drivers of local economic development. That is why, all over the world, governments are extolling the virtues of stimulating and supporting a healthy small business sector. The vitality of the small firm sector makes a considerable impact on local competitiveness. In developed countries, SMEs typically account for 99% or more of all firms. SMEs are flexible, innovative (Timmons, 2004; Schramm, 2004) and responsive. They tend to be more productive (Luetkenhorst, 2004). They are a crucial part of the supply chain – providing materials, sub-assemblies and services to larger businesses and distributing goods to customers. And as economies increasingly come to rely on "knowledge workers", and large firms increasingly "stick to the knitting" rather than pursue vertical integration, then small firms are likely to become more important. Economies with a high proportion of SMEs will be more resilient to external shocks and will be more likely to have more firms which grow into larger businesses. Furthermore, stimulating the creation of more SMEs enables nations to grow a solid middle class.

Michael Klein notes that the fall of communist regimes has demonstrated that market economies desperately need SMEs (IFC, 2004). He observes that they were missing in the transition economies and are currently the fastest growing segment of firms, often with productivity gains outperforming those of larger firms.

The Global Entrepreneurship Monitor is a cross-national assessment of entrepreneurship. Its Total Entrepreneurial Activity (TEA) index is a way of comparing levels of entrepreneurship internationally. Whilst this does not yet cover many of the countries of Central or Eastern Europe, one can see that those that are included (Croatia, Hungary and Slovenia) do not perform well compared to the rest.

Figure 1. Total entrepreneurial activity



Source: Bygrave W.D. *et al*., (2004), "Global Entrepreneurship Monitor: 2004 Financing Report", Babson College & London Business School, London

The GEM research appears to confirm the view that entrepreneurship is responsible for much of the business world's innovation and competitiveness. They are less certain, however, of the relationship between entrepreneurship and economic growth. They do suggest that entrepreneurship makes a positive contribution but they also suggest that the level of a nation's wealth contributes to entrepreneurial activity in a virtuous cycle. (Bygrave *et al.*, 2004)

Development organisations see supporting SMEs as an important part of their work and believe that assisting more firms to start and grow has an impact on economic growth and on poverty reduction. According to the World Bank website, their pro-SME policy "... is based on the argument that, relative to larger firms, SMEs enhance competition, entrepreneurship, job growth and spur economy-wide efficiency, innovation, growth and poverty alleviation."(World Bank web site)

Carl Schramm, CEO of the US based Kauffman Foundation, argues that SMEs make a significant difference to national economies. He notes that the US breeds a steady flow of new, high impact businesses, which "create value and stimulate growth" (Schramm, 2004). But he also notes that they do not appear automatically, but instead because the US nurtures and encourages entrepreneurs. He suggests that, on more than one occasion, new businesses and the new jobs that they create have pulled the US out of economic malaise. In particular, he argues that small businesses can lead to economic growth: he cites the companies spun out of MIT which, taken together, would now constitute the world's 24th largest GDP. Whilst this might be rather ambitious for many countries, Schramm argues that economic growth could be achieved simply by establishing the conditions that enable entrepreneurs to flourish.

Wilfried Lütkenhorst, of UNIDO's SME Branch, also stresses that SMEs play a critically important role and promotes the view that supporting SMEs is important in terms of achieving economic growth (Lütkenhorst, 2004). He argues that small businesses are a key agent of structural change, reducing marginalisation and achieving a more equitable income distribution. Schramm also makes this point: "ironically, entrepreneurs, who are by nature agents of change, may prove to be among the most important forces for global stability".

Government policies are crucial in creating an enabling environment – governments should do everything possible to improve the environment for business, not just in terms of simpler and more transparent regulation, but including tax policies, labour law, transparent property rights and ability to enforce contracts.

However, SMEs are unlikely to prosper without access to financial and business development services.

Access to finance is important

All commentators seem to agree that one of the most important barriers to entrepreneurship is access to finance. Ayyagari, Beck and Demirgüc-Kunt (2003) found that lack of access to finance was both negatively and robustly correlated to restraining the growth of the SME sector. Few entrepreneurs have or can raise from family and friends, the finance that they need to start in business. But even established businesses often need to raise more finance than can be provided by retained earnings. Developed financial markets provide payment services, encourage saving and provide loan finance and equity to firms who need it (and can convince the investor that it will be repaid). Ensuring that this exists may require financial market development, but it seems that this leads to faster growth in productivity and output (Lütkenhorst, 2004).

Lütkenhorst reports that doubling private credit as a share of GDP is associated with an increase in average long-term growth of almost two percentage points. Developed financial markets also reduce poverty – directly and through their role in economic growth. They reduce income inequality by alleviating credit constraints and increasing access to investment opportunities for poor households.

It is worth noting that whilst finance is a pre-requisite for successful entrepreneurship, it is not sufficient just to improve access to finance. Businesses also need to address issues of management, marketing, financial control and much else.

Too often however, SME support is neatly segmented into access to finance and business development. Both are needed – and providing incubator workspace as well offers prospective entrepreneurs a more powerful combination of business support, raising success rates to as high as 87% after some years of implementation.

The problem

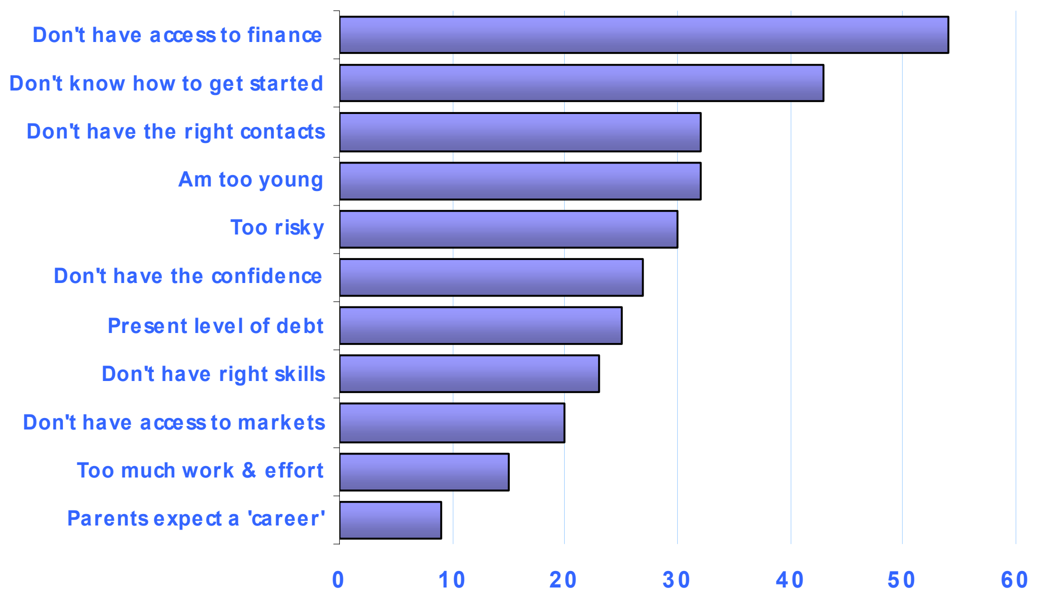
The problem exists at two levels: whether there is sufficient finance available from investors (including lenders) allied with the desire and skills to invest and whether prospective entrepreneurs can put together a sufficiently convincing case.

Prospective entrepreneurs need to be able to convince investors that they have a viable proposition and that they have the determination and tenacity to succeed. However, many have difficulty in defining clearly their potential customers and even more difficulty in providing good market research. And even when they do have persuasive evidence, they are often poor at communicating the message through a business plan – which is still the desired format for most investors.

The problem is often compounded by the fact that many people who would like to start in business, especially if they are young, have little or no money of their own, no collateral and little or no track record. The consequence is that potential financiers are reluctant to lend and, in many parts of the world, microfinance institutions have sprung up to offer limited loan finance.

The problem is most acute for young people and for women, usually because they have little track record and little or no savings or collateral. A survey in 2004 in the UK amongst young people who had not (yet) started in business suggested that access to finance was the biggest barrier.

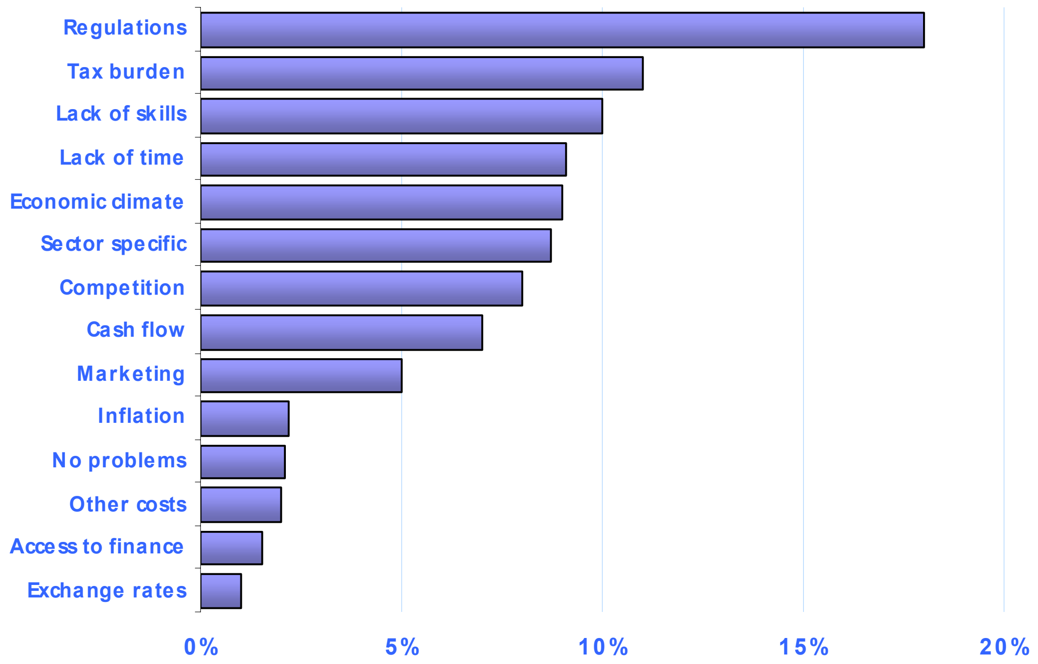
Figure 2. Barriers stopping young people from starting in business (UK)



Source: Patel, R. (2005), "The Enterprise Report: Making Ideas Happen", Enterprise Insight, London

However, once businesses have started, however, access to finance is quickly over-shadowed by other problems, with finance cited by fewer than two percent of respondents as a problem.

Figure 3. Businesses' most important problems (UK)



Source: Bannok, G. and C. Gray, (2005) "NatWest/SERTeam Quarterly Survey of Small Business in Britain" Vol. 21, No. 1, Q1 SERTeam, UK

The European Commission recognises that early-stage financing is a problem for many firms (European Commission, 2003). It sees loan guarantees and micro-lending as ways of providing small firms with access to finance. However, the EU emphasises the importance of sustainability of public sector micro-loan programmes. Indeed, the Commission has published a report outlining best practice in micro lending, (European Commission, 2003a) which they define as loans (including loans from banks) below EUR 25 000. The EC notes that "the insufficient supply of micro-loans is a major issue, in particular where business creators are unemployed persons, women or form part of ethnic minorities. Supporting micro-loan supply is therefore not only an issue of entrepreneurship and economic growth, but also of social inclusion."

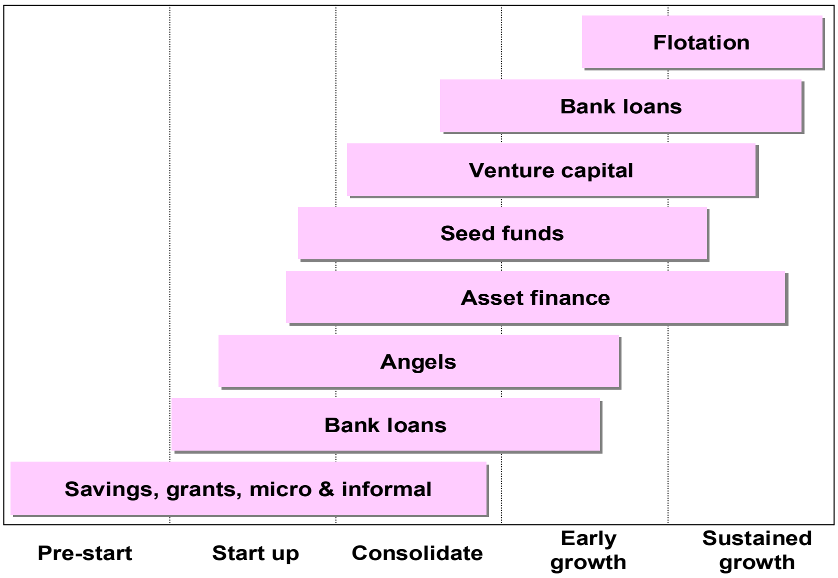
Based upon small enterprise surveys, the report noted that market gaps exist because micro-loans are "high risk and low return" have high transaction costs. For this reason the report recommends that mentoring should be provided alongside the finance.

Clearly then, business formation is inhibited by a lack of finance and barriers making finance difficult to access.

The finance escalator

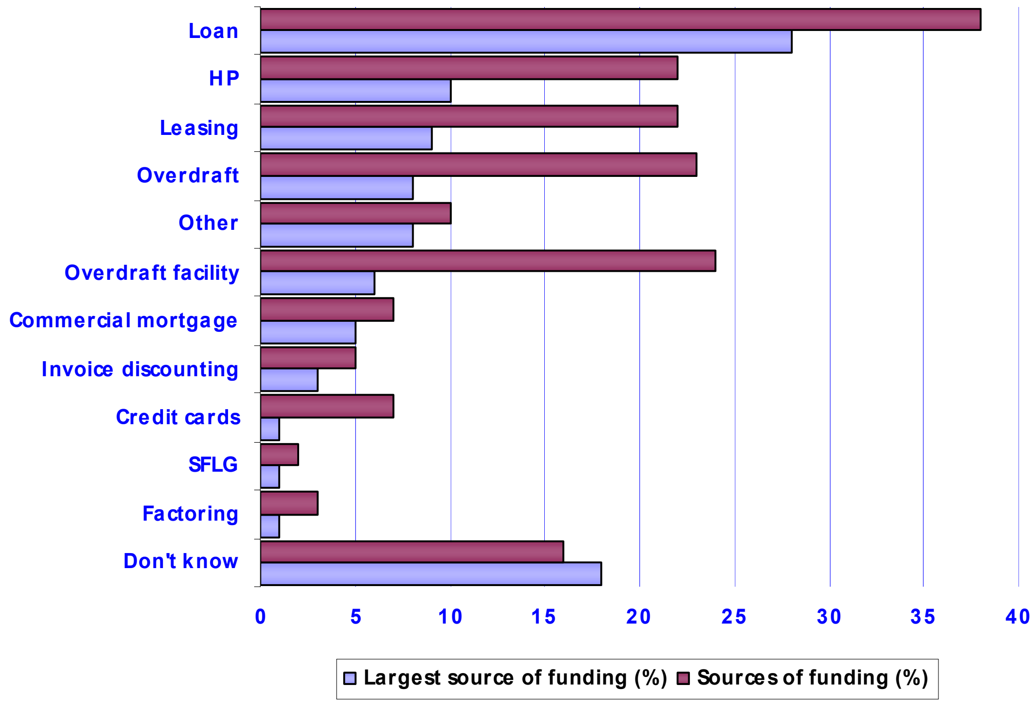
Businesses can source funds from three sources: equity, loan finance and retained earnings, though equity and loan finance may take different forms. For most businesses, the ways in which these can be accessed increase as the business grows.

Figure 4. Finance escalator



For new starts-ups, the most likely sources of finance are savings, family and friends, microfinance and bank debt, though a few entrepreneurs may persuade an angel to invest. Once businesses are up and running banks are still the most important source of finance, at least in the UK, as shown in Figure 5 below.

Figure 5. Sources of finance for UK businesses

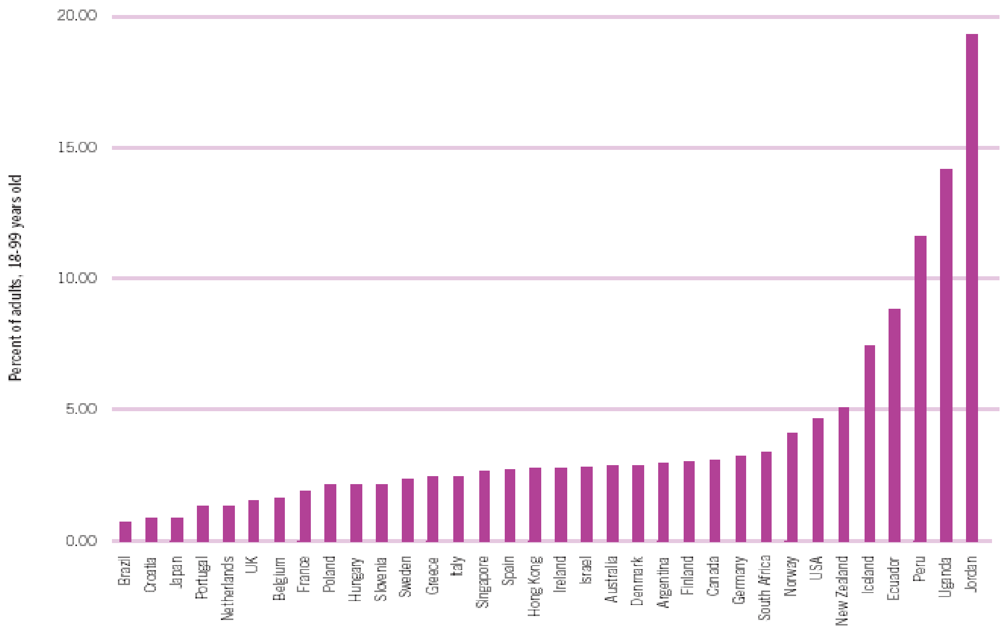


Source: Competition Commission (2002), "The supply of banking services by clearing banks to small and medium-sized enterprises", Competition Commission, London

Informal capital

According to the Global Entrepreneurship Monitor 2004 (GEM), close family members, friends and neighbours are the largest sources of informal capital for start-ups. They recommend, though in a circular argument, that entrepreneurs should, therefore, look to family and friends for their initial seed capital if they do not have sufficient savings of their own (Acs, Z.J. *et al.*, 2004).

Figure 6. Prevalence rate of informal investors



Source: Acs, Z.J. *et al.* (2004), "Global Entrepreneurship Monitor: 2004 Executive Report", Babson College & London Business School, London.

Microfinance

Microfinance is typically small scale finance (typically < EUR 25 000) provided to new and growing entrepreneurs. Often, though not always, it is provided by not-for-profit loan funds who have raised their capital from charitable and public sources in order to provide loan finance to entrepreneurs who would not otherwise be able to raise the finance that they need to start in business.

The World Bank estimates that there are over 7 000 microfinance institutions (MFI) world-wide, serving some 16 million poor people in developing countries, with many more in the developed world. The total cash turnover of MFIs world-wide is estimated at USD 2.5 billion with USD 7 billion in outstanding loans and repayment rates of 97 %. A snapshot survey by the International Association of Investors in the Social Economy of 86 organisations offering small business loans in the EU-15 showed capital of EUR 1.6 billion and a total loan portfolio of EUR 640 million.

Usually, microfinance is lent at a modest rate of interest, with a limited collateral requirement and, sometimes, a capital repayment period. There is usually a requirement to continue receiving business advice, sometimes directly from the fund but sometimes from an acceptable business support organisation.

Bank finance

Banks always represent the largest potential source of credit for SMEs, though they are sometimes reluctant to lend. Maybe they can get a better rate of interest elsewhere; maybe they perceive lending to SMEs as just too risky, maybe they consider the transaction costs are too high.

The amount of loan finance provided by microfinance organisations pales into insignificance next to the loan finance supplied by the banks. In the UK, for example, the Community Development Finance Association estimates that, in 2004, CDFIs lent some GBP 150 million and levered a further GBP 160 million – dwarfed by bank lending to SMEs of some GBP 40 billion. However, MFIs can have a greater impact by levering money from the banks. This presupposes that MFIs can generate confidence in the banks that they are lending sensibly. The banks will often then treat MFI loans as quasi-equity and lend on the back of them. Banks will also be reassured that the level of risk has been reduced if there is a business support organisation involved.

In some countries, there is still a need to build the capacity of the banking sector, so that it is willing and able to lend to SMEs.

Guaranteed loans

In many cases, prospective entrepreneurs are able to convince lenders that they have a sound idea, with a good chance of success, and the determination to see it through. But they have insufficient collateral to persuade a commercial lender to lend. This is where there is a need for some sort of guarantee.

In many cases, governments have established loan guarantee schemes. In the UK, for example, the Small Firms Loan Guarantee Scheme in the 12 months to the end of March 2005 guaranteed 7 130 loans with a cumulative value of GBP 481 million. The guarantee covers 75% of the loan and borrowers pay a premium of 2.5% on the guaranteed portion.

Mutual guarantee societies have developed in some parts of the world,. A mutual guarantee society is a group of businesses, which can be quite large, which come together to create a mutual group which borrows from financiers and lends to its members.

A number of microfinance organisations, most notably Grameen Bank & Accion Internationale, have made extensive use of credit circles and peer group lending. Typically a group has four businesses; all receive individual loans, but all the members of the group are liable if any member of the group defaults.

Angels

Business angels are (typically, high net worth) individuals who invest in new and early stage growth businesses. The investment is usually made by way of equity. In the UK, investments are typically in the range GBP 20 000 to GBP 250 000; sometimes angels will form syndicates to spread the risk and, occasionally, to invest larger amounts. Usually the angel asks for a seat on the board; sometimes they will want to take a larger role in the business. Investments are usually fairly short term; most angels will want to recover their investment (and their return) within five years. The advantage of angel finance is that they will often invest in start-up businesses which still need equity finance, or have not yet grown to the point where they can attract mainstream venture capital.

Asset finance

Asset finance is a generic term used for various kinds of finance used to purchase capital assets, including leasing, lease purchase and hire purchase (HP). The main advantage to the business is that the only security required is that represented by the asset acquired.

Factoring and invoice discounting

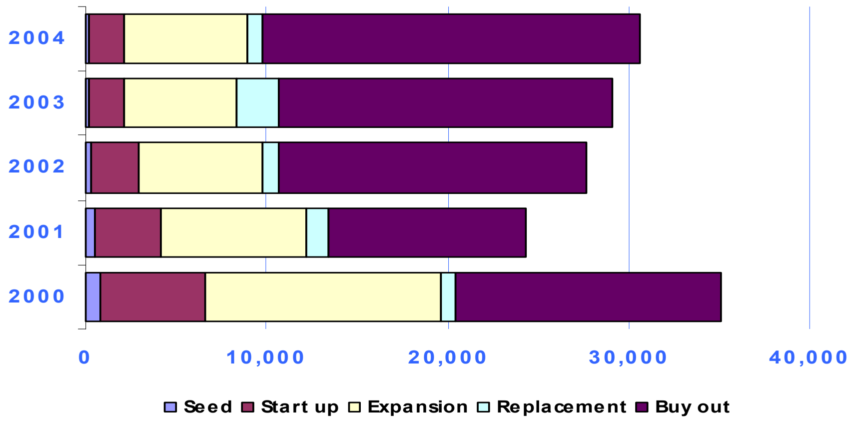
Factoring and invoice discounting are mechanisms used to speed up the payment of invoices and so reduce the overall working capital requirement. However, it is often expensive, requires a track record of sales and the business can still be hit by bad debts.

Venture capital

Venture capital funds provide equity finance to new and growing businesses. They typically look for strong management teams, proprietary intellectual capital, rapid growth and relatively high rates of return. They rarely support early stage development or 'pre-revenue' requirements.

In 2004, European venture capital funds invested around EUR 30 billion. However, just 0.7% (down from 2.2% in 2000) of that was invested as seed money and 6% (down from nearly 17% in 2000) was invested in start ups. Most investment went to buy outs – 68% in 2004 (up from 41% in 2000).

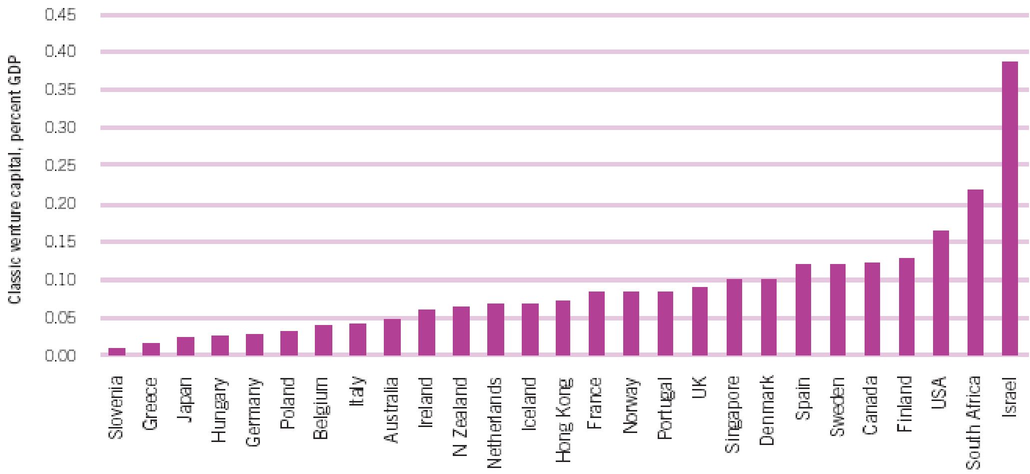
Figure 7. European venture capital investment (EUR/million)



Source: EVCA (see www.evca.com)

GEM (Acs, Z.J. *et al.*, 2004) notes that fewer than one in 10 000 start-ups attract venture capital and suggests that educators and advisers put more emphasis on financing from entrepreneurs themselves and informal investors and much less on venture capital. They have calculated that financing from entrepreneurs and informal investors pumps 3.5% into the GDP of the GEM nations, compared to only 0.1% for classic venture capital.

Figure 8. Classic venture capital as percentage of GDP



Source: Bygrave, W.D. *et al.* (2004), "Global Entrepreneurship Monitor: 2004 Financing Report", Babson College & London Business School, London

Flotation

If firms grow, eventually they may wish to seek a public share listing, possibly as a way of ensuring that the original investors can realise their investment, but also as a way of opening up new sources of finance. Some countries only have one stock exchange and one means of seeking public ownership. Some countries have developed 'junior' exchanges, such as the UK with AIM[1] and OFEX[2] which have less onerous reporting requirements, but are usually less liquid (that is, it is harder for people to buy and sell shares).

There is however a resurgent interest in regional stock exchanges. The US, in addition to the New York Stock Exchange, has long had growing regional exchanges in Boston, Chicago, Cincinnati, Philadelphia and San Francisco. Australia has an interesting model at Bendigo.

The advantages claimed for regional stock exchanges are that they:

- Champion regional SMEs.
- Provide support mechanisms for both businesses and investors.
- Work with local banks and brokers, enhancing local financial and business service sector capabilities.
- Encourage local ownership of equity.
- Develop networks between listed companies.

1 AIM is the London Stock Exchange's international market for smaller growing companies.

2 OFEX is an unregulated over-the-counter market in United Kingdom stock shares which specialises in small companies.

- Facilitate greater flexibility in terms of developing future growth and investment routes.
- Make a significant long-term contribution to the economic growth of the region.

CURRENT POSITION IN SOUTH EAST EUROPE

Introduction

Finding up-to-date and reliable statistics is a challenge for the countries of South East Europe, despite the fact that good data can assist understanding and provide the evidence for good policy formulation.

With the exception of Croatia, for which slightly more up to date figures were available, all the countries of SEE have a low number of SMEs compared to the EU, though many of them employ more people than the average EU business. Bosnia, Bulgaria and Croatia all achieve the same proportion of employment in SMEs as the EU, but the other countries are much lower.

It is likely, however, that these figures do not reveal large numbers of people working in the informal economy.

Table 1. Business statistics

	Albania	Bosnia & Herzegovina	Bulgaria	Croatia	FYR of Macedonia	Moldova	Serbia & Montenegro	Romania	EU
Year	2002	2001	2000	2003	2000	2001	2001	2000	2000
SMEs ('000s)	56	30	224	150	33	22	71	306	20m
SMEs/ 1 000 population	18	8	29	35	16	5	9	10	53
Ave size of SME (employees)	1.90	8.50	4.80	6.80	5.90	5.90	9.00	4.80	4.00
Employment in SMEs as proportion of private sector	0.54	0.65	0.65	0.67	0.50	0.24	0.44	0.47	0.66
Share of GDP			50%*	55%			40%		

*Note: according to Antonio Fanelli, Investment Compact for SEE, OECD.

Source: OECD-EBRD (2003), "South East Europe Region: Enterprise Policy Performance: A Regional Assessment", OECD, Paris and World Bank (2003) "Overview of SME Sector in Croatia", World Bank, Washington D.C.

Ease of doing business

The World Bank "Doing Business" surveys provide some indication of the ease of doing business in most countries of the world. Whilst the indicators only give a partial picture, they serve as a good proxy.

As can be seen, it is much harder to do business in all countries of SEE as opposed to the UK which is shown for sake of comparison. For example, in all countries it is much more expensive to create collateral; there are fewer legal rights so it is harder to enforce contracts; it is harder to secure credit information so businesses and lenders take more risks if they provide trade credit or loan finance, both of which make it harder to raise working capital.

Table 2. Doing business indicators

	Bosnia & Herzegovina	Bulgaria	Croatia	FYR of Macedonia	Moldova	Serbia & Montenegro	Romania	UK
Getting credit								
Cost to create collateral (% of income per capita)	15.2	1	6.1	15.9	1.5	87.4	1.1	0.1
Legal rights index (0-10)	5	6	4	6	6	5	4	10
Credit information index (0-6)	4	4	0	2	0	1	3	6
Protecting investors								
Disclosure index (0-7)	2	2	4	4	3	3	2	7

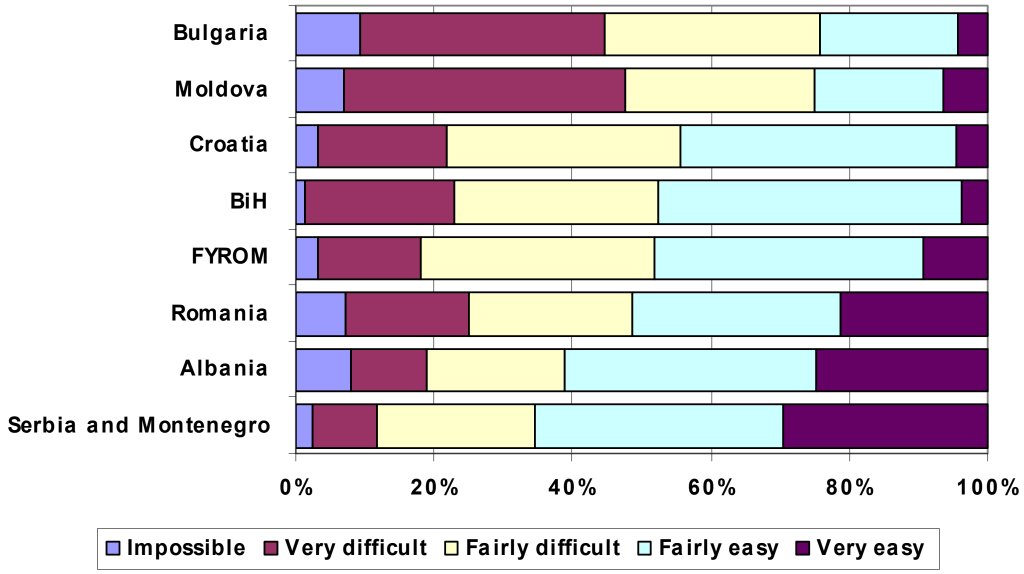
Source: World Bank (2005), "Doing Business in 2005: Removing Obstacles to Growth", World Bank, Washington D.C.

Availability of finance

The EBRD/World Bank Business Environment and Enterprise Performance survey of 2002 (Fries, S., T. Lysenko and S. Polanec, 2003) suggests that access to finance is ranked by entrepreneurs as being either the first or second most serious problem. In addition, the survey asked businesses, *inter alia*, how easy they perceived it would be to secure a loan from a commercial bank, firstly as a short-term loan to meet the need for additional working capital and, secondly, as a longer term loan for investment purposes.

In the charts below, the perceptions of ease in raising loans in SEE countries is shown. On this basis, 76% of entrepreneurs in Bulgaria believe that it is difficult to secure a short term loan, while entrepreneurs in Serbia & Montenegro and Albania perceive this to be relatively easy.

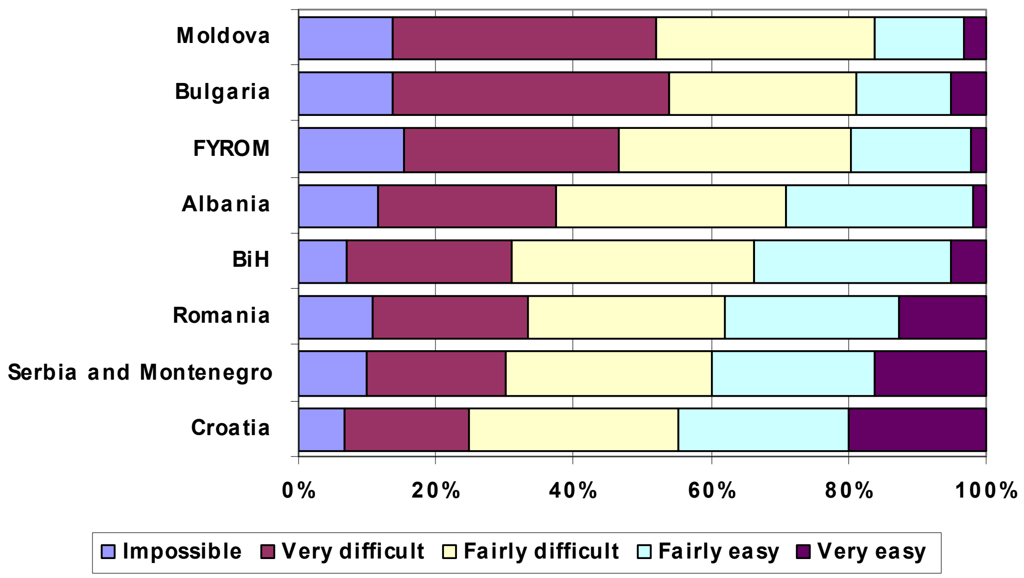
Figure 9. Perception of ease of rising short term loan



Source: Fries, S., T. Lysenko and S. Polanec (2003), "The 2002 Business Environment and Enterprise Performance Survey: Result from a Survey of 6,100 Firms", EBRD Working Paper No. 84

Perhaps not surprisingly, statistics show that perceptions of the ease of raising long term finance are more pessimistic. Some 84% of entrepreneurs in Moldova, for example, think that it is difficult or impossible to secure a long term loan. Even in Croatia, where more people perceive it as easy, 55% still think that it is difficult or impossible.

Figure 10. Perception of ease of rising long term loan

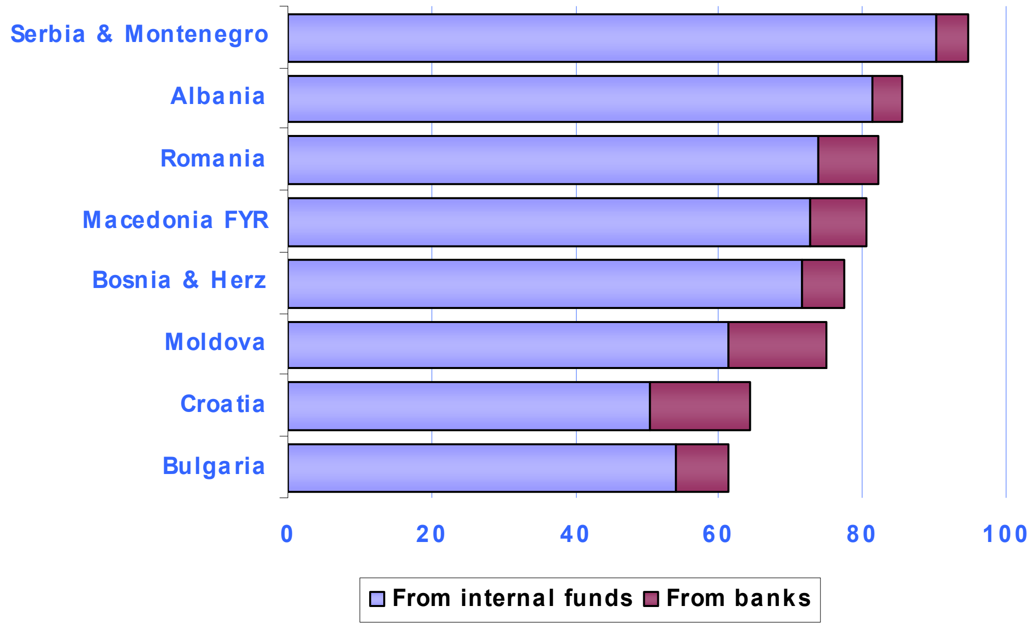


Source: Fries, S., T. Lysenko and S. Polanec (2003), "The 2002 Business Environment and Enterprise Performance Survey: Result from a Survey of 6,100 Firms", EBRD Working Paper No. 84

Perceptions matter, because they can reassure entrepreneurs that when support is needed it will be forthcoming, so they are therefore more likely to engage in activities that might lead to growth. However, perceptions only tell part of the story, since they do not cover what is actually happening when businesses are asking for loans, nor do they show the problems or ease of aspiring entrepreneurs in raising finance.

Surveys by the World Bank and IFC suggest that the reality bears out the perception. Businesses do have difficulty in raising finance for new investment. Most businesses have to rely on internal funds and retained earnings with just a small percentage securing investment finance from banks.

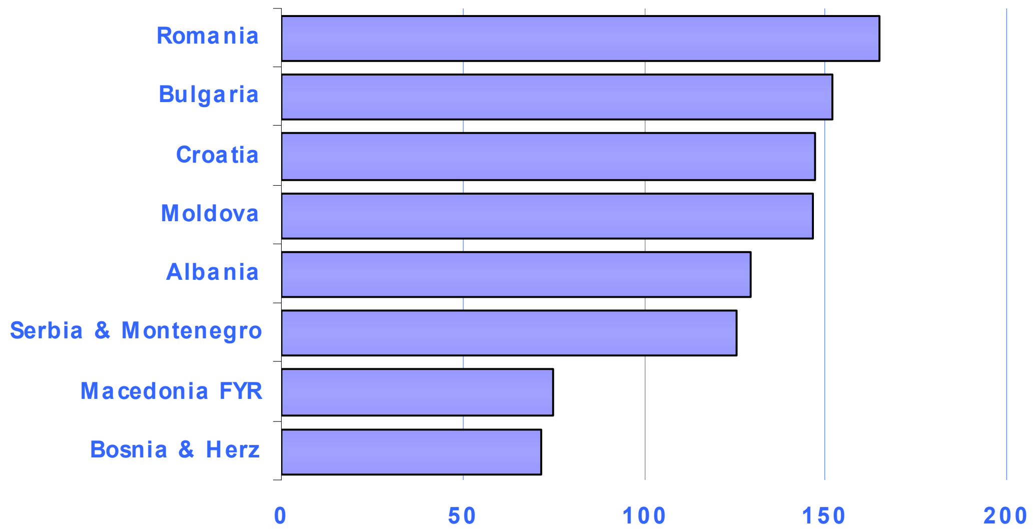
Figure 11. Source of finance for new investment (%)



Source: World Bank, "Investment Climate Surveys" see rru.worldbank.org

There are many potential reasons to explain this, but one is undoubtedly the high level of collateral demanded by the banks, often in the form of land or property rather than moveable assets.

Figure 12. Collateral requirement as percentage of loan



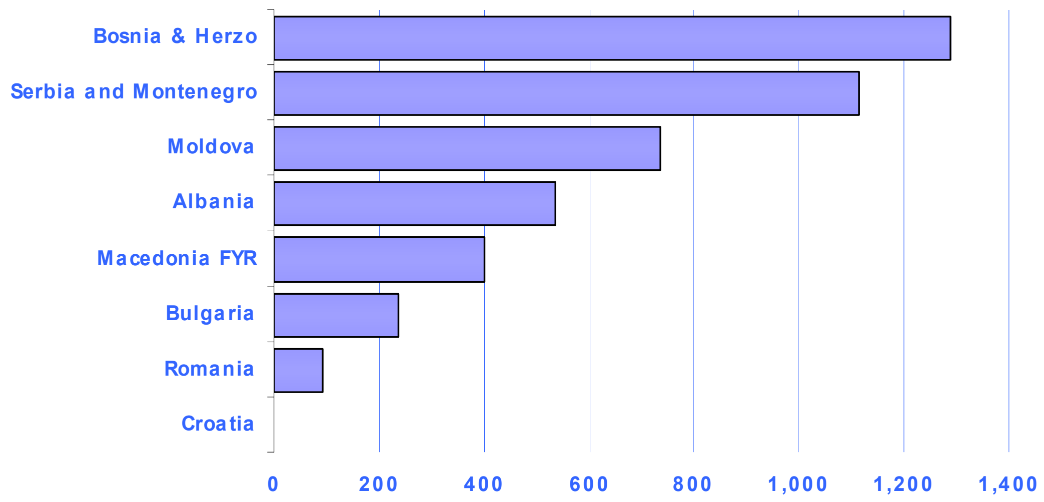
Source: World Bank, "Investment Climate Surveys" see rru.worldbank.org

In general, central banks do not require lending banks to record loans by size of business. In some countries, such as the UK, banks do so voluntarily, because it provides them with good market intelligence. The banks then collectively aggregate these data and make it available publicly, which assists policy makers.

One good source of data is the EBRD which has been promoting the need for greater availability of SME finance through bank loans and leasing as well as providing funds to a range of banks to enable them to provide what is effectively microfinance support. Furthermore the level of their support dwarfs most other microfinance activity, so their figures can be taken as an approximation for all the small business lending in most of the countries of SEE. Support is provided through loans and, to a much smaller extent, leases.

Figure 13 shows the total volume of loans and leases in each country standardised by business population, since EBRD facilities became available, typically three or four years ago. Loan size averages vary from USD 3 000 in Moldova to USD 12 000 in Romania; across all their SME lending in Central and Eastern Europe, the average loan size is USD 6 500. Very few loans have been made in Croatia and their arrears are at over 20%, whereas arrears in every other country are typically less than one percent. It is not clear why so few loans have been made in that country nor why their arrears are so high; possibly as the banking sector is highly regarded in Croatia, it may be that the banks have only used EBRD money to support the least promising businesses.

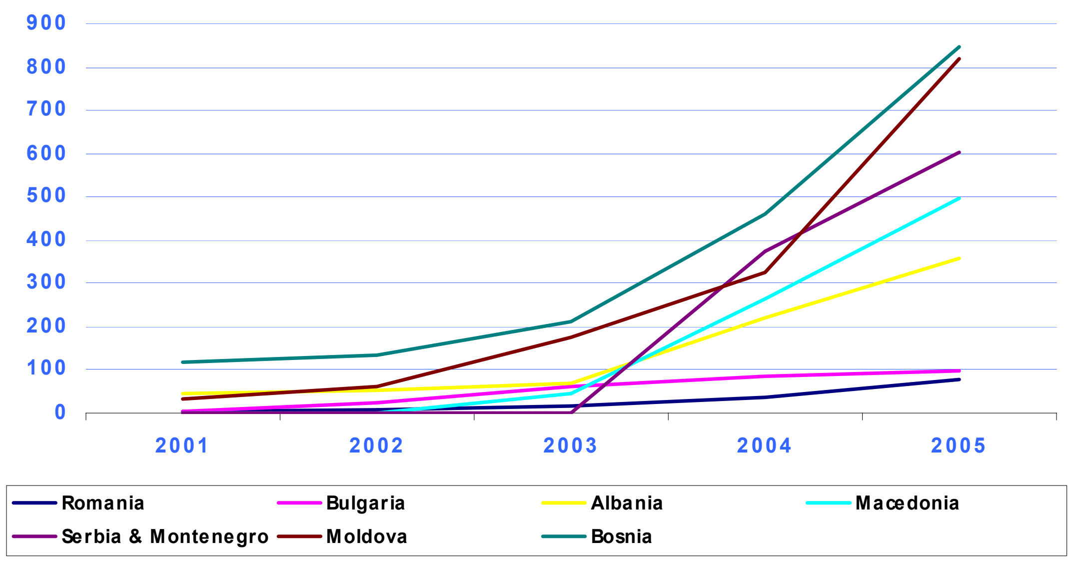
Figure 13. EBRD financed loans to SMEs (per 1 000 business population)



Source: adapted from unpublished data provided to the author by EBRD.

EBRD did not start lending in all countries at the same time but, as Figure 14 shows, there has been considerable growth in lending in most countries. Figures for 2005 are an estimate based on lending in the first four months of the year. In Bosnia and Moldova, it appears that the banks are coming close to making almost as many loans as there are businesses. It should be noted, however, that the figures have been standardised using the business populations shown above, rather than using updated figures for each year. The figures also do not reveal the number of businesses that secure repeat loans.

Figure 14. Loans by volume per 1 000 business

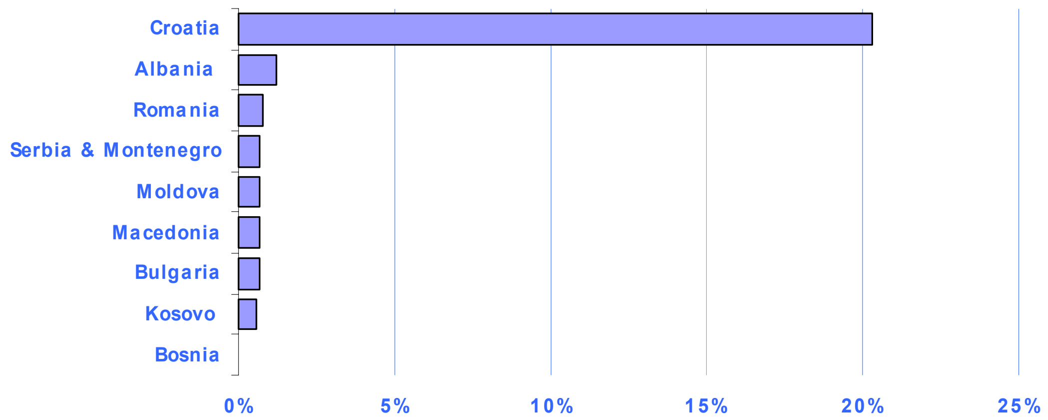


Source: adapted from unpublished data provided to the author by EBRD.

The most likely explanations for the surge in lending in some of the countries are that:

- There is considerable growth in the number of businesses, or at least more entrepreneurs transferring from the informal to the formal sector.
- The banks are becoming better at lending to smaller businesses (which would appear to be true judging by the figures for arrears – except for Croatia where there have been very few loans).
- Businesses are getting better at making the case for financial support.

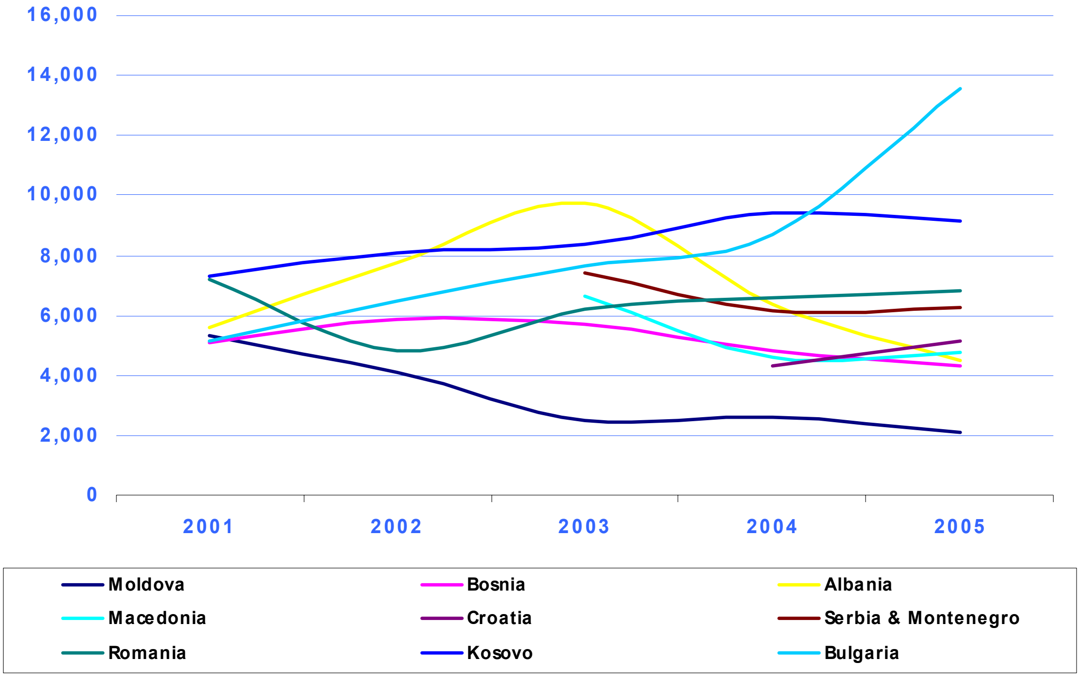
Figure 15. Arrears (%>30 days)



Source: adapted from unpublished data provided to the author by EBRD.

Whilst the total amount being lent is rising, it seems that, with the notable exception of Bulgaria, the value of each loan is static. This perhaps suggests either that the banks are not learning much about how to lend to small businesses or that the risk is still perceived to be too great so loan amounts are being kept down to mitigate risk, even though repayment rates are very high.

Figure 16. Loans by value (USD), average per borrower



Source: adapted from unpublished data provided to the author by EBRD.

The major source of finance in all SEE countries is from banks, helped considerably by the injection of support from EBRD. But the banks are unlikely to support every business. To keep their arrears and defaults down they will still require high levels of collateral. So other mechanisms are needed.

Some countries, such as Croatia, Serbia and Romania have launched guarantee funds. Most countries have micro-loan funds managed by NGOs alongside the provision of microfinance by the banks. They tend to take a softer view on the need for collateral, tending to replace it with advice and support to ensure that their borrowers succeed and so are able to repay their loans. Venture capital is still rare. There are a small number of venture capital funds and they are doing a very small number of deals, so are unlikely to make a significant difference in the short term. Leasing, or asset finance, could make a significant difference quickly and it seems it is growing though is still not universally available. However, leasing can only ever support the purchase of assets and still leaves businesses with the problem of raising working capital.

Bulgaria

Bulgaria has around 200 000 businesses, the vast majority of which are micro or small. There are some 23 banks which claim to want specifically to support small businesses. Some eight responded to a survey by the Agency for SMEs. In 2003, they supported nearly 9 000 businesses, that is, less than five percent of the total business population with loans totalling EUR 376 million (equivalent to EUR 18 million for every 10 000 businesses). A survey amongst small businesses suggests, however, that around 35% have been able to access bank credit.

It does seem that the banks are trying harder[3] with a number of the banks now developing their own micro-lending programmes. By the end of June 2004, there were just over one million loans of less than BGL 20 000 (EUR 12 000) totalling some BGL 2.5 billion (EUR 1.5 billion), though these figures include all lending rather than solely to SMEs. According to Vladimir Pavlov of the Foundation for Entrepreneurship Development, around 7% of urban businesses and 9% of rural businesses use bank credit. For businesses with fewer than 10 employees this falls to 5% of urban businesses and 6% or rural businesses. Pavlov suggests that many businesses do not seek credit because they do not expect to be successful and points out that there are no schemes specifically to finance start ups. Vlaho Kojakovic, economist for the Investment Centre at the UN Food and Agricultural Organisation (FAO), suggests that businesses in rural areas find some 70% of the funds that they need from remittances, savings, retained earnings, family and friends.

There are a growing number of microfinance institutions with some five groups aiming to achieve national coverage (providing 70% of total lending) and a further 33 local groups (with a further 15% of the lending). Between them they have 165 offices across the country. Kojakovic suggests that they have had limited impact but does note the important role that they play in providing technical assistance.

The Ministry of Labour, in 2001, established a micro-credit guarantee fund with a budget of EUR 12 million. It works in partnership with a small number of banks and, by the beginning of 2004, had supported 4 248 projects totalling nearly EUR 33 million. As yet, however, there is no wide scale loan guarantee programme.

There are a small number of venture capital funds, but their impact is relatively small. Caresback has invested in 23 companies, Trans-Balkan Fund in six companies up to the end of 2003, and Bulventures in three. One fund, the Bulgarian American Enterprise Fund focuses on construction and hotels.

Asset finance has become a popular alternative to bank loans. Several leasing companies sprung up when bank finance was difficult to obtain and several banks have now also established leasing companies. Leasing companies provided some EUR 350-400 million in 2003, though it is not clear how much of this went specifically to small firms. It seems that much of it went to finance motor vehicles (about 76%) though this is not so different to the UK. The Job Opportunities through Business Support (JOBS) programme has been experimenting with leasing aimed specifically at smaller businesses. It has established 37 schemes round the country, provided 660 leases totalling USD 5 million, and seen 100 leases fully repaid already.[4]

In the view of the Foundation for Entrepreneurship Development, the relatively low utilisation of bank credit is caused not by lack of supply but lack of business plans which make an effective case for loan finance or high risk, though it also argues that high interest rates are a deterrent.

The Minister for Economy, Milko Kovachev[5] stressed that the Government is now focusing on business support and competitive models. He noted the significant improvement in the financial regime with a move towards a flat tax system and improving access to credit. He noted the importance of focusing on improving the enabling environment and explained that some 160 regulations had been

[3] Pavlov, V, "SME finance demand and supply at regional and local level in Bulgaria", OECD LEED seminar, "Financing entrepreneurship in SEE"17 Mar 2005

[4] Taska Gabrovska, speaking at OECD LEED seminar, op. cit.

[5] Milko Kovachev, speaking at OECD LEED seminar, op. cit.

abolished in the previous three years. He also explained how institutional support had been reorganised in late 2004 with the creation of the Bulgarian SME Promotion Agency focusing on:

- Better dissemination of information.
- Involving SMEs in the legislative process.
- Responding to the needs of SMEs at the local level.

The Investment Compact sees the most critical issues[6] as:

- Ensuring and implementing a clear policy for information gathering and dissemination.
- Enforcing the rule of law, including eliminating corruption in the judiciary.
- Developing practical guidance on tax and social security for use by SMEs.
- Improving the mechanisms by which SMEs can enforce payment by debtors.
- Establishing business advisory services across the country.
- Creating a network of business incubators.
- Expanding the provision of education for entrepreneurship.

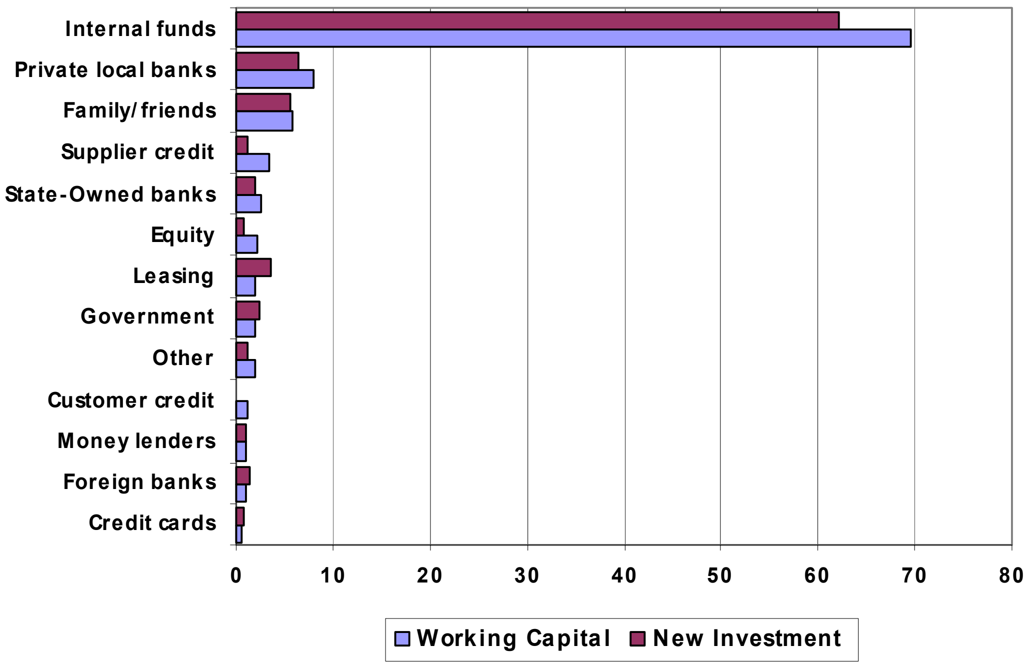
Romania

At the end of 2002, there were just over 800 000 registered enterprises, of which 343 000 were active SMEs. However, there are a large proportion of dormant enterprises, in part because exit barriers are high. The birth rate was significantly lower (7.5%) than the closure rate (19%) in 2002, mainly due to efforts to delete these dormant enterprises. The National Agency for SMEs and Cooperatives believes that 99.7 % of all enterprises are SMEs.

Whilst bank lending to SMEs is increasing, most money for investment comes from businesses' retained earnings – which is a problem. Banks provide just 8% of working capital requirements and 6% of new investment requirements (Pinto, 2004).

[6] Antonio Fanelli, "Enterprise Policy Performance Assessment" presentation at OECD LEED seminar, op. cit.

Figure 17. Sources of finance



Source: OECD-EBRD (2003), "South East Europe Region: Enterprise Policy Performance: A Regional Assessment", OECD, Paris

There is, however, no shortage of commercial banks. Two of the most important are the Romanian Commercial Bank (BCR) and the ProCredit Bank. BCR's loan portfolio to SMEs was around USD 600 million in 2003.

ProCredit Bank, formerly known as MIRO Bank, was founded in 2002 and specialises in providing finance to SMEs. It now has a loan portfolio worth EUR 23 million. It has recently secured an additional EUR 12.4 million from a consortium including EBRD, International Co-operation and Development Fund of Taiwan, Cordiant-International Finance Participation Trust (2004) and *Erste Bank der oesterreichischen Sparkassen AG*.[7]

There are six main microfinance providers: Community Habitat Finance International (CHF), Soros Foundation, World Vision's Credit Consulting and Training for Business (CAPA Foundation), ROMCOM, Romanian American Enterprise Fund and Opportunity International.

As elsewhere in SEE, leasing is expanding but it seems that the focus is on purchasing vehicles, rather than equipment, and it appears to be largely restricted to medium sized enterprises.

There are five venture capital funds operating: Romanian American Investment Fund, Romanian Post Privatisation Fund, Romanian and Moldovan Direct Fund, Advent Central and Eastern Europe II and Oresa Ventures S.A. However, there are no Business Angel networks.

Romania has a history of establishing credit guarantee funds:

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[7] See www.microfinancegateway.org, published 23 May 2005

- The Romanian Credit Guarantee Fund for Private Entrepreneurs (CGFPR) is a private initiative created in 1993.

- The Rural Credit Guarantee Fund (RCGF), created in 1994, issues guarantees of up to EUR 1 million mainly in agriculture and food processing.

- The National Credit Guarantee Fund for SMEs (FNGCF) was created by the National Agency for SMEs and Cooperatives in 2002 with state funding.

The National Agency for SMEs and Cooperatives, created by the Government in 2002, recognises the problem of inadequate access to finance:

> Although in recent years the Romanian banking sector has been transformed, entrepreneurs and SMEs still have difficulties accessing finance on acceptable terms. Credit is available but the credit technologies used by the banking sector work against SMEs – long-term loans or cash-flow support are rarely available. The banks impose debt-to-equity ratios that are virtually impossible for SMEs to meet because of their thin capitalisation and lack of collateral. Micro and small enterprises are unlikely to grow and entrepreneurs will be unable to enter the market with innovative ideas and products unless actions are taken to improve access to finance. (UNECE and National Agency for SMEs and Cooperatives of Romania, 2004, p. 25)

Croatia

There are some 150 000 registered SMEs accounting for over 99.6% of private sector enterprises. Despite a large number of banks and a wide array of suitable loan products, SMEs face difficulty in accessing both short and long-term finance, often because of the banks' onerous collateral requirements but also because of the inability of many businesses to provide a satisfactory business plan.

The Croatian Agency for Small Business (HAMAG) has been established by the Government and aims to:

- Encourage and support the formation of new businesses, especially amongst women and young people.

- Promote investment in SMEs, including extending loans, issuing loan guarantees, providing grants to reduce borrowing costs and subsidise interest costs.

- Provide business support, especially for job creation, utilisation of modern technologies, and for participation in international fairs and exhibitions.

Despite their role in providing guarantees, it seems that they do not approve many. In 2004, they had 5 000 applications but only approved 36; in the first quarter of 2005, they approved only two.

Serbia

The number of SMEs has grown rapidly from 20 000 in 1990 to over 190 000 (with an additional 184 000 retail outlets) in 1997. SMEs are estimated to comprise 98% of the total number of private sector businesses. Data from 2000 suggests that there are 61 000 active enterprises of which 57 000 are small.[8]

Up to the end of 2003, commercial banks approved loans totalling EUR 2.4 billion to the entrepreneurial sector, large enterprises and the SME sector.

Micro credit, providing loans of up to EUR 20 000, is an important source of support for new and early stage businesses. Micro-loans are provided by banks and other authorised financial institutions as well as by non-governmental organisations. ProCredit Bank, for example, in a three period up to 2003 has provided EUR 150 million through 23 000 loans with a default rate of just 0.1%. Loans of up to EUR 10 000 account for 86% of their lending. Since 2002, the savings bank Opportunity International, starting with a donation from USAID of USD 1 million and an additional USD 1.2 million of private capital has been offering micro-loans of EUR 250-15 000. By the end of 2003, they had made 2 600 loans totalling EUR 4 440 000.

NGOs offering micro-loans include UNHCR, Dicro Development Fund and Integra (which focuses on female entrepreneurship).

There are 10 registered leasing companies.

A Guarantee Fund was launched in August 2003 with the task of guaranteeing up to 50% of the credit provided by banks and other financial organisations to SMEs. By the end of 2003, it had provided just three guarantees totalling EUR 128 000. A local credit guarantee programme with funding from GTZ and UNOPS was launched in Alma Mons in 2004.

POLICY RECOMMENDATIONS

In conclusion, there is a need for work in three key areas:

- On the demand side, there is a need to build the capacity of entrepreneurs to manage their businesses effectively so that they can secure credit more easily and grow their business more quickly than if they relied solely on retained earnings.

- On the supply side, there is a need to fill the gaps, which may require a combination of new instruments and more enlightened banks.

- Intermediation, to match supply and demand, is important. In the short term, this requires effective business support agencies; in the longer term, it may lead to opportunities for business angel networks (say, returning wealth from the *diaspora*), regional stock exchanges, etc.).

Establishing levels of activity has been hampered by the fact that the countries of South East Europe do not collect data on lending to small businesses due to no requirements to do so. However,

[8] See www.sme.sr.gov.yu/state.htm

the figures gathered voluntarily by banks in the UK are most useful in understanding small business finance and in developing public policy.

Pinto (2004) asserts that there is a poor level of development of the financial sector with high levels of risk aversion and therefore more severe barriers to prospective entrepreneurs. He notes the importance of a healthy banking sector to provide finance for small enterprises. He argues, therefore that "the most effective method of providing finance for SMEs is to create dedicated channels for this activity: SME credit lines, micro finance banks, micro credit by NGOs, etc." (Pinto, 2004a). It is unlikely that commercial organisations which only lend to small businesses will be successful in the long term if they have to rely on savers and depositors for the bulk of their funds. However, it makes sense for all the banks to have dedicated small firm lending managers and to ensure they are properly trained so they understand small businesses and their needs.

Judging by the figures from the EBRD, micro finance has been a major success in SEE. Micro-lenders, more often banks than NGOs, have spread rapidly to all countries in SEE, except Croatia, where the financial sector is relatively developed. They have resulted in greatly increased levels of lending to micro-businesses and SMEs in the region. Arrears are low, except in Croatia.

However, it is likely that more could be done to make it easier for businesses to access micro-credit. For example, EBRD could provide funds to NGOs as well as to banks, which would provide more competition for the banks and demonstrate that lending can be successfully undertaken even when there is little or no collateral available.

For commercial banks, the transaction costs are often out of proportion for small loans. NGOs often have an advantage in that their transaction costs are lower, so they are more willing to make smaller loans.

There is a desire to recover loan finance as quickly as possible. Offering longer, more flexible, repayment schedules would help many more businesses. It appears that there is a need for greater availability of credit in the rural areas. At the same time, more effort is required to change the culture of farmers and artisans so that they are more willing to make effective use of credit. This requires, inter alia, better marketing by the banks of their products.

Not all countries have regulations which impact on lending by NGOs, providing that the source of their money is not depositors. This is the right approach. It is quite justifiable to have regulations to protect individuals who might deposit their money in a bank, and expect to get it all back. But the source of funds for NGOs is often grant aid, or loans from sophisticated investors. They should be able to understand the risks and make decisions themselves. So micro-loan funds managed by NGOs, if they are regulated at all, should be regulated with the lightest possible touch.

NGOs might also wish to experiment with micro-leasing and possibly with small scale equity investments, recognising that this is not suitable for every business. Leasing can be an effective way of providing financial support, but it is not yet widespread.

Non-bank micro-loan funds and business support organisations could and should work closely with commercial lenders to win their confidence. They need to learn that as businesses receive appropriate support the risk of failure reduces. This might result in commercial lenders becoming more willing to syndicate lending at an early stage in the development of a business and more willing to take on all the business's borrowing requirements as it grows.

There could be more experimentation with guarantee funds, either through the creation by groups of businesses of mutual guarantee societies or through the establishment by governments of national guarantee schemes. The UK's Small Firms Loan Guarantee Scheme has been modestly successful and could provide a good model. Where national governments are reluctant to introduce loan guarantee schemes, there is almost certainly a potential role for mutual guarantee schemes. These could be piloted on a local or regional basis.

Whilst there has been little discussion about the ability of entrepreneurs to manage their businesses successfully, this has to be a sine qua non to unlock more financial support. It is essential that there be a network of excellent business support organisations which can work with and support the entrepreneur during the market research phase and in the preparation of a business plan. The plan must describe a viable proposition; it must be clearly backed by good market research and clearly linked to financial forecasts; it must also demonstrate that the principal(s) will persevere and make it work.

Pinto notes that the legal and regulatory environment has an impact. High minimum capital requirements and lack of effective land registration translate into high collateral requirements, raising the barriers for SMEs (Pinto, 2005) so governments need to address these issues. Reducing the collateral requirement to a sensible level will make it easier for commercial lenders to lend more money to more businesses.

In many countries, corruption is a problem. This needs to be addressed, especially in the legal system so that businesses can pursue defaulting debtors. Indeed, some argue that creditors currently have more protection than debtors.

The growth of SMEs in SEE suggests that there is huge potential which needs to be released. This can only happen if it becomes easier for entrepreneurs to raise the finance that they need. But ultimately the biggest source of finance are commercial lenders, so the challenge is to put in place mechanisms which can demonstrate that lending to micro-businesses need not be as risky as the commercial lenders often think it is.

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CHAPTER 2:

ENCOURAGING THE INTERNATIONALISATION OF SMES

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Internationalisation has become increasingly important to the competitiveness of enterprises of all sizes. In today's environment, SMEs that start with a global strategy can move quickly to take advantage of cross-border activities, which provide opportunities not only for revenue growth but also for the exchange of knowledge and the enhancement of capabilities, thereby strengthening the long-term competitiveness of the firm. This chapter analyses the details of the different approaches, and the ways in which they are implemented, with regard to the variety of forms of SME internationalisation: intermittent exports, exports via agents, licensing or franchising and foreign direct investment in the overseas market. Despite the common understanding of the importance of internationalisation, there are still many internal and external barriers that impede the internationalisation of SMEs. This chapter identifies specific policy actions that could overcome market gaps and encourage the internationalisation of SMEs.

INTRODUCTION

Throughout 2005, the OECD's Local & Economic Development Programme (LEED) Trento Centre organised a series of capacity building seminars in South East Europe to assess key challenges in the area of entrepreneurship policy development. In April, a seminar was held in Montenegro focused on SME internationalisation. The aims of the seminar were to analyse the policies and instruments necessary to facilitate SME internationalisation. This paper has been prepared following that seminar.

The objectives of this paper are to:

- Investigate the opportunities and barriers to SME internationalisation and determine why certain SMEs are more likely to internationalise than others.
- Examine the current situation in South East Europe.
- Identify ways in which policy makers can target measures to address existing gaps or market failures in SME internationalisation.

THE ISSUES

Internationalisation and competitiveness

Internationalisation has become increasingly important to the competitiveness of enterprises of all sizes. In today's environment, small and medium-sized enterprises (SMEs) that start with a global strategy can move quickly to take advantage of cross-border activities, which provide opportunities not only for revenue growth but also for the exchange of knowledge and the enhancement of capabilities, which strengthen the long-term competitiveness of the firm.

Entrepreneurship is one of the most important drivers of local economic development. New firm formation and the activities of SMEs help drive job creation and economic growth through accelerating innovation and promoting the full use of human, financial and other resources. The vitality of the new and small firm sector is therefore a major determinant of local competitiveness, which in turn influences national economic performance (OECD, 2005).

Public policy at local, regional and national levels can play a significant role in encouraging entrepreneurship and SME internationalisation by tackling various market failures which can occur. These will be analysed in further detail in this paper.

Entrepreneurship, SMEs and growth

Entrepreneurship is about creativity, innovation and growth. It is, by its very nature, a bottom-up approach. A widely used definition from Harvard Business School is "entrepreneurship is the pursuit of opportunities beyond the resources you currently control" (Stevenson 1983, 1985; Stevenson and Jarillo, 1991). Entrepreneurship can be facilitated by creating an environment which provides incentives for entrepreneurs and reduces the barriers to starting and growing companies. However, entrepreneurship can not be "created" through top-down approaches.

Entrepreneurial economies are the result of multifaceted systems for nurturing high-impact entrepreneurship. Real opportunities arise from firms with new ideas that add unique value (Schramm 2004). Innovative entrepreneurs come in all shapes and forms, whether they start companies, grow existing firms, innovate within large companies or establish social enterprises. These are creative, proactive people pursuing a vision and galvanising the necessary resources along the way to make that vision a reality.

Entrepreneurs, as described above, are growth oriented although only a small segment of entrepreneurs are high growth oriented, meaning they are pursuing large, global markets with some unique and scalable technology or product. It is these high growth firms which are the largest source of job growth and wealth creation. These firms also tend to be more focused on internationalisation. In fact, many high growth firms, which are often venture-back companies, start with a global strategy from the onset. These firms are often referred to as "gazelles" or being "born global".

By definition, SMEs are "small and medium-sized" enterprises. The most standard classification of SMEs is by number of employees although sometimes revenues are also used. Many SMEs are of a stable size and are content to remain small. Firms in this category include many family businesses, most sole proprietorships and many other micro, small and medium-sized firms. While SMEs are clearly a large and critical part of most economies around the world, SMEs differ greatly in their growth orientation. The term "SME", which describes a firm's size, is therefore not adequate for measuring entrepreneurship or anticipating internationalisation of firms. Growth orientation as well as both the inclination and ability to internationalise are important characteristics in SME internationalisation.

SME internationalisation

SME internationalisation can take many different forms, including exporting, the creation of alliances across national borders and the establishment of operations or offices in other countries. These approaches, and the ways in which they are implemented, will be discussed in further detail in the following section. This section will focus on opportunities and barriers to SME internationalisation well as motivations.

International opportunities for SMEs

Improved technology and communications have made it easier for firms of all sizes and in various locations to do business with each other. The globalisation of large firms and service providers has improved opportunities for SMEs to participate in different parts of the value chain of those companies (OECD, 2004). New and innovative corporate approaches, including more network-oriented operating models provide more opportunities for SMEs to conduct business with larger firms. Better dissemination of management education and business tools has enhanced the competitiveness and quality of businesses across the spectrum. The reduction of language barriers and lower travel costs have also facilitated internationalisation.

These factors provide substantial international opportunities for entrepreneurial SMEs, which often have greater flexibility and are better able to internalise market information than large firms (Liesch and Knight 1999). Certainly those firms which are growth oriented can benefit tremendously from pursuing larger and new niche markets, exploiting scale and technical advantages, upgrading of technologies or lowering and sharing costs, including R&D costs. Pursuing international opportunities is also a way of spreading risk and can also improve access to finance. Substantial knowledge and capabilities are also gained in the process, greatly enhancing the competitiveness of the firm.

Barriers to SME internationalisation

Despite the trends facilitating internationalisation, many barriers still exist – both internal to the firm and external. External factors impeding the internationalisation of SMEs include national and international administrative rules and regulations as well as formal and informal trade barriers. Internal barriers for SMEs trying to internationalise can include cultural differences, lack of information or skills, insufficient networks, language barriers and lack of access to necessary finance.

The European Commission's European Network for SME Research (ENSR) survey conducted in 2003 identified the most frequently cited barrier by SMEs as the high cost of the internationalisation process (European Commission, 2004). Such costs include those associated with doing market analysis abroad, purchasing legal consulting services, translation of documents, adaptation of products to foreign markets, and travel expenses, in addition to the higher business and financial risk incurred.

Firm size appears to be a factor. The 2003 ENSR survey showed that fewer firms under 50 people internationalise (European Commission 2004). Clearly, high-growth oriented, "born global" firms are exceptions. The findings also confirmed that the size of the domestic market has an impact: smaller domestic markets drive SMEs with a specialised or large production to internationalise.

Many impediments to SME internationalisation may originate at the level of the national economy, institutions, and general infrastructure – related to issues of competition policy, legislative and regulatory frameworks, telecommunications infrastructure, research and education policy (OECD, 2005). Resulting challenges can include standards and international compatibility issues, intellectual property protection, political risks, corruption and rule of law issues.

Other perceived and real challenges include heightened international competition from foreign firms. However, by striving to be competitive and responsive to changes in the market, SMEs can survive and thrive both locally and abroad. Also, by working collaboratively with other companies both large and small, SMEs can increase their ability to succeed internationally.

Many internal challenges also create barriers. According to the 2003 ENSR study, a frequently mentioned problem is the lack of an explicit strategy in the initial stages of the business formation. Studies and data have confirmed this hypothesis by demonstrating that most export activity results from unsolicited demands rather than from proactive efforts. Other issues mentioned in the ENSR study included the lack of know-how with respect to international activities, identifying partners and assessing market potential.

The section on policy approaches, later in this paper, will highlight ways in which policy makers and others can help reduce some of these barriers to SME internationalisation.

Motivations and drivers of SMEs internationalisation

Often firm growth is the main goal or motivation of international expansion. The 2003 ENSR enterprise study shows that the primary motivation behind internationalisation is very closely linked to maximising returns and minimising costs in purchasing, production and sales. Secondary motivations included strategic development of the company by gaining access to international competencies, technology and labour as well as capital.

Extensive literature identifies the international orientation of the owner-manager or other key decision makers in SMEs as a key determinant of the nature and extent of internationalisation. The willingness and ability of the CEO, owner/manager or strategic leader is seen as dependent on his/her exposure to a range of factors, including existing formal and informal international contacts, knowledge of foreign competitors, experience of foreign cultures, language skills and educational background (Lloyd-Reason *et al.* 2004). Without a strong leadership commitment to internationalisation, SMEs are less likely to pursue cross-border activities.

A recent paper looking at the Cambridge high technology cluster (Myint *et al*. 2005) confirmed the important role of entrepreneurial individuals as drivers of growth, in the case of this research, within clusters. The findings reveal a core group of Cambridge entrepreneurs as the key influence on the success of the cluster growth process and their links between the companies as the structural and relational social capital (Coleman 1988, Burt 2000).

Segmentation of SMEs by growth orientation

As discussed in the section above, motivation to internationalise is a key factor in SME internationalisation. However, many studies have shown that only a small percentage of SMEs are inclined to internationalise.

According to a study recently conducted in Britain (Sear *et al.* 2004), 56% of SMEs sampled across the Eastern part of the UK were simply not interested in internationalising. They had a local or niche market and did not feel the inclination or need to pursue international opportunities. It can be argued that for these SMEs, there is little that policy makers can or should do to encourage internationalisation.

Table 3. International orientation of SMEs

SME segment* (by interest in internationalising)	Characteristics*	Percentage* (of sample of UK SMEs)	Public Policy Interventions	Private Sector Role
Not interested	Local niche/market	56%	General policies to support creation of SMEs	Limited
Curious	Reactive export/import only	15%	Basic information on exporting	Limited
Tentative	International less than 15% of sales (export/import)	13%	Information on legislation & regulations, culture and finance	Potential partnerships, alliances
Enthusiastic	Pursuing international markets & strategy	10%	Transactional to strategic issues	Potential partners and/or M&A
Successful	High-added value and wealth creating sectors	5%	Policies to support high growth companies, VCs, education	Venture capital financing, M&A/IPO

Source: Author's summary of research findings in paper by Sear, Mughan and Lloyd-Reason (2004)

The next set of SMEs in that study comprised of firms which the researchers classified as "curious". This group constituted 15% of the SMEs in the research set. Their interest in internationalisation stemmed more from a reaction to the interests of their existing customers, who themselves might have opened new branches abroad and therefore required services or products in those countries. For this group of SMEs, policy makers and others can assist by providing basic information on exporting.

The next group of SMEs in the study was "tentative" about internationalisation. This group constituted 13% of the study. It consisted of those firms with less than 15% in international sales. Policy makers and others can support these SMEs by providing information on legislation and regulations in specific countries as well as information on export finance.

The last two groups were categorised as either "enthusiastic" (10%) or "successful" (5%) in internationalising. The enthusiastic group was pursuing international markets and strategies. Useful support for them would include a range of assistance on transactional to strategic issues, primarily from private sector sources. Also, connections with potential partners or merger and acquisition (M&A) candidates could be helpful.

The final group, the "successful" international SMEs were usually in high-added value and wealth creating sectors, such as high technology or biotechnology. Possible support for these types of companies would include general policies to support high growth companies and venture capital. Education also plays a critical role both on the technical side as well as helping potential entrepreneurs learn how to grow companies. Other private sector firms tend to be very involved with these high growth firms, whether to provide venture capital financing, M&A or IPO expertise (investment banks, law firms).

This study highlights the fact that efforts to support and encourage SMEs to internationalise should be tailored, providing different levels and types of support for each target segment. There is not one policy approach which will suit all SMEs. While it is not always easy to identify which SMEs belong to each segment, providing a range of services and support should help draw SMEs to the right instruments.

In the study mentioned above, more than half of the SMEs were not interested in internationalising and 5% were already doing so successfully. It is the approximately forty percent in between which can benefit most from direct and specific support and policy intervention. Focused efforts and programmes are best spent on those segments of SMEs which have some interest in internationalising. At the same time, policy makers should continue pursuing general policies to support the creation and growth of SMEs and reduce barriers to international business and trade, as these actions can encourage more SMEs to become interested in internationalising.

The following sections outline various ways SMEs can internationalise as well as policy approaches which can facilitate SME internationalisation.

Methods of SME internationalisation

While the vast majority of SMEs may not be interested or ready to move beyond national or local markets, there are many target business segments with higher growth potential who would like to pursue international opportunities but may need help in overcoming various market failures or gaps in order to do so.

International expansion is a significant decision for small and medium-sized enterprises (SMEs) which traditionally have a small financial base, a domestic focus and a limited geographic scope (Lu and Beamish 2002). While some SMEs are "born global", most lack the resources necessary to internationalise and traditionally they have appeared reluctant to engage in global business activities (Kirby and Kaiser 2003).

However, globalisation, technological advances, improved information flows and changes in organisational structures have facilitated SMEs ability to internationalise and are reflected in their increasingly active role in international markets. In addition to exporting and importing activity, SMEs have increasingly engaged in cross-border strategic alliances, mergers and acquisitions and inter-firm networking and collaboration (OECD 2005). In their efforts to innovate, SMEs have increasingly relied on networks, clusters and partnerships which provide access to information, know-how and new technologies.

Traditionally, internationalisation was described as a gradual sequential process of various identifiable stages. Johanson and Widersheim-Paul (1975) found a regular process of gradual change involving the firm moving sequentially through four discrete stages: 1.intermittent exports; 2. exports via agents; 3. overseas sales via knowledge agreements with local firms, for example by licensing or franchising; 4. foreign direct investment in the overseas market. The rationale was that this approach minimises risk and investment amounts required at each point in time and allows for learning and experience gaining before further expansion. It was also observed that firms initially move to countries which are culturally similar to their own (a close psychic distance) and in close geographical proximity (Lloyd-Reason *et al.* 2004).

However, more recent research shows that firms do not necessarily follow any consistent pattern in their internationalisation, although the driving forces behind the process remain the same (Benito and Welch 1993). The "New Venture Internationalisation Theory" emphasises the importance of entrepreneurial vision (with the entrepreneur as a central decision-maker in the firm) and the initial resource endowment of the firm in facilitating early internationalisation decisions (Autio and Sapienza 2000). This is especially important in knowledge-intensive industries (McDougall *et al.* 1994, McDougall and Oviatt 1996).

It has been shown that the older a firm, the more established are routines and practices, and the higher the level of organisational inertia, the more resistance is exerted to pursuing internationalisation (Lu and Beamish 2002). This research showed a "learning advantage of newness" for SMEs who internationalise at comparatively young ages. They concluded that the sooner the internationalisation, the easier the learning in the international environments, the faster the firm's growth.

Context is also important. Certainly, internationalisation was different in the 1970s, than it was in the 1990s or than it will be in 2010. Economic, political and regulatory environments change as do the types of firms and management approaches.

Below are the various approaches to internationalisation, which we will look at in turn in the following sub-sections.

- Import/export.
- Strategic alliances/joint ventures.
- Foreign direct investment (FDI).

The table below highlights some potential advantages and disadvantages of each form of internationalisation.

Table 4. Comparing methods of internationalisation

	Exporting	Alliances	FDI
Benefits	▪ Relatively easy, fast	▪ Requires limited resources and market knowledge	▪ Increased firm competitiveness and growth
	▪ Low investment cost/commitment		▪ Location-based advantages
	▪ Flexible		▪ Development of new knowledge and capabilities
	▪ Lower risk		▪ Minimises transaction related risks
Challenges	▪ Possible lack of alignment with foreign sales agents	▪ Identifying the right joint venture partners is critical	▪ Complex, time consuming
	▪ Tariff and non-tariff trade barriers	▪ Structuring effective partnerships can be tricky	▪ High investment/commitment
	▪ Cost of transportation of goods		▪ Least flexible approach
			▪ Higher risk

Source: Author with reference to paper by Lu and Beamish (2002)

Import/export

While importing and/or exporting are the easiest and usually the first steps to internationalisation, only a small majority of SMEs are currently doing so. Many SMEs begin by importing goods from foreign suppliers and only start exporting in response to intermittent needs and demands (European Commission, 2004). Many other studies support those findings, including the UK study reviewed earlier, which showed that many firms begin exporting "reactively" based on the needs of existing customers rather than "proactively".

Table 5. SME internationalisation

Frequency of different types of internationalisation	Percentage of total (Europe-19) SMEs
Importing (foreign suppliers)	30%
Exporting	18%
Foreign collaborations	3%
Foreign subsidiaries or branches	3%

Note: The above percentages cannot be summed, since individual companies may figure in several categories.

Source: European Commission, 2004.

By selling directly or through sales agents to clients in new geographic markets, a firm broadens its consumer base and can potentially achieve a higher sales volume which provides the possibility of a higher production volume and expansion in production capacities to meet the market demands (Lu and Beamish 2002). Exporting is a relatively fast, easy and flexible way to enter foreign markets with low commitment and risk. It enables SMEs to respond quickly to changes in various markets, either reducing or expanding activities. It is easier to implement than other internationalisation approaches, such as creating alliances or setting up operations in foreign countries, which can be complex to structure and implement. The downside to exporting includes exposure to tariff and non-tariff trade barriers and the potential lack of alignment between foreign sales agents and the SME.

Studies have shown that most imports and exports are with neighbouring countries. ENSR 2002 research showed that within the Europe-19 countries surveyed, neighbouring countries constituted the easiest and most frequent business partners. A study of the internationalisation process in four European transition countries (Lloyd-Reason *et al.* 2004) showed that the first recipient country selected for export is often due to "previous contacts". In addition, collaborative alliances of various types with overseas companies are usually with those already active in the country.

Strategic alliances and joint ventures

Another way for firms to internationalise is through strategic alliances and joint ventures. Benefits of these alliances include access to financial resources, pooled research efforts, product development and wider distribution channels. Alliances are becoming increasingly important as international competition drives specialisation and the trend for larger companies is to increasingly outsource activities (OECD, 2005).

Joint ventures enable SMEs with limited productive resources and/or market knowledge to enter international markets. Alliances and networks can take many forms including joint research and development, manufacturing, marketing, sourcing of inputs, or cooperating in distribution. However, research conducted by Kirby and Kaiser reveals that initiatives appear to have been successful but that they are not without their problems and in many ways the experiences of SMEs involved seem similar to those of the large multi-national enterprises. They argue that the key to success appears to be the choice of the joint venture partner and concludes that, given the limited resources of small firms, assistance is required to help them locate and select appropriate partners (Kirby and Kaiser, 2003).

Clusters and networks

Operating in international markets demands resources, experience, skills and knowledge, many of which small businesses often lack. For SMEs, one way to acquire these skills is to cooperate with other small firms (Nummela, 2002). Although smallness is usually related to some advantages, such as flexibility and innovative capacity, it also creates some problems that can be significant obstacles to internationalisation. These problems may be based on insufficient financial resources, lack of knowledge and skills of operating in foreign markets. By co-operating with other internationalising SMEs the partners could use their sparse resources more efficiently, divide costs and risks related to foreign markets, obtain information and learn new skills which are needed in foreign markets.

Clusters and other networks can help in developing and securing international alliances by increasing productivity, innovative capacity and competitive performance of local firms, creating a more efficient division of labour between enterprises and facilitating joint development and marketing initiatives. These networks – which can include vertical supply-chain relationships and horizontal clustering – also have enormous potential. Networks link entrepreneurs with potential sources of financing, human skills, partners, suppliers and information. Through such networks entrepreneurs share information and assessments of broader cooperation. Benefits include (UNDP 2004):

- Enabling the transfer of skills, technology and quality.
- Ensuring that foreign direct investment has positive spill over effects.
- Bringing companies into the formal sector.
- Creating the capacity to govern transactions through commercial contracts.
- Opening markets and the supply of inputs to smaller firms through networks of larger partners.

- Improving the ability of small and medium sized enterprises in such networks to get financing on commercial terms.

- Increasing the choice and lowering the prices for consumers by bringing a greater variety of goods to the market.

Foreign direct investment (FDI)

Foreign direct investment can be a better way to achieve firm growth, although for most countries, only a small fraction of SMEs have established subsidiaries abroad (OECD 2005). Outward FDI, or the establishment of a subsidiary or branch abroad, allows a deeper penetration of foreign markets which can result not only in an increase in sales but also in the gaining of knowledge and technical expertise which might not have been possible from the firm's home base. Inward FDI also provides opportunities for SMEs by serving as a vehicle for SMEs to access international markets by joining the value chain of multinationals as well as providing an efficient way to diffuse technology and better business methods for SMEs to enhance their international competitiveness.

Outward FDI by SMEs generally occurs after successful experience gained in exporting and/or forming alliances. The ENSR 2003 survey showed that only 3% of SMEs in Europe have subsidiaries, branches or joint ventures in other countries (countries in the survey ranged from 0.5% to 10%). High growth "born global" firms normally have this integrated in their strategy from the beginning.

Box 1. Outward FDI

Exports and outward direct investment have often been characterised as alternative strategies. Firms can either produce at home and export, or produce abroad and substitute local sales of foreign affiliates for exports. It is not surprising, therefore, that there are concerns that outward direct investment may lead to loss of investment, exports and employment from the home economy, leading to a "hollowing out" of domestic industry. Recent economic research, however, casts doubt on these assumptions and suggests that outward direct investment is beneficial to the home economy under certain conditions. For example, by enabling multinationals and their domestic suppliers to expand into new markets and to gain access to new technologies, "horizontal" outward direct investment can secure well-paid jobs in the home economy. "Vertical" outward direct investment can facilitate a restructuring of industry in the home economy up the value-added chain by moving some labour intensive production processes overseas to more cost competitive locations, allowing the domestic operations to concentrate on "strategic" high value-added activities that pay higher wages.

Source: OECD, 1998

There are multiple ways in which SMEs can invest abroad. Certainly, the firm can build a subsidiary or branch from scratch. Another option is to invest through a merger or acquisition (M&A). By either purchasing or merging with an existing company, the SME can gain immediate access to foreign markets, along with an established market presence and an experienced management team. However, there can be significant integration issues, including some initial misalignment of objectives and operational procedures.

SMEs face considerable barriers when attempting to engage in FDI given their limited financial, managerial and information resources and their attitude to risk. However, such limitations can be overcome. Similar to exporting, FDI broadens a firm's customer base by entering new markets, enables the firm to achieve a larger volume of production, and helps the firm to grow. In addition, FDI provides further benefits which can lead to the sustainable growth of a firm, including contributions to the development of new knowledge and capabilities by providing access to various location-based advantages.

POLICY OPTIONS

The role of government

The entrepreneurial ecosystem generally includes micro, small and medium sized companies, multinational corporations, local chambers of commerce, associations, cooperatives, foundations and networks of individuals. It also includes local government, universities and other research organisations, banks and financial systems. For the whole system to function well, trust is a key component. For maximum benefit, all of these sectors need to work together in a coherent and collaborative fashion.

Local governments and development agencies are very active in the design and delivery of entrepreneurship programmes, including promoting exports and internationalisation. Given their proximity to SMEs, local governments should be empowered by national governments to take appropriate, targeted actions for promoting the growth and internationalisation of SMEs. The work of specialised agencies geared towards supporting and promoting SMEs also plays a very important role in SME internationalisation. These agencies often supply valuable information, provide critical networking platforms and allow for the exchange of ideas and best practice.

Public policies are critical to providing the right environment and incentives at the national, regional and local levels. However, the role of the government should be facilitative, not dictatorial, and public financial support should never be more than 50%. Most top-down prescriptions do not yield the intended results. Also, too much public financial support, without co-investment by the private sector or market, can hinder rather than help by creating possible market distortion. As mentioned earlier, these SMEs must be market-driven and competitive. If they are overly dependent upon public support, they surely will not be sustainable.

The environment is constantly changing, as are the opportunities for SMEs. Governments, specialised agencies, academia and others supporting SMEs also need to modify approaches as necessary, being entrepreneurial themselves, based on the changing context. That not being the case, their efforts will end up addressing problems of the past and will consequently be inefficient in dealing with current and future issues.

Range of policy approaches

While there are multiple actors and many potential areas for action, there are no standard products or approaches which will work in every circumstance. As a first step, data is needed about the SME population in a given country or region before the appropriate actions or policies can be developed. Once the SMEs are identified, they should be segmented, not just according to size and industry, but also according to growth orientation.

Further assessment is then required to determine the needs of those groups of SMEs. At that stage, it is important to reach out to SMEs and to hear directly from them regarding the challenges and opportunities they face. Effective dialogue between policy makers and SMEs is often less substantial than is desirable. SMEs have varying needs and managers have limited time. Support and intervention therefore need to be both targeted and of good quality.

There are a number of areas in which actions can be taken to reduce the barriers to conducting business abroad and, in fact, many efforts are already in place or being tested in various countries and regions. Below is a list of key areas for action and associated policy recommendations for addressing the market gaps that impede the internationalisation of SMEs.

Creating an openness to internationalisation

To create a culture of internationalisation there needs to be a positive attitude towards international markets. Public institutions play a key function in influencing attitudes and motivations by providing information and incentives. Specialised agencies, public-private partnerships and other support mechanisms create a context of social cohesion which can contribute positively to building and sustaining an entrepreneurial and internationally-focused environment.

As seen in many regions and clusters around the world, pioneers or champions play an important scouting role which can often later be leveraged by the whole local system. In addition, role models are important for changing attitudes and raising awareness. Examples should be made and publicised of local entrepreneurs who have been successful in internationalising.

Strategy formulation in small firms tends to be a less formal and less comprehensive process, with key decision makers making contingency-based decisions derived from the practical knowledge they hold. Programs specifically focused on further developing the international orientation of leaders and key decision makers in SMEs could be extremely valuable (Lloyd-Reason *et al.* 2004).

Encouraging entrepreneurs to learn foreign languages is also critical. Without the ability to communicate, there is little chance that any business can be conducted across borders.

Making information about international trade and business readily available

SMEs need to know how and where to access basic information about exporting and international trade. Providing easily accessible information with regard to specific information on tax, regulations and finance in foreign countries is therefore important in creating a broader pool of SMEs who decide to internationalise.

Encouraging the provision of targeted and quality business support services

A variety of business support services are provided by various players, both public and private. These include counselling, consulting and competence development through functional workshops and related activities. However, the quality of those programs is mixed, the content varied and awareness of these programs is low. In addition, many of these programs focus too heavily on exporting, rather than on the full range of internationalisation options available to SMEs (European Commission, 2004).

Areas in which SMEs wanting to internationalise often seek outside support include: technology, product standards and quality; access to, and use of, information related technologies; export directed training programmes; legal and accountancy services with a specialist export orientation; finance and marketing. However, there is concern that SMEs have resorted to using such services in a haphazard and ad hoc manner, reflecting the particular needs perceived at any given point in time by the key decision makers themselves, rather than using such support services as part of a strategic approach to internationalisation (Lloyd-Reason *et al.* 2004).

Perhaps some type of modular, accredited programs could improve not only the quality of these functional programs, but also their use among SMEs by providing clear modules, perhaps even with certification. In addition, there should be some quality measures, benchmarks, standards or minimum satisfaction ratings for these functional programs to ensure they are meeting the needs of the SMEs. Charging fees is one way to ensure that the product is meeting a demand.

Reforming education

In order to help prepare SMEs to access foreign markets, public authorities have recognised the importance of fostering competitiveness and productivity through training, modernisation of production equipment and transfer of methods and technology. Education plays a key role in both immediate technical and managerial training.

There is the need of longer term improvements in educational systems and teaching methods (from "rote" method to more creative, interactive learning methods). The World Employment Report (ILO, 2001) highlights the increasing importance of '…a variety of foundation skills, such as the ability to learn, to communicate and to analyse and solve problems, all of which are essential to work environments that rely on rapid innovation, and the interpersonal exchange and creation of knowledge'.

Governments and universities have begun to put educational reform high on their agendas. Universities in Europe are undergoing tremendous change through the implementation of the Bologna agreement which is creating clear standards between institutions of higher education. However, curriculum content must be rapidly overhauled as well and geared towards developing problem-solving skills which are greatly needed in today's knowledge-based society.

In addition, many technical and scientific universities have been establishing contacts with the private sector to build partnerships and links to promote technology transfer and the spin-off of new companies. Business schools are also increasingly integrating business people and entrepreneurs in their activities.

These changes are steps in the right direction but more needs to be done to foster an entrepreneurial and international mindset amongst students, who will become the workforce of tomorrow. Universities should formalise entrepreneurship as an important part of the curriculum and ensure students are exposed to all of the entrepreneurial growth phases, not just the start-up phase. There should be more international content within curricula as well as faculty with international experience themselves. On the last point, more must be done to facilitate faculty collaboration, exchanges and research across borders (Twaalfhoven and Wilson 2005). Apprenticeship has always played an important role in training and development. Creating internships for young people to work in foreign countries could be useful as well as targeted training programs for groups of entrepreneurs, focused on development of management capabilities.

Building of networks (cross sector and cross border)

Many support measures exist to help SMEs to link up with and engage in joint activities and ventures with overseas partners. These include corporate matchmaking services, customised market research intelligence and assistance with standards and quality issues. Also, the creation of networks in which entrepreneurs can come together for advice and mutual support is important. This provides an opportunity for shared learning about successes, failures and best practices. Regional development agencies and other related organisations play an important role in initiating opportunities for SMEs to establish cross border networks.

- Possible public policies to promote alliances and networks among SMEs include:
  - Improving SMEs access to information about networking opportunities.
  - Encouraging cooperation between all stakeholders: SME associations, public agencies and intermediary organisations.
  - Strengthening international linkages between national and regional hubs of relevant information flows.
- Increase the participation of SMEs in research and innovation networks.
  - Greater SME involvement in existing (regional, national and global) public-private partnerships.
- Support the emergence and maintenance of innovative clusters.
  - Stimulate collaboration between public and private research institutions.
  - Improve the availability of market information.
  - Strengthen cooperation among firms.
- Identify and promote best practice policies which support company innovation through cluster development.
  - Exchange experiences at the national and international levels.

Providing financial incentives and assistance

Public sector agencies provide specific tools such as grants for the commercialisation of products and financial and insurance support. Export credit insurance continues to be provided widely as well as other traditional types of trade-related support such as assistance for participation in international fairs and trade missions (OECD, 2005). Another policy measure is supporting export consortia to make available special funds to finance SME presence in international markets, or to favour access to credit on favourable conditions for international SME activities.

Supporting the development of a vibrant financial and venture capital community is also critical to the long-term sustainability of SMEs and high-growth oriented and internationally-minded entrepreneurs. Measures should be taken to address the primary funding gap, which is at the seed or early stage of new ventures.

Cutting the administrative burden of cross border activities

As seen earlier in this paper, administrative costs and burdens are among the leading barriers for SME internationalisation. An OECD (2004) background report prepared for the Istanbul SME

Ministerial Conference recommended that governments encourage the smooth, cross-border growth of SMEs by reducing the need for internationally active SMEs to comply with multiple sets of rules or requirements.

Important areas in this regard include standards, intellectual property rights, financial market regulations and other regulatory domains.

Encouraging trade and investment

The benefits of trade are well documented. So are some of the barriers to trade. Tariffs, quotas and distance from large markets greatly increase the cost of goods, sometimes enough to prevent trading completely. Global and regional agreements have lessened these barriers but more reform is needed (World Bank, 2005).

The OECD (2004) recommended that governments promote the role that foreign direct investment can play as a vehicle for SMEs to access international markets. In particular, the inclusion of local SMEs in the supply chains of multinational enterprises, and their resultant (indirect) involvement in exporting activity can lead to significant diffusion of technology and more efficient business models, thereby raising the international competitiveness of SMEs.

Proactive targeting of potential sources of inward FDI is increasingly seen as an important element of regional development strategies, especially in supporting export orientation, employment levels, technology transfers and cluster development amongst SMEs in the region (Lloyd-Reason *et al.* 2004).

Policies on outward FDI have three levels: capital account liberalisation; passive promotion, usually through bilateral investment treaties and double taxation treaties; and active promotion. In the last area, even in the largest developed countries (United States, United Kingdom, Japan, Germany etc.), outward FDI requires and receives active public assistance (UNCTAD 1999). This is usually in the form of an outward investment promotion agency, a development finance institution, or an investment guarantee scheme. Their services cover a wide range of areas, including information and promotional services, feasibility studies, project development, financing and guarantees (European Council, 2002).

Reinforcing the legal framework

There should be a level playing field between old and new firms. This can be done by protecting intellectual property (IP) and discouraging monopolies and unfair trade practices. Developing nations must resist pressures from existing businesses to preserve markets and prevent innovation (Schramm 2004). In term of intellectual property rights, SMEs lack a good working understanding of the system and consequently under-exploit current forms of IP protection.

In transition countries, enforcement of the legal framework is critical. Policies need to be consistent and equally applied. Otherwise, many SMEs will continue to operate “under the radar screen” in the informal sector.

THE SOUTH EAST EUROPE CONTEXT

SME internationalisation in South East Europe

The 2003 South East Europe (SEE) Regional Enterprise Policy Performance Assessment (OECD-EBRD, 2003) specifies that small and medium-sized enterprises (SMEs) play a crucial role in the transition processes in South East European countries. However, securing accurate data on SMEs in transition countries is extremely difficult due to both a paucity of accurate statistics as well as the high incidence of SMEs operating in the informal economy. Nevertheless, there is broad agreement that while the current contribution of SMEs to the internationalisation process in transitional economies is understated, much untapped potential still exists (Lloyd-Reason *et al.* 2004).

Integration with Europe provides many incentives for countries in the region. Croatia began full membership talks with the EU in October 2005 and both Serbia and Montenegro and Bosnia Herzegovina began preliminary stages which should lead to talks. In December 2005, FYR of Macedonia gained formal status as a candidate. Talks with Albania continue. Meanwhile, various economic deals have been done between the Balkans and the EU (The Economist, 2006). While providing access to an enlarged economic area, EU enlargement will also require SMEs to face a more complex and dynamic environment which will require greater competitiveness in terms of improved quality, efficiency and management practices (Szabo, 2002).

As might be expected, competitiveness in the region is currently lower than in the rest of Europe (World Economic Forum, 2005). The highest scoring country from the region was Croatia, which ranked 63 in the overall Business Competitiveness Index (BCI) but was behind all of the EU countries, including the ten new members. Romania and Bulgaria followed at overall BCI ranks of 67 and 78 respectively.

Table 6. 2005 Competitiveness rankings

	Slovenia (EU)	Croatia	Bosnia & Herzegovina	Serbia & Montenegro	Albania	FYR of Macedonia	Bulgaria	Romania	Moldova
Business (BCI)	32	63	94	86	112	83	78	67	93
Growth (GCI)	32	62	95	80	100	85	58	67	82

Source: World Economic Forum Competitiveness Report 2005 (116 countries ranked. Results based on country responses to surveys)

The 2006 Doing Business (World Bank, 2006) report ranks the overall ease of doing business in countries around the world. As a proxy for the ease of importing and exporting, the table below compares the number of days it takes for each of the two operations. Interestingly, it takes more days to import than to export.

Table 7. 2006 Doing business statistics

	Slovenia (EU)	Croatia	Bosnia & Herzegovina	Serbia & Montenegro	Albania	FYR of Macedonia	Bulgaria	Romania	Moldova
Overall ease of doing business (ranking)*	63	118	87	92	117	81	62	78	83
Importing (days)	24	37	43	44	38	35	24	28	35
Exporting (days)	20	35	32	32	37	32	26	27	33

*Ranking has been obtained on a total of 155 countries

Source: Doing Business in 2006 (World Bank & IFC)

While progress has been made in SEE countries, much remains to be done to maximise the potential contribution of SMEs to new jobs, growth, productivity and competitiveness. Strategies, plans and newly established agencies focusing on SMEs require both resources and a commitment to implementation with coordination at the national, regional and local levels. The 2003 SEE Regional Enterprise Policy Performance Assessment (OECD-EBRD, 2003) identified six key areas which are critical to developing a supportive environment for small businesses. These include an institutional framework for SME policy, rule of law and the regulatory environment, tax policy for small businesses, financial instruments for fostering small businesses and advisory services supplied to new and small businesses. Until a basic framework is in place, it will be difficult for SMEs in the region to thrive, much less to internationalise.

Imports, exports and FDI

Currently, very few SMEs in the region are international but the situation is changing. As seen in table 6 below, the growth rates of imports and exports in South East European countries have been strong. The rapid growth in exports mainly reflects strong foreign demand, but also could indicate better access to markets as a result of EU enlargement. Under the Stabilisation and Association Process arrangements, 80 percent of exports from the Western Balkans benefit from free market access to the EU. Some of those countries did not have prior preferential trade agreements, only MFN status, with the countries that acceded to the EU in May 2004 (UNECE, 2005).

Table 8. 2003 growth rates in imports and exports (rates of change and shares, per cent)

	Slovenia (EU)	Croatia	Bosnia & Herzegovina	Serbia & Montenegro	Albania	FYR of Macedonia	Bulgaria	Romania
Imports	26.7	32.4	22.1	18.8	24.1	15.3	35.9	34.4
Exports	23.3	25.7	35.4	11.5	35.2	22.2	30.7	27

Source: Economic Survey of Europe, UNECE 2005, p.93

From the mid-1990s, *inward foreign direct investment* (FDI) gained importance in an increasing number of CEE countries, reinforcing a successful reintegration of these countries into the world economy. *Outward FDI* has not yet reached a level similar to that of inward FDI, although official statistics on FDI may underestimate the real size of outward FDI. What is available usually confirms the young status of those investments. In most CEE countries, outward FDI seems to be hampered by a lack of management skills and know-how necessary to undertake investments abroad and to run a foreign business venture successfully (UNCTAD, 1996). In the longer run, outward FDI from CEE is likely to gain in importance as accession countries are expected to lose comparative advantage in simple manufacturing (assembly) operations based on low wages (European Council, 2002).

Table 9. South East Europe: FDI flows 2004 (as percentage of gross fixed capital formation)

	Croatia	Bosnia & Herzegovina	Serbia & Montenegro	Albania	FYR of Macedonia	Bulgaria	Romania	SEE REGION
FDI flows								
Inward	11.4	29.7	24.6	26.0	16.2	49.2	31.7	27.6
Outward	*3.3*	*0.1*	..	..	*0.1*	*-4.5*	*0.4*	*0.5*
Performance index*								
Inward	33.0	**	**	42.0	72.0	12.0	35.0	
Outward	*32.0*	**	**	*103.0*	*98.0*	*125.0*	*77.0*	

*FDI performance index covering 140 and 132 economies respectively

**Not covered by the survey.

Source: World Investment Report 2005

A look at the western Balkan countries

Croatia

The EPPA of Croatia (OECD-EBRD, 2005a) reported that, in overall terms, good progress had been made in setting out and beginning implementation of new policies to support the growth and development of SMEs. Croatia developed a well-articulated and far-reaching enterprise policy framework and launched a series of initiatives directed at providing financial and operational support to SMEs at the national and regional level. During 2004, Croatia launched new financial facilities for SMEs and refinanced existing ones, introduced new e-government schemes and endorsed the 'one stop shop' concept as a way to speed-up regulatory simplification.

Bosnia and Herzegovina

In the years since the war, Bosnia and Herzegovina has faced numerous transition challenges such as the establishment and development of a democratic society and the return of refugees and displaced persons at the same time as a transition to a market economy. According to the EPPA of Bosnia and Herzegovina (OECD-EBRD, 2005b), the authorities of the country are increasing the levels of support to the SME sector with the creation of SME-oriented organisations at the national, regional and local levels, as well as the approval of the Development Strategy Framework and the Interim Poverty Reduction Strategy Programme, both having an important private sector development focus. Recent legislative and regulatory changes have been implemented to simplify and improve the business environment.

FYR of Macedonia

In recognition of the growing importance of SMEs to the national economy, the Macedonian authorities are increasingly supporting the SME sector (OECD-EBRD, 2003a). This political support is reflected in developments such as a programme to stimulate domestic and foreign investment, a strategy to support entrepreneurship and competitiveness of SMEs, a new agency to support entrepreneurship and competitiveness and a co-ordinating Council for Entrepreneurship and Competitiveness, which includes participants from relevant ministries, private sector and other SME stakeholders.

Serbia and Montenegro

The EPPA of Serbia and Montenegro (OECD-EBRD, 2005c) indicates that the country has made progress in implementing better policies for the SME sector. The overall picture is that of gradual but limited and uneven progress over the broad spectrum of the policy dimensions outlined by EPPA. As might be expected, few SMEs in the country are international. Challenges include the lack of competitiveness of domestic enterprises, products and services, the need to modernise production, processing, packaging, the need to find new ways of selling and the necessity to adjust standards and other quality regulations to those of the EU. Understanding of legal regulations, especially in the areas of tax policy and custom duties is also important.

Albania

According to the EPPA of Albania (OECD-EBRD, 2004), SMEs make up the vast majority of private businesses in the country but most firms do not yet possess the required skills to compete with western European markets and are facing a number of constraints that, if not addressed, will continue to prevent the SMEs from achieving their full potential. Poor law enforcement, very weak corporate governance, both at the macro and at the enterprise levels, a lack of management skills, as well as underdeveloped banking systems and crumbling infrastructure, constitute major impediments to the development of the private economy and the attraction of foreign direct investment (FDI).

According to the Regional Development Agency (RDA) in Albania, the procedures for start-ups are still complicated and the labour market policy needs further improvement as does the legal and institutional environment. The informal economy remains high, around 30-40%, according to estimates by RDA. Challenges for SME integration in regional and European markets include: quality standard of products and competitive prices; specialisation of less sophisticated products based on competitive advantage; investments in traditional and local products with export potential; focus on marketing channels and export strategies; better use of the economic potential of expatriate communities; use of SME clusters in the SEE region combined with domestic market needs; investments in high technology to replace old technologies; transfer of know-how. better access of foreign markets.

Regional networks and international development activities

Clearly regional networks and links to the EU are tremendously important for the internationalisation and development of the region. In addition, it would be helpful for SMEs to collaborate more with each other to maximise the chance of success. The authorities in the region are increasing the levels of support to the SME sector in recognition of its growing importance to the national economy. This political support is manifested in developments such as the creation of SME-oriented organisations at national, regional and local levels. These include ministries and specialised agencies geared toward SME development, which can also play important roles in SME internationalisation.

In the box below are some examples of efforts being undertaken by various organisations in the region to encourage the growth and internationalisation of SMEs.

Box 2. Key organisations promoting internationalisation in SEE

SMECA. Smeca is an export credit agency which has as its mission to support sustainable economic growth in Serbia and Montenegro, increase the level of export activities and reduce the deficit in the balance of payments. SMECA does so by providing domestic enterprises with the necessary financing, security and technical assistance to gain market share and enter new international markets. Exporting is supported through export credit insurance, working capital loans and guarantees, exporter performance insurance and guarantees, factoring, import insurance/guarantees and consulting services. Import is supported through political risk insurance and import insurance and guarantees. Further information can be found on www.smeca.cg.yu.

RDA. The Regional Development Agency (RDA) in Albania launched the PPC Programme, a qualification scheme for junior executives and young professionals in SEE countries designed to help companies enhance their business performance. The programme is geared towards companies who want to export their goods and services as well as those looking to establish cooperation with foreign partners. So far, the programme has yielded good results. Key components of the programme include the focus on export-oriented entrepreneurs, providing capacity building and training as well as the charging of fees to ensure market relevancy and continuity.

Montenegro Business Alliance. The Montenegro Business Alliance (MBA) was founded in 2001. It is a coalition of more than 400 Montenegrin companies, entrepreneurs, business associations and international companies representing over 25% of GDP in Montenegro. The main activities of MBA are advocacy on the business agenda, promotion of MBA members, education, seminars and conferences. One of these activities is called “Business to Business”, which are a series of events to renew economic relationships between SEE countries, organised in coordination with similar organisations from other countries). For more information see www.visit-MBA.org

CEED. The Center for Entrepreneurship and Economic Development (CEED) in Serbia and Montenegro was established in 1993. The goals of CEED are to improve the business environment and promote it regionally as well as around the world, to change the mindset of the people by introducing best practices and promoting successful case studies and to raise a new generation of entrepreneurs. The primary services offered by CEED include 1) research, economic surveys and SME database development 2) policy analysis and recommendations 3) business consulting services 4) business plan development for aspiring entrepreneurs 5) basic and advanced business training for start-up and established firms 6) support for women entrepreneurs 7) publishing. CEED’s initial efforts have focused on issues such as time consuming and expensive business registration processes, high taxes and levies, lack of competitive knowledge and modern technology and the grey economy. For more information, see www.visit-ceed.org

CONCLUSIONS AND POLICY RECOMMENDATIONS

In conclusion, there are two broad areas in which policies can support the internationalisation of SMEs by addressing existing market failures:

1. Creating the right framework conditions.

    a. Legal and regulatory.

    b. Trade and investment.

    c. Education, training and culture.

2. Supporting specific SME policies and initiatives.

    a. Reducing the administration burden of cross border activities.

    b. Supporting appropriate financial instruments.

    c. Facilitating quality advisory services for new and small businesses.

    d. Encouraging networks (local, regional, international).

Contextual issues need to be dealt with at the national and international levels while specific policies and services are best handled at the national and local levels.

For the countries in the SEE region, SME policies are being put in place and specific initiatives are increasingly gaining support. Intermediaries are being established to help in this process. These include specialised agencies, NGOs and private sector organisations. At the same time, progress is being made on improving the framework conditions, which clearly must be in place in order for the economy and SMEs to thrive and grow.

For countries with sufficient framework conditions in place, focusing support on specific activities and services is important to encourage SMEs to internationalise. This includes providing the necessary information to assist internationalisation, including detailed information about doing business abroad as well as training and providing financial incentives and assistance, as well as facilitating networks at the local, regional and international levels. The service providers should be in close dialogue with SMEs to understand their specific needs and the services should be targeted appropriately to each market segment.

Policy makers should focus on reducing the administration burden of cross-border activities, facilitating both import and exports and encouraging collaboration between SMEs and larger firms, both locally and internationally.

Globalisation is a reality, not a trend or a fad, and it is driving internationalisation in all markets, including at the local level. Globalisation brings new challenges but also provides unprecedented opportunities to rejuvenate old businesses, grow new ones and create new jobs (Kanter, 1995). There are challenges in going global but the risks are even greater in waiting for globalisation to reach the local market and having to deal reactively with the consequences.

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CHAPTER 3:

PROMOTING SME INNOVATION

by
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Continuous innovation is central to economic prosperity; how such innovation is to be achieved in the globally competitive marketplace is therefore of the utmost importance. Policies which reflect and respond to the needs of specific localities or regions are required if they are to be effective in encouraging innovation rather than simply importing successful policies from other areas. Such responsiveness does not preclude, however, the recognition of a number of key factors to the development of policies which aid and encourage innovation to occur. This chapter explores those factors and the various tools that can be utilised so as to encourage innovation.

INTRODUCTION

The common economic context of developed countries in the early 21st century is conditioned by, amongst other things, the following two factors:

1. A permanent process of economic change and accelerated innovation based on specific, systematic activity organised at the private level in businesses and at the public level in the territorial (country, region, etc.) environment in which businesses operate.

2. A process of globalisation involving a growing number of activities and affecting local markets that goes beyond simple internationalisation (Feldstein, 2000). As Frankel puts it: "The two major drivers of economic globalisation are reduced costs to transportation and communication in the private sector, and reduced policy barriers to trade and investment on the part of the public sector. Technological progress and innovation have long been driving the costs of transportation and communications steadily lower..." (Frankel, 2000, p. 2)

One consequence of these processes is the increased importance of regional and local public authorities as facilitators of local networks, previously assured informally by private players. These networks, as a result of breakages caused by globalisation, now require organised intermediary bodies with new strategic capabilities to adapt local production systems to the competitive conditions of a globalised environment.

Businesses everywhere now confront an increasing number of competitors, which in some cases are based on low labour costs, and in others receive substantial support from governments in the shape of research, education, information and other infrastructure. This explains the need for businesses to become more efficient, and to produce increasingly innovative products. In such conditions, one key to growth in the framework of sustainable economic development lies in the capacity and willingness of businesses to innovate in their products, processes and their information and management systems (Malerba, 1992; Teece and Pisano, 1994; Herrigel, 2000).

It is increasingly difficult for enterprises in developed countries to survive exclusively on cost advantages. Even countries in South Eastern Europe (SEE), where foreign investment is currently made largely because of low labour costs, must take account of labour force quality and the facilities available for accessing markets as factors which influence investment decisions.

Bearing in mind that in the medium-term labour costs are set to increase substantially, other non-price-based factors generating added value are clearly going to become increasingly important in decisions made by foreign and domestic investors. Such factors, which go a long way to explaining business competitiveness in the most developed (and most expensive) countries, are to be found in product design, the technological capability to generate improvements therein or to design new ones, constant improvements in the way businesses organise and manage production, and a whole group of other elements that can be classified under the heading of 'innovation'. These lie at the heart of the competitiveness of businesses and territories.

However, it is often difficult for some businesses, such as those in traditional sectors located in developed countries and regions, to find the resources needed to implement successful, lasting innovations. These businesses, like those in more advanced areas, are faced with the need to make continuous changes in technology, management, human capital, financing and market globalisation to be able to compete effectively. The problem is that they do not always possess the right internal skills, or do not know where to look for them outside the company so as to be able to make such changes; this is particularly true for small and medium enterprises (SMEs), especially newly created ones.

Besides being the main determinant of the increase in business productivity and competitiveness, innovation is a dynamic process which works more efficiently in contexts where there is an intense interaction between those who 'produce' knowledge and those who 'acquire and apply' it in the production process (OECD, 2001; Tidd, 2006). In this context, where knowledge and information are increasingly important in maintaining competitiveness, measures oriented towards changing behaviour patterns and generating a varied range of co-operative processes are an essential ingredient of the policies promoted by the public sector. That is why public policy has shifted towards creating competitive environments and where support for innovation and technology is gradually replacing the old subsidy culture.

Back in the 1990s, according to the OECD report *The Knowledge-Based Economy* (OECD, 1996) something like 50% of the GDP of developed countries originated in investments in hi-tech products and services, mainly in information technology (IT). Since then, this kind of activity has become increasingly important in maintaining the economic advantage of regions and/or countries. However, despite the generalised spread of the concept of innovation and of the efforts made to promote it in the public and private sectors, major differences in indicators still exist. This merely underscores the fact that, for all the generalisation of measures and the increasing efforts made, other intangible elements continue to mark the differences between countries.

Concepts such as networks, the transfer of know-how and the like, are essential factors in the knowledge society. More attention must be given to the structure of science and technology within a country and their relationship to the social and economic environments, notably business circles. Also requiring improvement are the skills people have to create new businesses and to maintain an environment of permanent competitive improvement and innovation within existing companies. Ultimately what is being called for is a new approach for innovation policy.

THE ISSUES

In modern society, the public sector clearly needs to ensure the provision of quality physical infrastructure, such as housing, transport, telecommunications, land for business and so on. It also needs to ensure that the education and training systems, university education in particular, have the ability to provide people with the qualifications that the production system needs. But with the minimum level of infrastructure assured, the role of the public sector must also include the creation of the conditions for innovation to take place. To do that, it must act as a link between business needs and the sources of information available from a range of actors.

Innovation promotion policies are therefore essential to European Community Regional Policy (European Commission, 2003 and 2004a represent two recent orientations in this sense).

> The EU will need to concentrate its actions on a number of major themes which have a direct bearing on industrial competitiveness, such as pan-European partnerships between the public and private sectors, with a view to bolstering technological research, research infrastructures, human resources, the dynamism and productivity of European research, the creation of poles of excellence and the coordination of national and regional research programs and policies (European Commission, 2004b, p. 26).

This has quite clearly moved the structural funds from the old infrastructure- and subsidy-oriented style (*opening roads*) to a new style based on support for the creation of environments (Martin, 2003; European Commission, 2004b) which promote innovation and sustainable improvements in competitiveness. This, in turn, aids those aspects that might be termed intangibles, such as knowledge transfer, culture, trust, reciprocity and partnerships (*opening minds*).

There is a tendency for policies to copy successful ones which are applied in the most dynamic areas; these tend to address hi-tech activities. One essential task in less developed regions is to increase innovation levels in small businesses in traditional sectors. This requires implementing a system which facilitates co-operation between the many actors in the regional innovation system. Such a move will only be possible by taking into account all the factors that facilitate the competitiveness of a particular economic activity, from the generators of new technologies in the academic world and technology centres, to businesses needing innovation support, without forgetting the whole range of support and representative bodies, which includes business organisations, chambers of commerce, technology transfer offices and development agencies.

This, then, is the context in which the major lines of a research and innovation policy need to be designed. They must take account of:

- The specific needs of the economy where the policy is to be applied, as no model is always applicable.

- The need to offer support to innovative activities with high technological content and also for those traditional sectors in which the region or country in question specialises.

- The need to transfer technology from universities and research centres to the business world, creating a trend of co-operation between the centres that generate knowledge and technology and the users that will be applying such knowledge in a bid to improve competitiveness in businesses.

All the actors involved need to actively support the establishment and maintenance of relationships between themselves. By ensuring the development of such relationships effective co-ordination is made possible between various research organisations, machinery producers, support bodies and private consultants, etc.

Innovation policy design for those areas which face significant problems must take account of the lessons learnt from other underdeveloped areas, which include:

- The need for small businesses to receive the necessary institutional support to efficiently meet the demands of the global market, particularly systematic innovation. This is a new development compared to 20 or 30 years ago with regard to the requirements for competitiveness when economic players moved in local frames with higher levels of stability.

- In areas that do not tend to generate new technological or innovative activities, the private sector is not able to structure the phases leading to improvements in competitiveness.

- The importance of the provision of finance (from the public sector to begin with) to assist with the implementation of new forms of action which demonstrate the effectiveness of co-operation.

A new area for potential government intervention – whether at local, regional or national levels – has appeared, one that involves providing support for new forms of organised innovation through the generation of an environment favourable to the exploitation of new technologies in businesses in all sectors.

POLICY OPTIONS

As a result of the previous analysis, one may now accept as a working hypothesis that in the immediate future financing will be increasingly directed towards creating horizontal conditions for competitiveness, to the gradual exclusion of direct aid – subsidies – to businesses.

Risks

For the new direction to be efficient, several risks will have to be avoided:

- Considering technology and innovation policy as something that concerns technicians and scientists only, when the ultimate objective is to generate innovation processes, which are essentially economic processes. In other words, from the point of view of innovation support policies, knowledge only has meaning to the extent that it is transformed into competitive products on the market. To this end, it is vital to promote the entrepreneurial spirit in businesses to promote the generation of new products within a company (referred to as "intrapreneurship") and in society as a whole, particularly in research centres and universities, as a way of encouraging the appearance of new business projects – spin-offs – that facilitate the transformation of research results into economic activity.

- Considering technology and innovation policy as an exclusively public field, when in fact it will only be effective if it is defined in line with real needs (objective problem) and expectations (subjective problem) of businesses. This explains the insistence on defining and applying such policy from the perspective of public-private partnerships.

- Considering that technology and innovation policy should only respond to existing problems, without showing sufficient anticipatory capacity. On the other hand, it may take some time before research outcomes find a concrete application in the production system. Far-sightedness and long-term approach should therefore go hand in hand.

- Neglecting the fact that technological innovation moves faster than social and cultural innovation. This accounts for the growing need to consider innovation as a global process combining social, cultural, economic and technological factors that interact more or less harmoniously depending on the country in question. Such considerations are particularly important in countries where the collective culture has been less market-oriented, and where cooperative behaviour is less noticeable and certainly less likely to lead to partnerships. Making the collective cultural base more favourable to innovation processes is a requisite for competitiveness (Youngs, 1997).

Basic elements

Requirements for defining a policy of this kind properly include:

- A political authority at a level sufficiently identified with the territory, either because it is the result of the institutionalisation of the local and regional spheres, or because central authority is sufficiently decentralised to appoint a delegate to manage development processes in different territories. In exceptional cases, in countries where civil society is strong and well established, associations representing different social and/or economic sectors may take on the role of the political authorities.

- The role of the private sector being taken into account. It should be seen as the basic powerhouse of the innovation process, in accordance with which the entire logic of the network should be constructed.

- Territorial diversity should be acknowledged in the policies developed and instruments applied. The reality of regional production sectors needs to be recognised, suitably combining support for the modernisation and competitiveness of traditional sectors with the search for new activities and hi-tech sectors to develop in industry and services.

- Regional technology priorities should be rationalised. This involves identifying the technology areas in which the region may have a competitive position but whose feasibility depends on global criteria on which the region has little capacity to act and for which there is no internal demand, owing to a lack of producer or assembly firms (in turn divided into the ones with a limited number of potential clients – *e.g.* aerospace – and emerging ones where market potential is broader – *e.g.* biomedicine); new areas where a competitive international position based on existing traditional resources can be developed from small businesses; areas which, owing to their horizontal nature, need to be assimilated by the production sector as a whole (software, telematics, IT, quality); and areas that are instrumental for some well-established traditional sectors (*e.g.* robotics, production technologies and materials in a region with a major ancillary automotive industry).

Depending on the above, we need to determine:

- The criteria for defining priorities, the combination of existing and future sectors, and of technological excellence and economic feasibility. This selection should be made in the light of explicit and implicit demand from regional businesses, as well as the opportunities in international markets. Technological developments, social customs and cultural resources, and existing research should also be taken into account.

- The actual design of the measures, which need to be attractive to ensure that businesses want them, and for the academic world and technology centres to feel sufficiently motivated by them to orient their activities towards providing technological support to production.

- The definition of an organisational instrument (agency) capable of putting the above considerations into practice. Such an agency would have to be able to work as an effective co-ordinating body, with significant flexibility to enable it to respond quickly and appropriately to changing needs. In most regions, this agency should not be focused exclusively towards high technology, as most of the regional production structure will probably be based on traditional sectors.

In a realistic appraisal, the basic objective is to spread innovative behaviour to as many businesses as possible in the region, including SMEs, while defining a pragmatic policy for promoting business initiatives in new sectors. For this to happen, an entrepreneurial culture needs to be promoted, and support provided for the creation of new and innovative enterprises. The appearance of new businesses will further contribute to territorial innovation processes. Indeed, economic innovation is based on entrepreneurship as the key factor in transforming new knowledge into useful knowledge.

This will only be possible with a robust – but non purely interventionist – public sector-based, market-oriented policy that seeks to transfer the definition of its orientations to the private sector as economic players begin to assume the need for innovation-related performances.

The specificities of this policy should be defined so that policy instrumentation itself acts to mobilise players and raise their levels of awareness, and where possible to generate new cooperation networks. Public and private leadership will legitimise innovation support processes and promote them in social, cultural and economic circles, in response to the truism that innovation processes are complex and clearly go beyond an exclusively technological environment.

Criteria

Decisions will be needed on the following issues:

a) Conducting specific programs designed to maintain competitiveness in traditional sectors, including, in particular, some that are occasionally neglected, such as the food industry and tourism.

b) Defining a differentiated policy with regard to major companies located in the region. To this end, companies capable of pulling other companies with them need to be identified, as do businesses that might welcome improvements in the technological quality of regional suppliers (a cluster or industrial district approach), firms that might be interested in taking advantage of regional programmes, and companies whose research and development and innovation (R&D&I) activities give them direct interlocutor status with the national authorities. The ultimate objective of these measures would be to increase the level of territorial insertion of all the large companies with which it is objectively possible to make progress on such a purpose.

c) Defining a policy to stimulate the appearance of new businesses in innovative sectors classified as priorities for regional development, differentiating between measures designed to stimulate the appearance of spin-offs and new local businesses (including an active policy to accompany them in the process of consolidation, i.e. in the five years after their foundation), and those designed to attract companies from outside. This entails defining a highly selective strategy to maximise the impact of external promotion measures financed with regional resources, which are always going to be relatively scarce.

d) Delimiting the players' role, even introducing elements of professional ethics into the configuration of any cooperation networks promoted or encouraged. This means differentiating between the roles of:

1. Planner, stimulator and regional evaluator (*e.g.* development agencies).

2. Territorial stimulator (*e.g.* the secretariat of a cluster, technology parks).

3. Basic knowledge and higher training centre (universities and higher schools).

4. Technology support infrastructures (*e.g.* technology centres).

5. Technology transfer offices.

6. Innovation support services centres (*e.g.* sector groups, business innovation centres, incubators, technological parks).

Although in some cases roles may overlap and even partially coincide in the same player, conceptually they are different and the operational scheme must be accepted to avoid overlapping and conflicts. Besides, from the functional viewpoint the incompatibility between the functions of stimulators (1 and 2) and those of roles designed to respond to specific demands is quite clear, among other reasons, because for stimulator functions to be effective they need to be neutral from the players that respond to them, and should be addressed basically to stimulating demand.

Management and partnership bodies

The creation of a transversal body to manage this policy is the crucial point from which the whole process is launched. This is so because it will be the specific expression of that political will, and because it is the instrument needed for its start-up, so its specific form and its powers are not inconsequential.

To begin with, this body should be given, symbolically and legally, the role of leader of the regional innovation support policy, which would grant it the capacity to legitimise that leadership by entering into fluid partnerships with the private sector and other institutions, from local up to the national and supranational levels.

R&D&I policy should be inserted in international networks that are of interest to regional economic development (Landabaso, Oughton and Morgan, 2001). This necessity derives from the special impact of networking for innovation processes:

> The importance of interacting in innovation processes makes it clear that networking is an essential means of knowledge exchange and learning. Networks bring actors, resources and activities together and are thereby to be regarded as a system.[...]
>
> Network economics define network by a long-term relationship of different partners who co-operate on the same hierarchical level in an environment of mutual understanding and trust, while market transactions are characterised by temporary, non-lasting interactions, mostly

> regulated by contracts ... Innovation networks are a specific mode of this arrangement. They are understood as all organisational forms between market hierarchy which serve for information, knowledge and resources exchange which help to implement innovation by mutual learning between the network partners. (Koschatzky, 2001, p.5)

To this end, it will have the kind of high profile and economies of scale that no individual player would be able to achieve, while at the same time it will need to respect the autonomy of these players and not try to control the broad, dynamic process of relations through bureaucratic means.

To achieve this partnership systematically, and to assure that policy orientations are linked to market requirements, forums need to be created in which individual businesses, business associations, intermediate bodies and territorial institutions are present and able to work together.

The specific form should be determined in line with the requirements of each issue. Formal criteria need to be avoided, and a distinction drawn between issues requiring institutional and global representation (through associations) and others requiring direct contact with business problems and opinions, in which case it is better to work directly with businesspeople even if they lack representation.

Spot decisions will be required on the need, or not, to create specific working groups to cover different issues, whether horizontal (attracting businesses, financing, human resources, relations between the major lead companies and SME) or sector-based (food industry, components, tourism, cultural assets, multimedia, biotechnology, etc.).

When defining action, the policy must take into account the broad view of the innovation concept, and integrate the need to improve human resources training as the ultimate support for innovative action. Apart from permanent vocational training, this issue highlights the need for fluid contact with universities, which thus becomes the long-term basis for the renewal of professional qualifications, and the basis of the scientific knowledge on which the technological innovation process ultimately depends.

Resources

Ensuring the availability of necessary resources is vital. Such resources include:

- Human resources, bearing in mind that the technical staff needed will require a high level of specialisation and dedication and that stimulating demand and partnerships generation is a labour intensive process.

- Financial, maintaining the balance between objectives and the available resources.

- Institutional, ensuring that the policy has both credibility and the legal capacity to perform its tasks.

A major step in achieving the objectives of a regional innovation policy (in particular those aimed at greater social mobilisation) is to define the resources for publicising its objectives and mobilising players to create consensus on its formulation. In new EU member countries this includes communicating the new problems and opportunities which arise from the application of Structural Funds and other European programmes to support improvements in regional innovative capability.

SME innovation policy instruments

SME innovation policy instruments are similar in most countries. What differentiates them is the way these instruments are actually utilised, such as in the promotion of innovation culture, information, financing, support infrastructures and the like. The current shift from purely investment-related financial measures to ones which complement financial support is not an end in itself; rather it is one means within a process of support for the introduction of new, more innovative behaviour patterns. Direct subsidies for research and development, plus the use of innovation support policy instruments such as research infrastructure are now accompanied by new measures where the parameters for success have to do with innovative activity.

The following table gives some examples of the type of instruments promoted in different parts of the OECD. These instruments change as innovation support policy becomes more sophisticated and more specific requirements can be utilised. Experiences in a number of countries have shown that there is no single solution to the current challenges facing SMEs. However, one common instrument is the promotion of networking at all stages, albeit with support provided for the configuration of business groups or clusters adapted to each global context.

Table 10. Innovation policy support instruments

1. PROMOTING INNOVATION CULTURE	
Mid- and long-term research, development and innovation (R&D&I) plans and/or strategies	R&D&I plans and strategies are instruments of innovation policy that set targets, measurements and actions for the mid- and long-term, with a view to coordinating actors in the regional innovation system.
Exchange of experience	Identification of practices which facilitate the exchange of experiences. The object is to improve the capacities of public authorities to define and apply innovation support policies.
2. INFORMATION	
One stop shops (business and administration)	One stop shops are designed to close the gap between the administration and business by means of a single contact point offering an integral service, while ensuring greater levels of co-operation.
Competitive intelligence	"Competitive intelligence is the process of obtaining, analysing, interpreting and distributing information of strategic value about industry and the competition, which is given to decision makers at the crucial time." Gibbons, P.; Prescott, J. 1996. *Parallel competitive intelligence processes in organisations*. International Journal of Technology, Special Issue On Informal Information Flow Management, Vol. 11, nº 1-2.)
Technology surveillance	"Technology surveillance consists of the observation and analysis of the science and technology environment and of the present and future economic impacts to identify threats to and opportunities for development." (Jakobiak, 1992, p. 108)
3. TECHNOLOGY TRANSFER	
Technology centres	"Technology centres are bodies with the mission to provide technology services, to perform R&D under contract, to transfer and publicise technology, to provide information and assessment on innovation management and even training. Their basic objective should be to facilitate the introduction of innovation culture in business and demonstrate that they too can, and must, innovate." (COTEC, 1998, p. 68)
Offices for the Transfer of Research Results	Interface structures working to stimulate relations between

	the academic science milieu and business circles, so that firms can take advantage of the results of research activity done at university. (Red OTRI-Red de Oficinas de Transferencia de Resultados de Investigación)
Industrial cluster	“Clusters are networks of interdependent firms, knowledge-producing institutions (universities, research institutes, technology-providing firms), bridging institutions (e.g. providers of technical or consultancy services) and customers, linked in a production chain which creates added value. The concept of cluster goes beyond that of firm networking, as it captures all forms of knowledge sharing and exchange”. (OECD, 1999, p. 56)
Competitiveness poles	“These involve combining, in a specific territory, firms, training centres and research units, in an association to create synergies around pooled innovation projects, which in France is designed to give them the size they need to work and flourish abroad.” (CIADT, 2004, p. 5)
University-business foundations	“These are organisations created by one or several universities and some kind of business organisation, frequently Chambers of Commerce. They work as information and coordination centres for firm in their relations with universities, thereby giving them a better idea of the university in its social and economic context. Basically, these foundations manage and administrate projects, organise training activities, promote in-house practice and the diffusion of technical publications.” (COTEC, 1998, p. 72)
4. CREATING BUSINESSES	
Spin-offs	When one or more individual/s is/are leaving an organisation (quitting his/her/their employment) with the intention to start a new firm that is based on elements from the firm he/she/they is/are leaving, and where the originating organisation (the employer) has neither a dominant influence in the new firm according to ownership or power.” (Ahlström Söderling, 1998, p. 3)
Incubators and business innovation centres	“Business incubation is a dynamic process of business enterprise development. Incubators nurture young firms, helping them to survive and grow during the start-up period when they are most vulnerable. Incubators provide hands-on management assistance, access to financing and orchestrated exposure to critical business or technical support services. They also offer entrepreneurial firms shared office services, access to equipment, flexible leases and expandable space - all under one roof.” (NBIA National Business Incubation Association)
5. R&D&I SUPPORT INFRASTRUCTURE	
Science and technology parks	“A Technology and Science Park is an organisation managed by specialised professionals, whose main aim is to increase the wealth of its community by promoting the culture of innovation and the competitiveness of its associated businesses and knowledge-based institutions. To achieve these goals, a Technology and Science Park stimulates and manages the flow of knowledge and technology between universities, R&D institutions, companies and markets; it facilitates the creation and growth of innovation-based companies through incubation and spin-off processes; and provides other value-added services together with high quality space and facilities”. (IASP International Board, 6 February 2002)

Testing and measurement laboratories	"They are bodies entrusted with performing trials and tests on materials or final products. They also certify that the products in question comply with existing official standards." (COTEC, 1998, p. 71)
6. FINANCING R&D&I	
Venture capital	Temporary shareholdings in the capital of non-financial, non-real estate businesses. Businesses benefiting from this type of financing work in dynamic or strategic sectors but whose operations may have a high risk factor. Once the firm has passed through the development phase, or is fully consolidated, the venture capital investor withdraws their stake in the firm's capital.
Mutual guarantee	Mutual guarantee companies back SMEs in their dealings with financial institutions by giving them access to different sources of financing.
Seed capital	Money used for the initial investment in a project or start-up company, for market research or initial product development.
Business angels	"Business Angels are defined as private investors, also called informal investors, who invest in unquoted small and medium sized businesses. They are often businessmen and women who have sold their business, and provide not only finance but also their experience and their business skills to the entrepreneurs with whom they are in contact." (EBAN European Business Angels Network, 2004, p. 1)
Stakeholder loans	A financial instrument that improves SMEs' financial structure during the key stages of business development. They have more favourable interest rates and do not require real guarantees, putting the emphasis on the viability of the project. For these reasons, it can be considered an instrument of economic and innovation promotion policies.
Tax incentives	Instruments for R&D&I promotion usually involve tax deductions on investments in R&D&I activities.
Financial aid programmes	Public support to businesses can include financial aid programmes with a series of requirements and/or measures with which the firm must comply to receive such support.

Besides these instruments, economic, regional and local development agencies have also developed in different ways in different places.

> In spite of their diversity, development agencies have developed original forms of economic intervention amongst which are principally those of:
>
> - Assisting in company creation; counselling companies and training their staff.
> - Promotion of enterprise zones or attraction of local or foreign investors.
> - Stimulation of technology transfer and inter-firm partnership.
> - Creation and management of company incubators.
> - Provision, in certain countries, of risk capital.
> - Conducting studies and territorial planning initiatives.

- Regeneration of areas made derelict by industrial blight. (EURADA Web site, www.eurada.org/whatwedo.php?menu=2, accessed 20 November 2006)

The use of such measures and instruments depends on the case in question. Indeed, policy success requires a suitable combination of instruments adapted to specific local features.

Rather than a change in the instruments employed, the shift towards a knowledge society requires them to be reoriented in a context of global change in business innovation promotion policy. This implies devoting resources to spreading innovation culture.

One measure involving a growing concentration of efforts is the promotion of clustering and encouraging regional businesses to work together to obtain the critical mass needed to conduct joint research and innovation, including stable cooperation with universities and technology centres.

Another key measure now being added to country-wide policy agendas is the concern to promote entrepreneurship as a vital element in tackling the creation of more innovative companies, and favouring the development of new technology- and knowledge-based activities. To that end, together with specific promotion initiatives, increasing efforts are being directed at creating innovative project incubators, to analyse aid processes and to develop an integrated entrepreneur support system.

Box 3. SME innovation: the cases of Castilla y León and Balearic Islands

Examples abound of the efficient application of innovation policies in SMEs, all of which could be used for case study analysis. We have selected two that have certain unusual features that make them noteworthy. The first arose from the combination of innovation support instruments, like technology centres, with innovation support networks. The innovative nature of the second case lay in its use of innovation policy, more commonly linked to the development of traditional and/or more industrial sectors, in the services sector and in particular towards the tourist industry which has major innovation potential across all facets of its economic activity

The first case occurred in Castilla y León, where a regional network of innovation agents was started up as part of a pilot programme called LEGITE, itself defined in the framework of the Regional Innovation Strategy and supported within the European Regional Development Fund (ERDF)'s Regional Innovative Action Programme.

The measure was a clear case of integrated action in that it combined support for SMEs scattered over a sparsely populated territory with the coordination of the regional technology supply as a whole. This was done in a bid to provide an agile, close-at-hand and efficient response to the specific needs of SMEs and to reduce territorial imbalances in innovation and competitive development.

Working in the frame of a set of complementary measures designed to stimulate the demand for innovation, the creation of sector-based science forums and the development of competitive surveillance, the network's activity was a key factor in incorporating innovation processes in new businesses, and above all enabled progress to be made on territorial integration in a general setting of cooperation between the private and public sectors. In this way, LEGITE has facilitated the use of the services of technological centres and technological transfer units located in big cities to SMEs in peripheral areas.

In the Balearic Islands, innovation policy focused on supporting businesses linked to the tourist industry. A cluster-oriented perspective of tourist activity led to an analysis of the supply chain of hotel and tourist firms. The analysis of what was required for innovation amongst enterprises led to the detection of major potential for technological and innovative improvements in software, food technology, energy and building materials. A future development here is the creation of a technological centre and a tourist industry innovation centre which will help to improve the diffusion of innovation processes in the region.

THE SOUTH EAST EUROPE CONTEXT

The development of an appropriate regional innovation support policy is particularly important in less developed regions (Morgan and Nauwelaers, 2003), as is the case in SEE, with virtually no innovative culture and traditionally low levels of scientific and technological resources. Getting such a policy right is vital if a region's strong points are to be properly harnessed and obstacles to the development of innovation are to be overcome.

A more integrated vision of innovation needs to be imbued, from the institutions working in basic research, through to the businesses that take their products and services to compete in the market, to the market itself where the economic and social results of innovation are put to the test.

One key to success lies in the capacity of the interested parties to co-ordinate actions within a consensual framework. In this approach, public authorities must stimulate both business and scientific circles, with subsidies and direct aid to businesses becoming less and less important.

The general objective of the approach can be summed up as the definition of an innovation support strategy in the short, mid and long terms, which is agreed on by the most representative economic, social and institutional regional actors. Such an approach should be designed to improve business innovation potential as a means of increasing competitiveness in global markets. Subsequently, new measures and programmes that complement this approach would need to be designed and implemented.

It has often been difficult to apply these ideas in less developed regions, which until recently had based their regional development policies almost exclusively on the creation of new infrastructures – including scientific ones – and on the provision of aid (subsidies) to business. The challenge is to define and develop innovation support policies based on the generation of public-private and inter-institutional partnerships, and the creation of an environment favourable to innovation in which enterprises find the necessary elements (qualified staff, suitable science and technology supply, venture capital funds, etc.) that they need to be competitive.

An interesting cross-national comparative study on research and development in Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR of Macedonia, Serbia and Montenegro has been developed by the Austrian Society for the Promotion of Research. The Western Balkans, Romania and Bulgaria are characterised by national innovation systems that are undergoing radical institutional and structural changes, and a research and technology infrastructure that is largely obsolete with a disproportional amount of basic research undertaken. This is combined with very low business expenditure on R&D, and often relatively aged human potential in R&D, which is hindered by the negative effects of the internal and external brain drain and suboptimal integration into European research and technology projects (Gesellshaft zur Förderung der Forschung, 2006).

At the European Council meeting in Lisbon the EU set itself "a new strategic goal for the next decade: to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion." (Lisbon European Council, Presidency conclusions, 2000). There is certainly a general understanding of the importance of innovation as a concept in the SEE countries, but the kind of polices required to encourage innovation and its integration in a wider policy setting have not yet been adequately implemented or understood in the region (Gesellshaft zur Förderung der Forschung, 2006).

For a strategy which seeks to promote innovation to be successful and effective, some basic premises need to be fulfilled in the territory in question. A selection is outlined below.

A mid- to long-term perspective

To begin with, territorial/regional development policies must be conceived as long-term policies, as their final objectives are the transformation of the regional production system, growth in production and improvements in the population's quality of life. The need to achieve cultural and social changes and a shift in attitudes, besides economic change, makes the mid- to long-term perspective vital in consolidating the process and ensuring that it is assimilated and accepted by business circles and regional society as a whole.

Clear definition of the policy and territorial framework

The territorial framework for development strategies must be identified and delineated, which involves identifying a territory with a solid administrative organisation or political and cultural identity.

Endogenous perspective

As opposed to strategies based on financial and technological support to external investment into the territory, which generally has weak production links with the local economy, efforts are needed to promote and consolidate the territory's own resources, to assure the commitment of regional financial, production and research actors, and achieve greater cohesion in, and structuring of, the territorial production and business sector. Also required is a greater capacity to adapt and increased flexibility to respond to technological change.

An endogenous perspective is therefore essential in the attempt to develop and consolidate the economic, social, cultural and other resources the territory possesses. So regional policy needs to identify, mobilise and develop those factors and activities which can generate competitive advantages.

Indeed, for the intervention model to be effective, the territorial environment must be taken into account when the strategy is conceived. The strategy must be based on a suitable diagnosis of the territory's weaknesses, potential and resources.

This diagnosis will mean that proper attention can be paid to all kinds of situations and the territory's specific features. Instead of the traditional, single, national-level strategies which are indifferent to the special needs and circumstances of individual businesses and communities (or copied mindlessly from what has worked well in other regions), what are needed are tailor-made policies adapted to the specific strengths and weaknesses of each territory. From these, intervention priorities can then be defined.

Importance of political will

The political will to implement policy and programs is crucial, as political leadership is essential to legitimising the process and getting the necessary support and resources.

Regional and local authorities need to be given a more central role in the development of territorial and innovation strategies and endowed with greater capacity to accept responsibility for different aspects of economic activity (commercial, training, financial, scientific and technological, among others) conducted in their territory and which affect the area of innovation.

Public-private coordination

Co-ordination and consensus between public administration levels must be guaranteed. Failures are frequent and are usually due to overlapping responsibilities and the lack of coordination between different levels of public administration. For the policy to be genuinely effective and efficient, co-ordination is essential to fix and systematise both vertically and horizontally the functions and powers of the institutions involved. A set of coherent, integrated initiatives adapted to the needs of the regional economy is vital. Such institutional co-ordination and consensus must be extended to the private sector, whose involvement and commitment to the targets, goals and mechanisms of the strategy are the key to its realisation.

Businesses are ultimately the target group for innovation, as they have to apply and make profitable any technological developments produced. At the same time, they are themselves a source of innovation, because businesses generate their own processes of innovation. Besides, as the end receivers, they are the ones that should, in practice, set the direction of innovation processes, to ensure they accord with the needs of regional enterprises and that any technological developments can be taken on board.

Organisation in networks

Establishment a network is a basic premise in preparing a strategy of this kind as it ensures the participation of all actors.

Here a lead actor that stimulates and encourages the network is needed to guarantee the network's effectiveness and integration. It must identify the bodies, institutions and businesses that will form part of the institutional organisation, such as large companies, SMEs, training and education organisations, development agencies, chambers of commerce, etc., and bring them together. Generally, a lead actor in a network will be a regional development agency (Halkier, Danson and Damborg, 1998). At the same time it is necessary to create stable networks between public research actors and businesses, perhaps with institutions acting as intermediaries.

Business character

Most regional level projects work due to the initiative and management capacity of regional business circles. Entrepreneurs are the real strategic agents of the regional development process, with the regional public sector basically acting as a stimulus.

Strategic orientation

A strategic framework is needed for short- and mid-term planning, but with a long-term vision based on a consensus between regional economic players on the region's opportunities and potential.

Assuring participation and consensus of players

Public opinion in the region must be won over, as it is important to promote a business culture that facilitates the creation of new activities and enterprises. This involves the creation of a framework for debate and discussion. Such a framework will, in turn, facilitate the institutionalisation of an agreed process for diagnosing problems and designing policies, leading to the generation of networks as an element of cohesion and awareness-raising.

Control, follow-up, evaluation and measurement instruments

A whole range of instruments must be defined to ensure that the policies and programmes implemented are fully and appropriately assessed and evaluated. This will enable an analysis of those policies that have favoured regional economic development, and to what extent they have done so through greater efficiency in innovation processes and improvements in production.

CONCLUSIONS AND POLICY RECOMMENDATIONS

This chapter is based on the idea that innovation is generally understood to be an essential ingredient in business competitiveness. In all countries and regions, innovation support policies are part of the political priorities for economic development, and in some cases, such as the EU Structural Funds for the 2007-2013 period, have become an inevitable reference for the programmes supported. The general adoption of these policies has led to a wide acceptance of the instruments and measures used, which are very similar everywhere. However, these policies, so similar in form, achieve very different results depending on the region. This is because innovation is a process with major technical and economic ingredients, which also involves cultural, sociological and organisational factors. This is why they have to be taken into account to ensure positive results for policies approaching implementation.

Many politicians are strongly tempted to buy miracle, "turnkey" solutions; however, innovation policies with the potential for success need to be tailor-made for each situation, with a major component aimed at changing business behaviour patterns. They therefore need to be mid- or long-term to be effective.

In contrast to the recent approaches which have involved the search for best practice which is then applied mimetically, regardless of the specific context in which they developed, best practice in contemporary innovation policy can be used as a point of reference and inspiration, but cannot be applied wholesale. What cannot be avoided is the individualised process of reflection in the definition of measures specifically adapted to each specific situation, and the adaptation of identified best practice to local needs.

Even so, it is true to say that most innovation policies now being successfully applied involve a series of instruments which make up the 'state of the art', despite the fact that the actual combination of these may differ quite markedly from case to case.

Such factors include:

- Considering the private sector as a central factor in innovation processes and to which policy should be directed.
- Integrating into such policy the promotion of new (and where appropriate technology-based) activities and support for modernising and diversifying traditional sectors.

- Establishing priorities to be acted upon so that resources can be concentrated appropriately to achieve significant effects.

- Defining measures realistically in line with the financial and human resources that can be mobilised and introduce instruments to manage such measures properly.

- Developing public-private partnership processes and promoting the creation of effective networks.

- Policy managers maintaining a proactive attitude designed to encourage the appearance of new innovation-oriented patterns of cultural and entrepreneurial behaviour.

- Designing a mid- and long-term strategy to give every single action a role within a wider strategy.

- Defining and preparing a system of indicators to permanently monitor and evaluate the effects of policies implemented.

A frequent phenomenon of innovation support policies post-implementation is an immediate response from a certain number of businesses, which rapidly become programme users. Policy success can often be achieved by observing the earliest results.

Leaving aside the question of the efficiency of measures defined this way (being true that they respond to the needs of innovative businesses which then demand to be their beneficiaries), one must not forget that a proportion of beneficiary businesses often stagnate after a first phase of growth. It is also not unknown for those businesses which utilise innovation support programmes to remain constant year after year, whatever the programme implemented.

The reason for this is that in any production system there is a certain proportion of 'naturally' innovative enterprises, concerned with systematically analysing the potential of their environment (which includes the use of available aid) and which are ready and willing to adopt the kind of behaviour they think will improve their competitive position. This core of businesses, which can be called 'the first ring of innovation' will be larger, the more dynamic and innovative the economy. The major feature of such economies is the presence of innovative behaviour patterns in a broad range of businesses.

In less dynamic regions and countries, this group of innovative companies will be smaller and relatively stable. Conventional innovation support policies (reactive or window-based, that is which waits for users to come to them for aid) applied in these areas will therefore be used by a small group of users that does not change over time.

It is true that in less dynamic areas there is a more or less wide group of businesses whose patterns of behaviour make it very difficult for them to adopt radically innovative behaviour patterns. But there is another group of businesses, which, for cultural reasons or owing to the kind of activity they engage in, may become potential users of these innovation support programmes, particularly if they are well-connected to the real situation of the regional economy.

However, this group of companies, which we can call "the second ring of innovation", does not use the programmes or engage continually in innovative processes for cultural or organisational reasons (lack of time, of the right staff, remoteness from innovation support centres, etc.). As a result, changes in their behaviour are difficult to achieve unless it is through the implementation of proactive policies, which, by means of persuasion, encouragement and the offer of tailor-made measures, are capable of changing business behaviour patterns and ensuring that the second ring of innovation plays an active part in innovation support policies.

To solve problems of this kind and to change behaviour patterns that hinder innovation and reduce business competitiveness, a bottom-up, consensus-driven innovation promotion policy adapted to the specific local and regional environments must be designed and implemented to create areas for business connections and promote the generation of social capital. Such a policy needs to be implemented proactively to integrate the second ring of innovation.

One key aspect of innovation promotion policies in the second ring of innovation, apart from strengthening the research and development infrastructure, will therefore be the generation of social capital and promotion of demand for innovation. A network of facilitators ('innovation brokers and promoters') must be created to encourage businesses to behave innovatively ('demand push').

The expression of collective needs and requirements must also be encouraged through the structuring of demand, something that will also favour business cooperation processes. The creation of clusters, innovation clubs, workshops and sector or thematic seminars should be actively encouraged through personalised connections, the systematic use of the media and activities designed for the educational system to generate an innovation-friendly culture.

One useful instrument for promoting demand for innovation involves performing in-house technology diagnoses and designing action plans to facilitate the appearance of research, development and innovation projects that are adapted to the real needs and requirements of businesses.

A frequent characteristic of less dynamic regions is the weakness of their research and innovation support infrastructure. Developing this infrastructure to a level where it can be competitive in providing services in the framework of a globalised economy is a long and expensive process. Besides, in many cases in these regions innovative companies are to be found in a broad range of sectors, there being no critical mass to ensure that such infrastructure is profitable.

So it is vital to conceive the policy from the beginning in light of the possibilities in the national and international markets (more so in the framework of the European Union, where international is also internal). At present there is a quality supply of freely accessible technological services, at least at the normal level of requirements for businesses in these regions. It is not necessary to develop innovation support infrastructure for every sector in every region, as those existing in other regions can also be used. This means that from the very beginning, policies should include mechanisms for facilitating the use of non-regional technology supply, promote participation in inter-regional networks, facilitate the integration of local players in research and development excellence networks, etc.

A crucial point in this approach is that to ensure effective, proactive policy management, it is important there are sufficient human resources available. Arrangements should also be made for the generation of formal and informal cooperation networks for the managers of different measures, as well as permanent training for policy management. Once the methodological bases of innovation policy for these areas have been discussed, it is a good idea to remember some of the instruments generally used in contemporary policies.

This kind of requirement and the diagnosis to which it implicitly refers in the case of SEE countries is actually very similar to those found in other European Objective 1 regions. Clearly starting conditions are generally less favourable in SEE countries than they were in Objective 1 regions in the old EU-15, as the process of adaptation to the market economy is based on an unfavourable culture and structures. But it is also clear that the philosophy and orientation of recent innovation support policies actually respond to the type of problem detected here, because one of its basic objectives is precisely to encourage the appearance of cultures and patterns of behaviour favourable to innovation, and to orient support infrastructures much more towards the logic of innovative behaviour. All of this needs to take place in a context where a framework favourable to innovative activity, and to transferring scientific work to production is being developed, and where innovative attitudes become increasingly widespread, reaching ordinary people as well as firms and businesses.

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CHAPTER 4:

INFLUENCING ATTITUDES AND SKILLS FOR ENTREPRENEURSHIP AND SME GROWTH

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Effective entrepreneurship policies address not only the practical and financial elements which hinder entrepreneurial activity but, crucially, take account of the wider social and cultural factors that contribute to the development of entrepreneurs. Attitudes and behaviours are inculcated long before entrepreneurial activity may commence, therefore it is critical that young people are taught not only the practicalities of business, but also to value entrepreneurial activity from an early age. This chapter explores in depth the way in which positive entrepreneurial attitudes can be taught to young people and draws on a range of useful examples as illustrations. Policy recommendations are also presented as to the most effective ways to develop an entrepreneurial culture amongst potential future entrepreneurs.

INTRODUCTION

The role of culture, attitudes and skills in influencing entrepreneurship is an important one to consider when attempting to formulate appropriate policies to stimulate entrepreneurial activities. The aim of this chapter is to analyse these in relation to entrepreneurship and small and medium sized enterprises (SMEs) in South East Europe (SEE) and consider a number of case studies. The chapter takes a closer look at the cultural and attitudinal issues with regard to entrepreneurship, new firm formation and the birth and growth of small businesses in the SEE area. Finally, a number of policy options are outlined which seek to address the need to change the culture and attitudes towards entrepreneurial activities and to increase interest in self-employment and entrepreneurship. The conclusions and recommendations are based on information obtained locally and regionally, and also draw on previous research from around the globe.

THE ISSUES

Setting the agenda

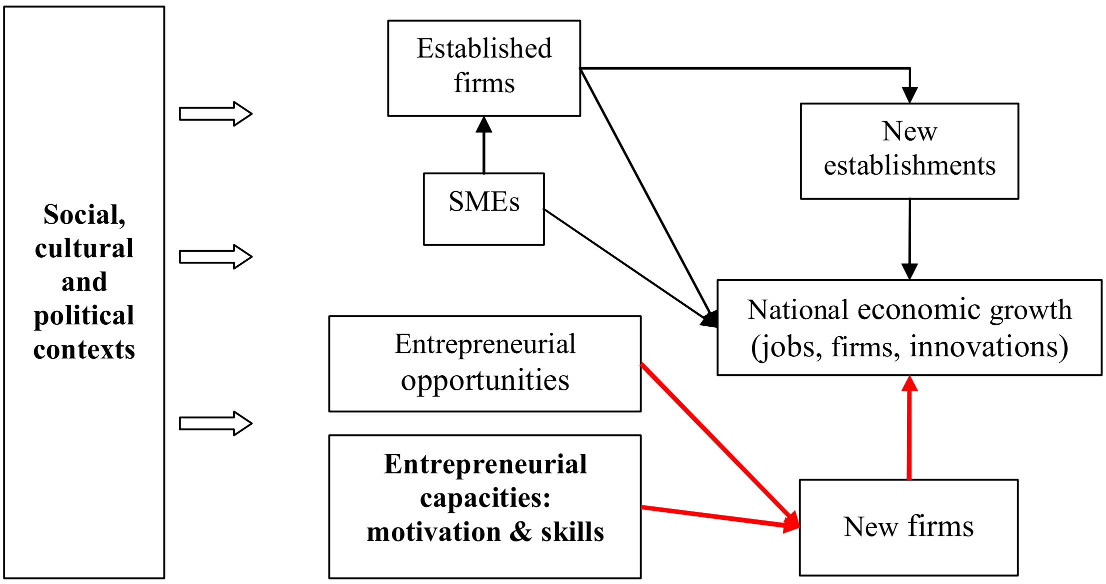
Entrepreneurship has a crucial role in the transformation of economies. Indeed, there is an overwhelming amount of research evidence which indicates that entrepreneurship is of crucial importance for national development. Entrepreneurship is also related to the development of stable democracy through its contribution to economic stability. The importance of entrepreneurship therefore lies not only in the economic and measurable monetary values, such as national economic growth and development, but also in the societal and cultural values engendered by an entrepreneurial spirit. Culture is an important factor to take into account when influencing attitudes and value systems: evidence ranges from the influence of religion (Max Weber) on economic performance to the importance of social capital in economic development (Robert D. Putnam).

Policy research sometimes makes a distinction between entrepreneurship and business start-ups and new business creation, and the different types of policies related to these two phenomena. Even if they can both be seen as two sides of the same coin, economic dynamics and development, they might nevertheless need different types of policy instruments. Entrepreneurship exists in a wide range of different forms and situations and often, but not necessarily, leads to the establishment of new businesses, while new business creation can take place through established businesses as well. The generic term entrepreneurship will be used here, as the focus is on the ways the skills and attitudes can be fostered in enhancing entrepreneurship.

The key to initiating entrepreneurship lies within the individual members of society, and the degree to which a spirit of enterprise exists, or can be initiated, with specific regard for the social, cultural and political context of the nation-state. Policies can be developed which seek to enhance this spirit of enterprise. Societies differ culturally in ways that are relevant to economic performance. The distribution of wealth within the nation and occupational choices at the national level are found to be related: thus the individual's drive for social status can affect economic performance at the national level. Also, cultural differences may act, together with economic incentives, in a way that can produce outcomes such as entrepreneurship (Fershtman and Weiss, 1993).

It is important to consider what hinders more positive attitudes towards entrepreneurship activity in SEE countries. Contextualisation is important for understanding how policies can encourage attitudes that better reflect the real risks and rewards of entrepreneurship, and in what ways, and to what extent, policies may be transferable from one country to another. Therefore this chapter will start by contextualising the key issues and policy levers.

Figure 18. Relationships between national economic growth entrepreneurial capacities, motivation and skills



Source: Arenius, Autio and Kovalainen, 2005; Minniti et. al., 2005

Different social, cultural and political contexts enable, and create, possibilities for entrepreneurial activities, but may also hinder the development of entrepreneurial capacities, and the motivation and skills required to develop entrepreneurial new businesses and SMEs. Very often research, when focusing on these contexts, has analysed the frameworks that enable and support large firms and multinational companies (MNCs).The importance of large firms and MNCs is significant to many nation-states; through direct job creation, research and development activities, investment and new initiatives they greatly influence national economic growth. A less analysed, but nevertheless important relationship also exists between the birth of new firms and SMEs, and national economic growth. Thus, the importance of firms which embody an entrepreneurial spirit should not be overlooked. In developing and transitional SEE countries, SMEs play an important role in, and have great relevance for, economic development and thus also for policy-makers (Bateman and Lloyd-Reason, 2000). In this way the economy is not isolated from policy matters. The development of entrepreneurial activity and the attitudes and culture which influence its development in SEE is being shaped and influenced by close connections to European Union countries, the expansion of the European Union and its activities, as well as the impact of the processes of globalisation. The tradition of entrepreneurship is represented in SEE countries by craft workers and artisans, and this tradition continues to be strong and important. The frameworks for the growth of new types of entrepreneurship have been unfavourable, with issues ranging from undeveloped business legislation to unstable or underdeveloped financial systems. The person-specific resources and capabilities that most often form the basis for entrepreneurship are always shaped, enhanced and constrained by the external environment, notably in countries where economic transformation is taking place (Peng and Heath, 1996). Economic and social, as well as cultural development, should therefore take place hand in hand.

The importance of culture for entrepreneurship

Economic activities have cultural outcomes (Fershtman and Weiss, 1993). It is thus important to recognise that not all countries develop in a similar fashion, so local and regional aspects in policy development and implementation are indeed crucial. SMEs are indispensable for the delivery of growth and for the delivery of new jobs locally, regionally and nationally. At the European level, the revitalisation of national economies requires a contribution from entrepreneurial activities. Indeed, it is evident from research in OECD countries that SMEs drive economic growth; for example job creation is substantially higher in the entrepreneurial sector than within established corporations (Audretsch and Thurik, 2001). Therefore, it is crucially important to use policy measures to enhance European, regional and local entrepreneurial culture. Revitalising the economy also increases foreign direct investment, highlighting the need for the appropriate framework conditions for profitable business activities. Policies targeted at changing attitudes have important, indirect effects as well.

Small, domestic and local economic production and service markets, limited access to financial capital, a shortage of specific skills, and the absence of legislative stability may all be factors that hinder the growth of those entrepreneurial activities that contribute to addressing unemployment and/or increasing economic output. Present threats in many SEE countries include a weak banking tradition, which may cause suboptimal lending behaviour which considers profit-maximisation too costly and time-consuming; thereby ignoring or displaying 'negative' attitudes toward small-scale lending or self-employed people (Cziraky, Tisma and Pisarovic 2005).

As much as entrepreneurial culture is a national and supranational issue, and is often related to arts and crafts, it is also to a large extent an issue for the economic system. For example, due to inadequacies in the banking culture, loan schemes have proven to be inefficient tools for SME funding in some countries. This suggests that other measures or support mechanisms might be needed nationally or regionally. Entrepreneurial culture is thus not only evident in values, attitudes and habits as most often thought but can also be found in the existing social, legal and economic institutions, practices and processes.

Cultural and social factors are important, alongside economic ones, when entrepreneurship is initiated and support policies planned. In addition, several non-cultural and contextual factors play a significant role in shaping entrepreneurial behaviour and activities. The impact of culture, as a set of historically evolved and learned values, attitudes and meanings which are accepted and shared by the members of a given community, influence directly the material and non-material way of life. All the issues mentioned above emphasise the classical idea of an enterprising spirit which manifests itself in the cultural and attitudinal aspects of individuals, something which this chapter acknowledges.

The role of attitudes in promoting entrepreneurship

How do values, attitudes and meanings become part of a person's identity? It has been suggested (Tayeb, 1988) that members of any community and society learn shared characteristics through the different stages of the socialisation processes through such institutions as the family, friends, religion, education, and society as a whole. In promoting culture as the starting point for entrepreneurial activities and an entrepreneurial spirit, we need to remember that culture is a complex phenomenon as it is a shared, collective understanding and interpretation of the world by a group of people, in which differences in understanding also exist.

For entrepreneurship the positive image of economic activities presented in a society, as described in Figure 1, is important. The social, cultural and political contexts create different kinds of possibilities for established firms but they also differently affect entrepreneurial opportunities and possibilities at the national, regional and local levels. Furthermore, they indirectly have an effect upon entrepreneurial capacities and the potential to build such capacities. Through capacity-building, entrepreneurship can support national economic growth. Therefore the overall importance of individuals should be acknowledged.

The vast majority of research literature (Reynolds, Bygrave and Autio 2003; Wong, Ho and Autio 2005) demonstrates that individuals start up new businesses for two reasons: they either want to take advantage of the business opportunities they perceive in their surroundings, or they are pushed into entrepreneurship because no other viable, or desirable, option exists for paid employment. These two motives divide start-ups into two rough categories: (i) opportunity entrepreneurs and (ii) necessity entrepreneurs. Both of these motives are reactions to completely different kinds of economic situations, possibilities, opportunities and threats. Attitudinal aspects are important when reacting to both opportunities and necessities in the economy, whilst stability and predictability of the rules and regulations concerning the economy are critical to the positive motivation for entrepreneurship.

Research results confirm a strong connection between individual start-up motives and new business survival. Evidence shows that, in general: (i) individuals involved in entrepreneurial activities are more confident with their own skills when compared to those individuals that are not involved in entrepreneurial activities, given the same age, education, etc.; (ii) they are less likely to let fear of failure prevent them from starting-up their own business activity; (iii) the decision to start-up a business is a complex process with many contingent factors effecting the process; (iv) the presence of role models is important when considering the transfer from paid employment to self-employment; (v) confidence in their own skills and abilities is crucial; (vi) a positive attitude to risk, and a willingness to take risks is needed; and, (vii), alertness to unexploited opportunities is important in the recognition of business start-up possibilities (Minniti *et al.,* 2005).

In SEE countries necessity, as well as opportunity, is a driving force for entrepreneurial activities. Research shows that in middle-income countries, which many SEE countries are, the fear of failure amongst those not involved in entrepreneurial activities is lower than in high-income countries such as in Scandinavia. This is because whilst necessity might be a driving force towards entrepreneurial activities, there is less sensitivity to the fear of failure amongst those who are not in entrepreneurship. However, the GEM 2005 analysis highlights that amongst those who are already engaged in entrepreneurship the fear of failure is higher in middle-income countries than in high-income countries, where social security networks are wider (Minniti *et al.,* 2005).

Even if national GDP does predict the general level of and motivations for entrepreneurial activity, culture is a strong predictor of an individual's own attitudes towards entrepreneurship. Culture also directs and influences the ways in which an individual perceives existing business opportunities. Culture is embedded in and is mediated through public policies at all levels of government. Accompanying this are such things as technology, the general level of economic development, national demographics, as well as the role and impact of institutions and legislation, which all separately and collectively have an effect on the ways in which entrepreneurship takes place and evolves. An individual's assessment of the risks and rewards related to entrepreneurial activities occurs through these social, cultural and technological conditions. Therefore policies that aim to influence culture are important.

How then can entrepreneurial potential be unlocked? Importance needs to be given to the needs of the individual and at the cultural and policy levels. In this process, policy can do much to encourage the development of entrepreneurial potential. However, policies are not global in the sense that they need to adjust to local and regional cultures in order to function properly.

POLICY OPTIONS FOR THE PROMOTION OF ENTREPRENEURSHIP

"It is culture that serves as the conductor and the entrepreneur as the catalyst." (Berger, 1991, p. 122)

Several research reports have confirmed the presence of a relationship between specific individual traits such as risk-taking propensity, high achievement goals, locus of control, and entrepreneurial activities (McClelland, 1961; Bird, 1989). Other research reports confirm the relationship between behaviour and entrepreneurial activities (Gartner, 1988; Morrison, 2000), as well as the contribution of other factors e.g. entrepreneurs being more likely to be the first born, or had early role models (Reynolds, Bygrave and Autio, 2003). The view that entrepreneurial activities are dependent on individual traits, family-related positions or role models, is challenged by views that emphasise macro level variables, such as family and support systems, financial resources, and government and local activities in enhancing the potential for entrepreneurship. It can be concluded that individual features do not explain entrepreneurial activities and national differences alone, rather cultural and contextual factors also need to be taken into account when developing entrepreneurship policy.

Research findings confirm that at the broad, national level:

- GDP growth and the development of social safety nets have a positive effect on the amount of opportunity-driven entrepreneurship.
- Necessity-driven entrepreneurship declines with the growth of other options in the labour market. This result has been found in SEE countries.
- Effective entrepreneurship programmes are nationally tailored to fit the national contexts (and cultural and social features are considerations). This result has also been found in SEE countries.

Since individual activities, as well as political, legal and economic systems, are all embedded in and intertwined with the national culture, any analysis of entrepreneurship needs to take the cultural system and context into account. While central planning systems broadly destroyed the private sector through nationalisation and confiscation, some small agricultural and craftsmanship activities did remain as private entities for some time. The collectivistic culture gave little room to those entrepreneurial attitudes and ideas that develop new business ideas and create economic growth through competition. It is therefore unsurprising that the shift to a culture that supports entrepreneurial behaviour may take a longer time than expected, as entrepreneurship most often develops from the bottom up, and not as a centrally planned and developed activity. Here policy measures can help to facilitate this.

The central state needs to rebuild trust, and policies that are developed in collaboration with local and regional agencies and the public can assist in this process. Furthermore, it is important that entrepreneurial activities recognise local needs when they are developed in close cooperation with the business community.

Barriers to entrepreneurship

Cultural values and norms have been found to either converge, or conflict, with a country's ability to develop a strong entrepreneurial focus (Trompenaars, 1994). The issues that can hinder entrepreneurial activities are manifold, and policy instruments should take the following into account.

Structural, formal barriers

Structural, formal barriers to entrepreneurial activities include: fiscal legislation, the administrative burden, the general nature of the regulatory environment, the malfunctioning of the labour market and a lack of human capital.

The general regulatory environment consists of legislation and formal regulations that control entrepreneurial economic activities and actions, which includes administrative burdens. Fiscal regimes are often indicated as key factors in either promoting (such as in Ireland) or hindering (as in Scandinavian countries) entrepreneurial activities. In Ireland, a policy developed for lowering capital gains taxation and corporate taxation has increased the profitability of Irish firms and increased the number of new business start-ups. This lowering of taxes required a stable and predictable taxation environment (Fitzsimons and O'Gorman, 2005). More importantly, SEE countries need stability and transparency in fiscal legislation, although lowering the taxation for specifically targeted SMEs or new start-ups might be beneficial. Here, policies aimed at providing financial support and guarantees, and ensuring stability and consistency, are required.

A lack of human capital can be classified as a formal barrier for entrepreneurship to the extent that inadequacies in the formal education system hinder the development of a national reserve of human capital, and contribute to limiting the employment opportunities of individuals. Policies targeted at improving the types of education and training available are crucial.

Process related, informal barriers

While the regulatory environment can create formal barriers, the implementation of regulations may create informal barriers, e.g. through haphazard or irrational implementation of rules or regulations, corruption, or unfair competition from the informal sector. Here again, policies can help create a set of standards with which to address these issues.

Haphazard or irrational implementation of rules or regulations can hinder the emergence and development of entrepreneurial activities. Corruption has a similar kind of indirect effect and can hinder the development of new businesses because of the lack of transparency and predictability of the business and regulatory environments. In addition, unfair competition from a large informal sector is often regarded as a barrier for any sort of economic development, as it also suggests the existence of a large informal and inefficient financial sector. Process related, informal barriers deal more directly with attitudes and skills, and policies should be able to take these into account. If unethical behaviours, such as the unjust implementation of rules and corruption are accepted as the norm, it will take longer to change wider attitudes. For that change, education and training are needed, firstly to reveal the unwanted consequences of these informal barriers and, secondly, to demonstrate and link these to better ways of working and reward them accordingly.

Skill-based and environmental barriers

Many of the barriers to entrepreneurial activities are not simply formal or informal by nature but are more related to the changing context in which economies evolve and develop. This includes such barriers as the lack of properly functioning infrastructure, adequate financial resources, lack of skilled employees, and insufficient market demand.

Environmental barriers may include a dearth of information for potential entrepreneurs. Information on how to start-up a business can be provided via electronic services, web-pages, e-mail services and online help lines. This could even be extended to incorporate e-business models.

Inadequate financial resources in the form of traditional bank loans, soft loans, or venture capital act as an efficient barrier for any form of economic development at the national level. The need for financial capital should be taken into account in a national action plan for the development of entrepreneurship. Micro-financing and informal investors are all part of the existing funding opportunities which lower the barriers for business start-ups. According to the GEM report 2005 (Heinonen, Kovalainen and Pukkinen 2006), for every 100 persons, there are 3.3 persons who invest their savings in another person's business start-up. Friends and relatives are the most common informal business angels.

At the national level the general problem of low purchasing power is an additional issue that can act as an environmental barrier for new business start-ups (Wong, Ho and Autio, 2005). An additional barrier is the lack of skilled or trained workers. These two barriers affect new businesses differently, depending upon the sector in which they operate. Several countries have looked at their own demographic factors and labour market inadequacies and have developed policy initiatives which target immigrants and other groups in unfavourable positions. For example, the national agency for the development of businesses in Italy, Sviluppo Italia, promotes self-employment amongst young people and in the less developed areas of the country by providing education, training, investments and running costs for new start-ups (Reynolds, Bygrave and Autio, 2004).

Policy options for addressing attitudinal and skills barriers to entrepreneurship

Predictability and stability are required in the formal regulatory framework to create favourable conditions for business start-ups. This involves structural stability more than policy level stability. Transparency and possible reductions in regulation are also required. The simplification of rules and regulations is one step towards diminishing the barriers for new SMEs and business start-ups. A business-conducive regulatory framework is also important as it demonstrates the progress made towards stabilising the economy as a whole.

Most barriers are intertwined: informal barriers are closely related to the environmental ones, and partly follow from a lack of skills and education. Therefore, no quick remedy is available to eliminate the barriers to entrepreneurial activities. However, not all culturally-based habits are irrational; for example, there is a recently formed and legitimate rationale for the deep lack of trust in the banking system in many Balkan states. Therefore, embedding new policy measures and activities into the national culture is important in the establishment of a stable state system. There are policies that can be adopted in order to accelerate the smooth impact of changes; these are explored below.

Policy option 1

Entrepreneurship should be integrated into the basic education system. Education and training are central to increasing the national human capital. Human capital increases through the formal education system, as well as through training and consultancy. Primary education is an excellent platform for promoting knowledge of entrepreneurship, and the requirements of self-employment and entrepreneurship, as well as economic knowledge in general. Entrepreneurial education increases the individual's capability to learn to recognise their own skills and abilities, and it enhances the individual's self-esteem. In addition, vocational education is an important link and channel for spreading knowledge of economic activities, as it easily combines two issues: firstly, the provision of vocational expertise and secondly, an understanding of the economic activities required for becoming self-employed or starting up a business on the basis of the vocational capacity acquired. The education process does not end at the secondary or vocational training levels. At the tertiary/ university level, the Bologna Process[9] and its requirements promote mobility and employability of university graduates. This fits well with the importance of the individual recognising their own skills and abilities.

Entrepreneurial activities often take place during the later stages of a person's life, when some work experience is acquired. Initial business activity is not usually started directly after secondary education, although vocational training and the stimulus to self-employment following it, may be an exception. It is therefore vital to ensure that there is a systematic promotion of entrepreneurship and provision of entrepreneurial information at all levels of the education system.

Policy option 2

The promotion of best practice and success stories should be undertaken to change attitudes and show 'how everybody can do it'. Such actions have taken place in primary schools in SEE states through, for example, the *Junior Achievement Programme*, which is supported by donors in many countries (see Box 3). At the secondary school level, practice-oriented mini-enterprises are being introduced in many countries (such as Croatia, Kosovo, FYR of Macedonia, Serbia, Bosnia and Herzegovina). Teacher capacity-building activities are also being utilised (European Commission, 2006). These notwithstanding, the dissemination of best practice and the exchange of experiences are still needed. At the same time, the relationship between higher education and entrepreneurship needs to be further developed and strengthened.

Policy option 3

Skills-based barriers, such as a lack of business related skills and experience can be targeted through tailored educational programmes that focus on skills development and complement initiatives to change attitudes. Basic knowledge of business activities, for example, can be imparted.

Policy option 4

Provision of in-house training and education should be made for those already in business. Educational programmes might be usefully extended to the present management of SMEs in SEE countries, even if the target group is different. According to the life-long learning idea, the training should be extended to all age groups and social strata. The management of SMEs, which form the

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9 . At the first OECD Conference of Ministers responsible for SMEs, hosted by the Italian government in Bologna, Italy, in June 2000, Ministers from nearly 50 member and non-member economies adopted the *Bologna Charter for SME Policies*. They envisaged the Bologna Conference as the start of a policy dialogue among OECD member countries and non-member economies that would be followed up by continuous monitoring of the progress made with regard to the implementation of the Bologna Charter. This has become known as the *OECD Bologna Process*.

overwhelming majority of all businesses in SEE countries, should be included in the systematic education plan. Part of this plan could consist of in-house training and consultancy.

Policy option 5

Increase the number of training institutions offering entrepreneurial, vocational and skills related training.

Policy option 6

Barriers such as the instability of the general regulatory environment and lack of financing and low purchasing power can be addressed by policies that can stabilise the economy and guarantee basic finance and access to sources of support (information support, networks of specialised support concerning growth and export). Other policy instruments, such as micro-credit schemes, credit guarantee schemes and start-up loans, should also be developed.

Policy option 7

Faster start-up processes, such as those offered by one-stop shops for new business registrations in some of the SEE countries are important considerations. When looking at the SEE situation, business support services in the form of local/regional centres, business incubators and clusters are in existence, and their activities could be developed further. Why are one-stop shops relevant? They are found to increase the likelihood of those who are in the process of starting up their own business to seek advice. It is not necessary to have a high level of knowledge before seeking advice and in this way one-stop shops are valuable entry points for potential entrepreneurs. Also, for those already in business, one-stop shops make it easier to find the latest information on specific questions related to entrepreneurship.

ENTREPRENEURSHIP IN SOUTH EAST EUROPE

Entrepreneurship is seen, at the European level, as being not only the driving force for the creation of new jobs and economic growth, but also as one way of dealing with the structural changes as a result of the transfer from nationally-focused to globally-integrated economies. In order to enhance the growth of entrepreneurial activities at the national and regional levels, the European Commission action plan sets out a European Agenda based on five strategic policy areas: (i) promoting entrepreneurial mindsets; (ii) encouraging more people to become entrepreneurs; (iii) gearing entrepreneurs for growth and competitiveness; (iv) improving the flow of finance; and, (v) creating a more SME-friendly regulatory and administrative framework (European Commission, 2004).

All the above mentioned strategic policy areas could, and should, be part of any local and regional economic policies. Most SEE countries do have both a SME strategy and a SME agency, as basic SME policies were developed as one of the steps towards economic stability (European Commission, 2006). Most of the above mentioned strategic action plans by the European Commission can be related to any sort of development phase in any economy. In the case of SEE, the last three strategic policy areas should be emphasised, as they resonate with the structural, formal barriers found in many of the countries.

The domestic market often presents unfavourable conditions for the growth of entrepreneurship, as potential entrepreneurs may face competition not only from the informal sector but also from the influx of goods from other countries. However, in the transition period, the domestic market may play an important role in the increase of entrepreneurial activities, when the value-added from entrepreneurial activities are seen as an important asset for the country. For example, skills can be systematically developed with appropriate policies and support, and instead of using skills for relatively modestly paid work a business start-up based on those skills could add value for the skilled workers. For these sorts of activities to flourish, a small or relatively modest economic input in the form of machines and other production equipment is needed, which could be delivered by well targeted policies.

The macro-economic indicators for the SEE countries show that most of them have suffered from slow GDP growth and high and persistent unemployment. The reasons for the latter can be many, including the presence of a large informal sector. Statistics show that entrepreneurship is based on labour-intensive activities rather than on capital-intensive activities in most SEE economies. That is, there is a concentrated large manufacturing sector and value-added activities still need to develop. The challenge to local and regional level policy makers is to ensure effective co-ordination between activities. Therefore, inter-organisational collaboration is needed if innovative business ideas are also to be developed in the traditional manufacturing sectors.

Foreign direct investment to developing economies brings with it other assets besides financial ones. Indeed, important elements are the new managerial practices and processes which may accompany FDI and the expertise that can be positive if taken up locally. Local economies must be ready to benefit from such spill-overs, particularly with a willingness to learn. Again, the cultural aspects mesh with the financial ones.

Enhancing entrepreneurship: case studies

Embedding an entrepreneurial culture, if it is to be effective, should start as early as possible. As the Junior Achievement Programme (discussed below) demonstrates, inculcating a positive vision of entrepreneurship has the potential to make an important long-term contribution to the entrepreneurial activities within a country.

Box 4. Junior Achievement Programme

The Junior Achievement - Young Enterprise Europe network is a Europe-wide programme that aims to educate and inspire young people about the world of enterprise and entrepreneurship. The network functions nationally and locally, each national organisation works closely with its local education authorities in the development and implementation of programmes. Therefore, different adaptations of the programme can be found, but the core idea is to provide business training and services. Entrepreneurship training is, in this programme, strongly linked to the desire to become self-employed in the future and it provides basic information about starting and running a business. In a recent survey which included Balkan countries, young people were shown not to be risk averse: 58% of respondents (N over 10 000) did see risk as part of business activity, but fear of failure would not stop them from starting up a business. It is worth mentioning here that when asked, whether "*your friends would consider it 'cool' if you set up your own business*" three Balkan countries were among the top five most positive countries: Moldova, Serbia and Montenegro, and FYR of Macedonia, had 90%, or close to 90%, of students agreeing with this statement.

When the European Commission says that 'we need to promote a more entrepreneurial culture in Europe', what does it mean? Is the EU exploiting its entrepreneurial potential? According to Eurobarometer, almost 60% of

EU citizens have never considered setting up their own business. When the 'Young Achievement Programme' asked the question, 'Do you plan to become self-employed in the future?', the results show that there is substantial entrepreneurial potential in younger generations. In Eastern Europe and the Balkan countries over 93% positively responded to this question.

Source: Junior Achievement Young Enterprise, 2005.

The Slovenian case study below highlights the importance of developing solid local consultancy networks as well as communication between different agencies across sectors and regions. Sector-specific, local and regional activities should all be taken equally into consideration when activities in training are planned by the local, regional and national actors. National cultural characteristics should not be forgotten: substantial local and regional know-how needs to be incorporated, as well as drawing upon best practice from around the world.

Box 5. One-stop shop and voucher-advisory system: the case of Slovenia

In July 2005, one-stop shops were established in Slovenia for company registration. This enables entrepreneurs to complete all the necessary legal documents needed for the registration of a company in one place, at 205 locations in Slovenia. The ease of the registration produced 1 600 new company registrations during the first three months.

In Slovenia, a voucher advisory system was established in 2000, in order to offer support for SMEs and new business start-ups. The advisory system is funded by several Ministries and run by the Public Agency for Entrepreneurship and Foreign Investments. Vouchers cover 100% of the costs for an advisor for new start-ups, and 50% of the hourly costs for already established SMEs. Advisors are selected through a bidding process among local and regional networks. In 2004, over 4 000 entrepreneurs and SMEs were offered support and counselling.

The importance of the one-stop shops and voucher advisory systems is that they help change the attitudes towards the issues that are often thought to be difficult and complex in new business start-up. Being able to visit a one-stop shop to register your company changes your attitudes towards the bureaucracy related to entrepreneurship, and changes the general climate as well. Similar experiences are related to the voucher advisory system. There is an increased likelihood that those who are in the process of starting up their own business will seek advice.

Sources: Rebernik, Tominc and Pusnik, 2006; Bygrave 2005; Reynolds, Bygrave and Autio, 2004.

CONCLUSIONS AND RECOMMENDATIONS

It is important to understand that most entrepreneurial activities, that is the majority of businesses, products, services, etc. do not present original or innovative business plans. Still they are an important part of any dynamic economy. Therefore all SMEs should be included in policy activities, not only new, innovative start-ups. It is equally important to recognise that the majority of businesses show either no or very limited growth potential in terms of new job creation, but that, nationally, most new jobs are created by SMEs.

Those countries with predictable, stable and simplified regulatory frameworks, stable economies, low levels of corruption, and proactive measures taken to improve human capital appear to do better in the processes of development. Favourable economic national conditions, as well as regional and local conditions are all found to have a direct positive relationship upon the survival and expansion of newly created enterprises. At the micro-level, the qualifications of the business owner and creator, as well as employees, are crucial. Management skills should also be included as part of these qualifications. Of increasing importance is the need to have networking capabilities in place, both regionally and cross-border.

All of these notwithstanding, it is vital to recognise the importance of attitudes and skills for stimulating entrepreneurial activities and to acknowledge the need to change and develop such attitudes and skills appropriately. Education is the key to this process of change and with this in mind a number of key conclusions can be identified:

- A strong commitment to entrepreneurship education is vital. The elementary and secondary school levels are very important for fostering entrepreneurial ideas and opportunities.

- The importance of identifying role models which reflects the diversity of the population, such as age, sex, highly educated, crafts-oriented, etc. should be taken into account.

- Advice counselling should be made easier through the use of one-stop shops, voucher-systems, and, transparent counselling services for business-plan writing, funding applications, etc.

This chapter has explored the attitudinal and skills-related barriers, and touched on some of the formal barriers, which confront new and growing new businesses. SEE countries must make important decisions in the identification and implementation of appropriate policy instruments and levers if entrepreneurial activities are to be effectively stimulated.

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CHAPTER 5:

YOUTH ENTREPRENEURSHIP IN SOUTH EAST EUROPE: SOME POLICY RECOMMENDATIONS

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Entrepreneurship has come to be seen as a crucial tool in addressing unemployment and social exclusion amongst young people. In countries of South East Europe entrepreneurship also appears to offer one way of addressing the ‘brain drain’ of young people. However, encouraging entrepreneurial activities amongst the youth can not be done by simply applying generic policies as may be directed towards the wider population. As this chapter demonstrates it is important that specific policies be developed and applied which take account of the needs of young people. Following an exploration of the key issues around youth entrepreneurship, and utilising examples from Albania, Slovenia and Serbia, this chapter concludes with policy recommendations should help to stimulate entrepreneurship amongst young people.

INTRODUCTION

The role that entrepreneurship plays in the socio-economic development of a country is well acknowledged. Following a long period of entrepreneurial activities having been suppressed by centralised systems, post-communist countries have largely benefited from the contribution of entrepreneurial activities to the process of industrial restructuring, the enhancement of the competitiveness and innovativeness of the enterprise sector and in generating new employment. As a result, governments and international organisations have designed a large number of programmes to support entrepreneurship to fulfil its economic and societal roles. However, while the attention upon entrepreneurship in general has been considerable, youth entrepreneurship has never been high in the agendas of many countries due to the perception that the concepts of entrepreneurship and youth entrepreneurship are interchangeable. This has been accompanied by the use of 'one size fits all' policies and programmes that have tried to address problems of entrepreneurship in the same way for different groups within the population.

Recently, high levels of unemployment amongst some groups of young people have fuelled interest in youth entrepreneurship as a way to foster employment opportunities or to address social exclusion. Moreover, entrepreneurship is seen as an outlet for the talents of many highly educated young people in areas such as information technology, biotechnology and other modern industries. Furthermore, in the case of South East Europe (SEE) countries[10], entrepreneurship is considered a way to avoid problems such as a 'brain drain', and to reinforce political stability in the region and to promote regional cooperation.

Based on these wider considerations, this chapter discusses issues in SEE countries with an emphasis on the programmes designed to encourage and support youth entrepreneurship. The first section outlines issues relevant to young people and entrepreneurship in OECD countries. In the second section, emphasis is given to the broad features of entrepreneurship, and youth entrepreneurship, with particular regard to the economic, political, social and cultural characteristics of the SEE countries. The third section looks at the various initiatives at governmental, international and NGO levels, and the youth entrepreneurship issues they try to address. In the fourth section, some good practice examples are reviewed, and their potential sustainability and replicability will be considered.

This chapter concludes by making some policy recommendations for promoting youth entrepreneurship. General attitudes towards entrepreneurship, skills and training, access to finance and support are all issues to be addressed if there is to be wider involvement of young people in

[10] There is no specific definition of countries that should be included under South East Europe. The nature of the research specifies these countries. For this particular research, under SEE countries will be included the Western Balkan countries (Albania, Bosnia and Herzegovina, Croatia, FYR of Macedonia, Montenegro and Serbia), as well as some other countries that have already joined EU such as Slovenia or countries that are about to join such as Bulgaria and Romania to allow for some comparison between the two groups with different degrees of integration into the EU.

entrepreneurship. Of particular interest are the connections that should be made between the general problems of young people in these countries and wider socio-economic and entrepreneurial strategies.

MAIN ISSUES IN ENCOURAGING YOUTH ENTREPRENEURSHIP

With increased interest in entrepreneurship as a way of boosting economic competitiveness and promoting regional development, youth entrepreneurship has received more attention in recent years in many countries. While youth entrepreneurship is an under-explored field in academic and policy debates, two main elements account for its growing policy focus in developed countries. The first is the increased number of unemployed young people compared to the rest of the population; the second is the need for greater competitiveness, and the accompanying pressures for skills development and entrepreneurship as a way of addressing the pressures of globalisation. The second is most notable in the case of EU countries which, as various European Commission reports argue, do not have a high level of entrepreneurial activities. In this respect, policy responses, as will be discussed in the rest of this section, have been developed at different levels to tackle the immediate problems of youth unemployment and also to gradually change the place that entrepreneurship has in many societies.

Youth unemployment

The need for a better focus on youth problems has been related to increasing levels of unemployment amongst young people. The OECD report notes that youth unemployment has been very high in OECD countries, reaching levels twice as high as those of adult unemployment rates in some countries. Chambers and Lake (2002) report figures as high as 300 million unemployed or underemployed young people aged 18-30 years around the world. In general terms youth unemployment is connected to: firstly, the difficult transition from school to work; secondly, the unwillingness of employers to employ inexperienced workers, and; thirdly, the frequent job changes by young people in an attempt to find a satisfactory job (United Nations, 2003). However, figures consistently indicate that a large number of young people are outside both the education system and the workplace, creating other challenges in tackling this problem. Furthermore, in many countries youth unemployment is related to economic development and shows regional patterns.

The problems of youth unemployment have mainly been discussed under the heading of traditional labour policies. Labour policies have been concentrated upon addressing market failures, by helping the unemployed to find jobs, providing financial support through safety net policies and by providing training for the unemployed in order for them to acquire the skills that are required in the market. Problems have been further exacerbated by the globalisation trends that have led many companies to concentrate upon their core competencies and to outsource their other activities. In turn, subcontractors also focus on core competences, which means that temporary jobs are the norm and eventually young people are the ones to be employed. According to the OECD (2001) these changes in business organisation, work practices and skills requirements have made the traditional labour policies pursued in the majority of the OECD countries unsuitable to deal with the growing problems of youth unemployment.

The current approach taken in OECD countries is aimed at promoting self-employment and entrepreneurship to young people. Although the literature on youth entrepreneurship is scarce, there is evidence (Greene, 2005) that young people consider working for themselves as a career option since it offers them an interesting job, independence and autonomy which other working environments might not provide. Nevertheless, the levels of youth unemployment are worrying. The challenge stands in developing a culture of entrepreneurship through education and skills development that eventually will lead young people to choose entrepreneurship as a career option. The OECD (OECD and EBRD, 2005) argues that youth entrepreneurship should have a place in the national, regional and local labour market and education policies. Thus, efforts have been made to design programmes and policies that try to encourage young people to take up self-employment.

Main policy issues in OECD countries

At an OECD-country level of analysis, the discussion of youth entrepreneurship mainly concentrates on three main areas:

1. Offering financial support to young entrepreneurs, with the rationale that young people differ from entrepreneurs of other ages in that they are at a disadvantage when applying for funds. As a result, many governments and other organisations in OECD countries have been willing to create programmes that finance young entrepreneurs' ventures, or offer mentoring or counselling before and after the start-up of a business. Examples such as *Imprenditorialità Giovanile* in Italy or *The Prince's Trust* in the United Kingdom are notable in that they have inspired efforts by policy makers to promote youth entrepreneurship. The main concern with programmes of this type is the fact that after the assistance ends there is rarely any data on what happened to the young entrepreneur and their enterprise.

2. Education and the development of the range of skills necessary to start a business is another major area for public intervention. Entrepreneurship education is considered to increase the chances of start-ups and self-employment and enhances individuals' economic reward and satisfaction. Moreover, any dynamic SME that wants to grow will benefit from young people with entrepreneurial mindsets and skills (European Commission, 2005). This indirect intervention aims at developing beliefs, motivation and behaviours which, in the longer term, will create an enterprising spirit amongst young people. As Hafterndon and Salzano suggest, learning should be directed towards "...developing in young people those skills, competences, understandings, and attributes which equip them to be innovative, and to identify, create, initiate and successfully manage personal, community, business and work opportunities, including working for themselves...". (Haftendorn and Salzano, 2003, p. 13)

   The European Commission (2005) notes that whilst not all youngsters who develop entrepreneurial competence will become entrepreneurs, some evidence demonstrates that around 20% of participants in mini-company activities in secondary school go on to create their own company after their studies. The mini-companies activities organised in many secondary schools throughout the EU have been praised by the Commission as very influential initiatives, because students have the chance to learn by doing. These activities still face many challenges, as European Commission (2005) notes, including problems related to: (i) the lack of independence and autonomy of schools to engage in extracurricular activities and to create links with local community actors or businesses; (ii) a lack of funding; (iii) an occasional overloading of teachers and students with activities not included in the school's curricula; (iv) a need for teachers to be trained in appropriate teaching methods which are different from the traditional ones; (v) a lack of business mentors in many areas; and, (vi) non-supportive public authorities regarding the inclusion of such programmes in the curricula of the schools.

Nevertheless, in the EU the benefits of entrepreneurship education are not limited to more start-ups, innovative ventures and the creation of new jobs. Entrepreneurship is a key competence for all, helping young people to be more creative and self-confident in whatever they undertake and to act in a socially responsible manner.

3. Another trend which has been noted in many countries is the creation of strong partnerships between public and private structures, which usually involve Chambers of Commerce, business agencies, public education and training institutions, community based organisations and also regional and local governments. In this respect, successful initiatives may be created such as the *Global Partnership for Youth Development* of the World Bank, and *The European Youth Forum,* which facilitates support to young people and promotes the interests of young people to higher levels of government. The business sector has been quite a successful partner in acting as local mentors for start-up businesses. One well recognised initiative that has been applied in many countries is *Youth Business International*, which enables the business community to act as a mentor and to finance young people's enterprises. According to Chambers and Lake (2002), this initiative has helped more than 50 000 disadvantaged young people aged 18-30, with over 60% of them still in business in their third year. Moreover, in EU countries businesses are strongly encouraged to participate in different entrepreneurship education programmes by viewing participation not only as a form of long-term investment, but also as a form of corporate social responsibility.

   To summarise, the policy programmes on education have some common characteristics, despite the context in which they are being utilised. They rely, to a certain degree, on learning by doing, and they encourage the imagination and creativity of young people to unfold. They also encourage the participation of the business sector and partnerships within civil society and non-governmental organisations.

Nevertheless, there is no satisfactory evidence with regard to the outcomes of these programmes, apart from the self-promotion of their success in tackling youth unemployment problems. Entrepreneurship education is difficult to measure quantitatively, as is the impact of the interventions because of the very nature of education. At the same time, entrepreneurial education is a long term, visionary approach because it attempts to change the mindsets of people about entrepreneurship. Evidence has relied mainly on short term measures such as the number of start-up enterprises that have been created. However, these figures do not say much about the success rate of these activities and the impact of these programmes on the lives of young people. Moreover, the role of different levels of government is still not very clear with respect to various youth entrepreneurship initiatives.

In an environment such as SEE these issues take on a different perspective, since many of these countries are still in the process of creating the conditions for entrepreneurship in terms of the economic, institutional and social environment conducive to the development of entrepreneurship and competitive enterprise activities.

FEATURES OF YOUTH ENTREPRENEURSHIP IN THE BROADER CONTEXT OF ENTREPRENEURSHIP IN POST-COMMUNIST ECONOMIES

Entrepreneurship is very high on the agendas of the EU and other international organisations, as well as on those of individual countries themselves. This is recognised by a range of activities and initiatives at different governance levels including the EU, national, regional and local levels, so as to create the conditions for entrepreneurship to prosper. These efforts range from the creation of regulatory frameworks that do not act as a burden on business activities, to the creation of a business support infrastructure that supports the acquisition of the information and knowledge required for entrepreneurship. Moreover, one of the key requirements is the establishment of dialogue and co-operation between the state and representatives of entrepreneurs at different stages of the policy process (Smallbone and Welter, 2006). In many countries this has been encouraged by the effective participation of representatives of entrepreneurs and business owners in policy formulation, implementation and evaluation. Furthermore, in many European countries special attention has been given recently to the encouragement of a culture of entrepreneurship across the population. Obviously, all the above considerations also apply to the encouragement of entrepreneurship amongst young people, albeit from a slightly different perspective to try and address their specific needs.

It was previously mentioned that one reason which may have contributed to the increased attention towards youth entrepreneurship has been the higher levels of unemployment experienced by young people compared to total unemployment in many countries. Moreover, youth in different countries tend to differ in their perception about the career choice that entrepreneurship represents and the status that it offers to young people. Even in developed countries where the external environment is more conducive, there are differing perceptions as to the opportunities in terms of career, money, and job flexibility. Youth entrepreneurship, as any other type of entrepreneurial activity, promotes innovation, creates jobs and increases competition in the market place.

However, the encouragement of entrepreneurship in the SEE countries has been promoted on grounds apart from the clear economic rationale. Entrepreneurs have, for a long time, been perceived as embodying the values of hard work, self-reliance and determination which support the capitalist order, and upon which prosperity is based. Entrepreneurship and the small business sector, intimately linked to capitalism, have also been considered to be the source of growth of the middle class. Thus, the emergence of the private sector as an agent of change in ‘achieving the norms, values and rules of conduct’ was considered to be crucial to the performance of the market economy and, therefore, in promoting the freedom of individuals as expressed through their choices (Brezinski and Fritsch, 1996; Scase, 1997). If entrepreneurship was to develop, it would have an impact on the process of democratisation in the post-communist countries of SEE.

This has implications for the encouragement of youth entrepreneurship in these societies. Younger people may be more receptive to new trends and opportunities. The encouragement of entrepreneurship at a younger age can positively encourage the values of self reliance and responsibility in younger people and also increases the overall wellbeing of society (Blanchflower and Oswald, 1998).

Another area of interest is the value placed on entrepreneurial culture in post-communist countries. Generally speaking, an entrepreneurial culture is one that values the beliefs, attitudes and norms which encourage entrepreneurial activities in a society. This culture needs to be embedded at all levels of society in order for entrepreneurship and small businesses to have a valued place in a society (Gibb, 1996). In this respect, the social appeal of being an entrepreneur, becoming wealthier and having a sense of achievement, should be part of the benefits of entrepreneurship in societies where the only business culture previously was what Bateman (1997) calls the "bureaucratic-administrative" business culture, which failed to encourage innovative, constructive or efficient entrepreneurial activities.

Moreover, considering the legacy of the past, entrepreneurs in many transition economies have been associated with speculators or exploiters who made use of the economies of shortage at the time, and were part of the black market. The situation is not much different now in many of these post-communist countries, where entrepreneurship is still associated with tax evasion, corruption, criminality and other non-compliant behaviours. As Chilosi points out:

> [I]f an entrepreneur, instead of being subject to the rule of law, must look for the protection of politicians and local authorities, lobby them and bribe them together with bureaucrats, and the social prestige attached to his status is inadequate, then the psychological advantage of choosing entrepreneurship in relation to other life alternatives, such as being a rentier or an employee, may be drastically reduced. (Chilosi, 2001, pp. 340-341)

The overemphasis on the process of privatisation and a top-down transformation of the economy pursued in the majority of post-communist countries did not contribute to the creation of better and more efficient enterprises to replace the old ones. Instead, the focus on the speed of the process or 'privatise now, regulate later' (Stiglitz, 1999) contributed to the creation of strong interest groups with a stake in maintaining the monopolies and hampering efforts to create competitive markets in these countries. In this way, people with good connections to the reformers who, in turn, had the right information were the ones that benefited most from the privatisation process by converting the limited *de facto* property rights into *de jure* ones and at the same time, opened the way to protective activities, rather than productive investment and longer economic horizons (Feige, 1997, p. 29; Stiglitz, 1999).

The "privatisation from below" (Winiecki, 2001; Boettke and Leeson, 2002) or the "bottom up transformation" (Brezinski and Fritsch, 1996) was not given proper attention by the creation of the conditions for enabling entrepreneurship and the creation of a private sector. However, in post-communist economies where private activities and entrepreneurship were alien to the central systems it could be expected that younger people would be the first to grasp the opportunities and to embrace entrepreneurship as a viable employment alternative. As a matter of fact, in these countries many businesses have been started by young people as opportunities in the public sector declined. In Croatia, for instance, it was observed that the highest number of entrepreneurial activities were in the age-group 25-34, with the second highest in the 15-24 age-group (Reynolds, Bygrave and Autio, 2003). Such groups are those that may be entrepreneurial because of necessity, as well as to pursue an opportunity. There is a tendency to overemphasise "forced entrepreneurship" in the literature on post-communist countries as a characteristic of entrepreneurship in these societies (Scase, 2000), however, there has been criticism of such categorisations (Smallbone and Welter, 2006). Rather, the reasons for entrepreneurial activities amongst these age groups should be seen as a complex blend of a range of factors including age and educational attainment.

Another problem cited is related to the obvious mismatch between the demands of the labour market and the qualifications that are offered in education curricula. This makes it more difficult for educated people to find a job to suit their qualification. The problems that have accompanied the transformation of many of these economies have also contributed to the creation of an extensive informal labour market. This has brought with it another daunting problem for young people in parts of the SEE region which is related to the lack of decent work opportunities. More than ten years after the collapse of communist regimes in the region and despite obvious signs of economic recovery in most SEE economies, the average youth unemployment rate in SEE remains 2.5 times higher than the EU average and three times higher than the adult unemployment rate (La Cava, Lytle and A. Kolev, 2005). This contributes to a problem which is regularly reported in some post-communist economies in the SEE region, notably the high number of unemployed youngsters that do not even look for a job. Apathy and scepticism about recovery and growth in a region that has suffered from a long and dramatic transition have been noted amongst young people. Moreover, the uneven development in these countries with entrepreneurial activities concentrated in the capitals and major cities also contributes to the spatial nature of unemployment and youth problems.

It is noteworthy that the problem of SME sustainability is acute in many countries of the region, and that the death – or exit – rate amongst small enterprises has been relatively high. Disparities in the entry rate across SEE countries points to another problem characteristic of the SME sector – the presence of significant barriers and difficulties to establishing new enterprises which aspiring entrepreneurs face. In this respect, entrepreneurs often confront economic barriers to entry such as those related to resources, technology and/or government restrictions which can be institutional in nature or policy-driven (Broadman *et al*., 2004). Different studies undertaken in SEE countries have indicated that policy or regulatory inconsistency has created a lack of certainty and a general sense of caution within the business community about making investments. The most important barriers to entry are administrative burdens, high tax rates, the high cost of credit, corruption and the anti-competitive practices of other businesses (Hashi, 2001; Bartlett and Bukvic, 2001; Bartlett, Bateman and Vehovec, 2002; Broadman *et al*., 2004).

These barriers not only discourage many entrepreneurs, including young people, from pursuing their ideas in the market, but they also lead to a sub-optimal selection of entrepreneurs in the market. As a result of the above-mentioned difficulties in conducting business in these areas, the most successful entrepreneurs are those that are better in bribing or getting along with politicians and bureaucrats (Chilosi, 2001). This situation creates rent-seeking entrepreneurship, which harms the productive entrepreneurship that will contribute to economic growth. Furthermore, some of these barriers, such as corruption which often takes the form of petty corruption like bribing are widely considered in the literature as an informal institution. The need for many entrepreneurs to spend their time dealing with the inefficiencies of the system harms sustainable entrepreneurship by diverting the resources that could be utilised more productively (Smallbone and Welter, 2003). These features create a further disincentive for young people to engage in entrepreneurship by sending the wrong messages about it.

Opportunities for entrepreneurial activities differ from country to country, depending on the structure of local demand. At the same time, the mix of opportunities available to would-be entrepreneurs at the local level may change very quickly, as countries become more integrated into the European Union or into the global economy, as has happened with many of the CEE countries. It is important for policy-makers to develop youth entrepreneurship policies which take these perspectives into account and promote entrepreneurial activities that could benefit from enlarged markets.

YOUTH INITIATIVES IN CENTRAL EAST AND SOUTH EAST EUROPE

Government level initiatives

One way governments show their commitment to addressing youth problems is by designing appropriate youth strategies that are based on extensive research into the lives of young people and produced by incorporating the voices of all the relevant actors dealing with youth issues. In those CEE countries that have joined the EU, national youth policies have been designed as part of the adoption of *acquis communitaire*. In this respect, the EU acknowledges that its future is highly dependent on integrating young people into society and making better use of their potential to ensure sustainable growth in Europe. To this end, the EU adopted a *European Pact for Youth* in 2005, which is based on the revised Lisbon Strategy[11]. The *European Youth Pact* (European Commission, 2005a) focuses its actions on three main areas:

1. Employment, integration and social advancement.

2. Education, training and mobility.

3. The reconciliation of working life and family life.

In the first area an important emphasis is placed upon the promotion of young entrepreneurs and to encourage young people to be entrepreneurial in their thinking. This aspect of youth policy is evident in a number of programmes that are already in place, such as the *European Social Fund*, the *European Regional Development Fund*, and the *Competitiveness and Innovation Framework Programme*, which all contribute to promoting entrepreneurship amongst young people. While these programmes are aimed at the wider population, the EU has also designed a *Youth Action Programme* targeting youth issues. Of interest is a specific programme called *Initiative for Youth*, which has been designed to support innovative and creative projects promoted by young people. The European Community recognises the need for greater understanding and knowledge of youth problems through exchange and dialogue, as well as establishing networks, all of which will contribute to better policy designs in the future.

Nevertheless, the EU approach to youth unemployment problems appears to be more focused upon indirect measures that aim to facilitate and encourage a culture of entrepreneurship in Europe, rather than through more direct, individual measures aimed specifically at youth. Moreover, the challenge to incorporate youth issues into the broader programmes rests with national, regional and local authorities; they must utilise their knowledge of youth problems to ensure that policies designed at EU level can be used to address amongst other priorities, youth entrepreneurship.

When considering youth initiatives in SEE countries the picture is more mixed. Some countries, such as Croatia, have made more progress in developing youth strategies and have encouraged the participation of other social actors in this process. Others, like Albania, have followed a more centralised path and have

11. The Lisbon Strategy, also known as the Lisbon Agenda or Lisbon Process, is an action and development plan for the European Union. It was set out by the European Council in Lisbon on March 2000.

a youth strategy that was designed without taking into account the voice of young people and of other actors involved in youth issues (Homans, 2003).

When reviewing government policies and programmes for sustainable growth and poverty reduction, one feature is clear: the use of the education system to encourage entrepreneurship, and an enterprising culture, by changing the national curricula. One very recent example comes from Serbia, which adopted a *National Employment Strategy 2005-2010*. The strategy has been harmonised with the *EU Employment Strategy* and the Ministry of Labour, in co-operation with other institutions, prepared the *Action Plan for Employment 2006*. According to the *National Employment Plan*, the main priority will be education and training for entrepreneurship, and educational institutions will be required to harmonise their education programmes and focus them on the needs of local labour markets (European Commission, 2005b).

In the case of Albania, entrepreneurship education takes place in the context of training programmes for business start-ups. However, the Albanian government appears to be unconcerned about educating for entrepreneurship (Xheneti, 2006). Indeed, the attention devoted to entrepreneurship education in Albania was scant until the recent 2004 Enterprise Policy Performance Assessment (EPPA) (OECD and EBRD, 2005) report on SME development in Albania, which emphasised the role and importance of education and vocational training. A turning point in this respect was the EU Charter for SMEs that the Albanian government adopted in September 2003. The Charter reflected the EU agenda on the need for SME owners to acquire entrepreneurial attitudes and skills, and training to create a business (European Commission, 2003). The action plan of the European Commission to promote entrepreneurship argued that:

> In order to create a strong and vibrant business community we have to start by developing a spirit of enterprise, and a different approach to risk-taking as well as recognition of the value of failure as a learning experience. At present, most people do not think of, and are not prepared for an enterprising life.
>
> [...]
>
> Entrepreneurs, in contrast, need an education, which gives them attitudes, and skills such as self-motivation, creativity, opportunity seeking and the ability to cope with uncertainty. There is a fundamental cultural problem in Europe in that these concepts and skills are not sufficiently present in national education systems either at primary, secondary or university level (European Commission, 1999, p. 7).

However, the Albanian government has not yet expressed an equivalent interest in entrepreneurship in the above terms in any documents or action plans. This lack of expression puts in doubt the government's real commitment to entrepreneurship policies and suggests that its decisions are taken mainly to fulfil EU conditionality (Xheneti, 2006).

Efforts to provide entrepreneurship education are required because, as was mentioned previously, there are a large number of young unemployed people in these countries due to a mismatch between the education curricula and the demands of the labour market. Moreover, the negative attitudes towards entrepreneurship can be overcome only by a significant effort to change them through entrepreneurship education.

Nevertheless, there is a more pressing reason to develop policies and strategies for those many young people who do not attend school. In this respect, vocational training outside the formal education system becomes very important and needs to be incorporated in the broader employment policies and entrepreneurship and small business policies.

In all the SEE countries, vocational training, not part of the education system, is tackled through the network of employment agencies spread all over their territories. The activities of these employment agencies are mainly oriented to the unemployed or those who will be affected by redundancies as a result of restructuring processes. Another way the unemployed are addressed in these countries is through entrepreneurship and small business development agencies. The examples outlined below are run by agencies for entrepreneurship or small business development in the CEE and SEE countries.

In Serbia the National Employment Service (NES) is responsible for the implementation of the Employment Action Plan, as mentioned earlier, through the application of active employment policy measures, including training for start-ups and promotion of entrepreneurship. By 2005, the NES had developed a network of 16 business centres. About 20 000 beneficiaries, primarily unemployed people, were included in a range of different business centre activities. 11 500 people attended seminars conducted by NES trainers and 11 250 have started their own businesses (European Commission, 2005b). These business centres are organisational units of the NES's branch offices, thus regional coverage is ensured, and they represent the main actors in increasing employment by encouraging entrepreneurship.

The beneficiaries of these Centres are those who seek employment – all categories of unemployed, surplus employees, employers/entrepreneurs, and others. The Centres provide information, advisory and educational services. These services are continuous and in line with the needs of beneficiaries, and one-day seminars are organised and conducted by NES trainers, with workshops lasting around three hours. The Centres provide advice on issues including, business registration, financial sources, employment regulations and also legal advice.

In Albania, the National Employment Service is the responsible institution for vocational training, through eight Vocational Training Centres. Moreover, about 102 NGOs and private individuals were licensed by the Ministry of Labour and Social Affairs during 2004-2005. These have delivered vocational training in tailoring, IT skills, plumbing, and hairdressing for 6 245 trainees, of which 56% are under 21 years old (European Commission, 2005c).

In Slovenia, the Ministry of Labour, Family and Social Affairs has a special programme for the promotion of self-employment as part of active employment policies; it is intended to address and prevent unemployment through self-employment and the subsequent creation of new jobs. The aims of the programme are connected to the EU Guidelines to the promotion of entrepreneurship and the creation of new jobs. In 2003 the *Promoting Self-Employment Programme* was aimed at unemployed persons and at workers whose work had become permanently redundant or whose employment contracts had been terminated for business reasons. A total of 2 561 persons were involved in 2003 (of this number, 1 897, or 74%, became self-employed) (European Commission, 2003).

In Bulgaria, a vocational training system has been developed that aims to increase the access to training for the adult population and enhance the skills level of the workforce. This should include the further development of continuing training activities both for employees and for the unemployed as an integral part of active labour market measures, especially for those population groups at risk of unemployment and/or of social exclusion (ETF, 2004). Vocational training can be offered by a large number of actors such as employment agencies, private and public training centres, NGOs and enterprises, however a disparate range of providers can create confusion for people as to where to go for help.

The initiatives mentioned above are of a more general nature which attempt to address unemployment problems in their societies by including youth as one of the groups of unemployed people. However, there is less evidence of youth specific government funded initiatives, with a limited number of programmes running in various countries.

Start-up assistance and business development assistance

When it comes to start-up assistance and business development assistance the emphasis tends to shift towards international organisations. In this respect one of the main programmes on youth entrepreneurship, *Youth Business International* (YBI) has been present in the countries of SEE. Youth Business International is a programme of *The Prince of Wales International Business Leaders Forum* (IBLF). The objective of YBI is to mobilise the global business community to help those young people who are unable to find help elsewhere to become entrepreneurs and set up their own businesses. YBI is guided by the principle that if young people are supported in starting up their own enterprise, they can contribute to strengthening the small business sector. As such enterprises grow and develop they may be able to employ other people, so having positive effects for the communities in which they are based. The YBI's programme has three core principles:

- To work with disadvantaged young people.
- To provide access to financial support to those young people with a viable business proposition but who are unable to find support elsewhere.
- To provide successful applicants with a volunteer business mentor and full access to the organisation's local and national business support network (Chambers and Lake, 2002).

YBI's programme is designed on the basis that even if a business is not successful the young person has learned from this experience and their employability will be increased. The programme works with the business community through local, national and international partnerships that are facilitated by YBI and IBLF. The IBLF comprises corporate members committed to promoting international leadership in responsible business practices. It counts some of the world's largest companies among its members, many of which work at the grassroots level with YBI to promote youth entrepreneurship.

The YBI's core principles were first developed by The Prince's Trust in the UK in the 1980s. In the last few years these ideas have been taken up by a number of countries around the world. In CEE the first country to apply one of these programmes was Hungary in 1993 by the Eletpalya Alapitvany Foundation. Pilot programmes are running in Poland and Albania. Considering the success of these programmes and the ease of replicability based on local conditions, other CEE and SEE countries including Croatia and Slovakia have expressed their interest in implementing programmes of the same nature (YBI, 2006).

Another initiative in support of youth entrepreneurship is the Balkan Children and Youth Foundation (BCYF). It was created in 2000 and is part of a global network of youth-serving organisations which work in partnership with each other to improve the lives of millions of young people around the world. BCYF was created in the Balkan region and aims to strengthen the capacities of young people in the region through support and networking opportunities. Only a year ago, BCYF emphasised its new focus on strengthening the economic and social engagement of young people in the Balkan region. According to the BCYF (2005) the Foundation's intention is to do so through programmes that aim to increase the employability of people in the region and stimulate business entrepreneurship and youth entrepreneurship.

Training outside the formal education system

The European Training Foundation (ETF) is an agency of the European Commission, established in 1990 to contribute to the development of the education and training systems of EU partner countries. ETF assists partner countries in developing quality education and training systems and putting them into practice. ETF work is based on the belief that education and training can make a fundamental contribution to increasing prosperity, creating sustainable growth and encouraging social inclusion in developing economies. ETF is running a project in some SEE countries (Albania, Croatia, the FYR of Macedonia, Serbia and Montenegro) which will investigate how national educational systems are supporting the development of core competences and how different segments of the education systems support the development of 'learning to learn' and 'entrepreneurship'. Policy recommendations will be made to national governments on the basis of the research. In Croatia the research will be conducted at the level of primary education only, whilst in Serbia it is at the secondary level only, whilst both levels will be examined in Montenegro, and secondary and higher education in Albania and FYR of Macedonia.

Training is offered by a large number of support actors in the CEE and SEE area. However, the majority of these actors are international donors that have funding available for training activities and who, in the majority of the cases, do not make any distinction between training for start-ups in general or training for young entrepreneurs' start-ups. Nevertheless, a review of the work done in the field identified the following training initiatives in the region.

In Croatia, Microsoft Croatia and the UN High Commissioner for Refugees provide training for refugees and displaced persons in order to equip them with the basic IT skills that will increase their chances of getting a job. Numerous initiatives are found in FYR of Macedonia with the private sector involved in offering training and employment opportunities to young people (Homans, 2003). In Albania, the SOROS Foundation has funded projects which aim to increase the entrepreneurial skills of women and young people with the co-operation of regional development agencies in the country. In the framework of a wider project for economic development promoted by TEULEDA (an Albanian Foundation), established with the support of the UNOPS-PASARP programme (European Commission, 2005c), a competition has been organised along with the University of Shkodra and Chamber of Commerce of Shkodra which aims to promote the best new entrepreneurship idea for a business start-up or to further develop an exiting business in the district of Shkodra. Three winners had 1 000 USD to support their business idea in any of the following sectors: handicraft, fishing, tourism and agro-industry.

However, these one-off initiatives do not track what happens to those young people who have attended the training. While it is true that the employability of young people who have undergone training is increased, there is no evidence on how the participants were selected, what were the accepted benefits of such training, and no general evaluation of these programmes.

BEST PRACTICE EXAMPLES OF YOUTH ENTREPRENEURSHIP SUPPORT PROGRAMMES IN SOUTH EAST EUROPE

In the previous sections, an emphasis was placed on the general types of initiatives that have been designed to encourage youth entrepreneurship through direct or indirect forms of support. In this section, some of the initiatives that could set a positive example to be replicated elsewhere in SEE countries are reviewed in more detail. Three types of initiatives have been selected: one each from the international community, the government and the civil society organisations in three different post-communist countries.

Youth Business Albania

Youth Business Albania (YBA) is the product of a unique partnership between the *Balkan Children* and *Youth Foundation*, *Youth Business International* and the *Mjaft Foundation*, which is responsible for implementing the programme in Albania. Albania is one of the poorest post-communist countries and has experienced a variety of problems in the transition years that have negatively affected young people. A large number of youngsters leave school either for economic reasons or because they are unhappy with the programme offered at schools, with the majority belonging to the first group.

YBA is a very recent initiative and was launched in 2005. It aims to provide financial support and technical assistance to young people who aspire to start-up their own business. According to BCYF figures (2006), 17 loans have already been provided to young entrepreneurs aged 21-29 years old which, due to this financial assistance and to the other forms of support that YBA has offered, have employed 50 young people to date. The business ideas vary from internet centres to those offering recreational services.

Positive aspects of the scheme

- The initiative is based on appropriate local delivery mechanisms, such as Chambers of Commerce and Legal Studio Tonnuci. Their contributions complement each other in offering the full technical assistance that is needed to start a business. In this respect, the scheme benefits from the participation of the Chambers of Commerce which help with the licensing procedures for young entrepreneurs. Most importantly the Chambers of Commerce of Albania allocate business mentors to all the participants that advise on issues related to running an enterprise. The legal studio helps with the legal requirements of running a business in Albania.

- This initiative aims to not only make a change among the people that are already part of the programme but also to raise awareness about the scheme. Many support initiatives are not sustainable simply because they do not raise awareness amongst the groups they offer support to. In a country like Albania, the role of raising awareness is crucial in nurturing the already fragile entrepreneurial culture that has been crated during the transition years. The promotion of young role-model entrepreneurs can act as an incentive for other young people to consider entrepreneurship as a viable alternative that can offer them good career opportunities and which also makes a difference to the communities in which they live. Furthermore, it might have an impact in reducing the number of young Albanians that do not see any good job opportunities in the country and simply emigrate.

- MJAFT Foundation, the implementing partner of the scheme, has been working on youth issues for a number of years which increases the chances of good cooperation with young people in Albania.

- The scheme is based on personal initiative which means that young people are the ones that come up with the ideas. The scheme acts only as a facilitator in putting ideas into practice.

Aspects that need further development

- YBA is concentrated in the capital, Tirana, which has the highest level of enterprise creation and also the highest concentration of enterprises in the whole country. Whilst making a contribution to changing the lives and fulfilling the dreams of many young Albanians in becoming entrepreneurs, YBA risks replicating what the majority of programmes do; that is, they are concentrated in the capital where it is easier to identify business opportunities and where a network of support for entrepreneurs is already present. This leaves other areas of the country without much-needed support.

- The scheme needs to develop a commercial orientation so as to reduce the legacy of dependence evident in many SEE countries.

- The scheme is in its early stages. Nevertheless, experience with other youth schemes has shown that there is a need for flexibility, rather than rigidity, in administrative procedures in order for young entrepreneurs to really benefit.

Developing entrepreneurship and creativity among young people: Slovenia

In Slovenia the programme *Developing Entrepreneurship and Creativity among Young People* is delivered by the Small Business Development Centre and brings together different national measures for promoting the development of entrepreneurship and self-employment amongst young people between the ages of 12 and 30 (European Commission, 2003a).

In 2003 the bulk of the funding came from the Ministry of the Economy and the Employment Service of Slovenia, with part funding from extra-budgetary funds for programme implementation. The following activities have formed part of the scheme:

- Training programmes for entrepreneurship (11 different programmes).

- Support projects (10 different projects).

- Mentor training (2 forms of training).

- Promotion of the programme nationally and internationally.

- Links to international networks.

- Management and monitoring of programme implementation.

In 2003, a total of 4 857 young people were involved in the programme (2 079 in training for entrepreneurship programmes, 2 778 in support projects). The participants in the training for entrepreneurship programmes were:

- 55% female, 45% male.
- 73% primary school pupils, 19% secondary school students, 4% college and university students, 4% young unemployed persons.
- 72% aged 12–15, 18% aged 16–19, 8% aged 20–24, and 2% aged 25–30 (European Commission, 2003a).

As part of the programme, additional training has been provided for 89 people currently working as mentors. These mentors will continue to carry out various forms of training for entrepreneurship and other projects within the scope of the programme.

The programme has been promoted locally, nationally and internationally and active involvement in various international networks aimed at entrepreneurship among young people has continued.

With the aim of encouraging and promoting entrepreneurial endeavours among young people, a selection was made of the best enterprise plans compiled by young people (15 teams involving 58 students took part in the competition) and a prize awarded to the most inventive and enterprising idea (59 projects/tasks were entered in the competition).

Positive aspects of the scheme

- This is an example of a government being proactive and encouraging entrepreneurship outside the education system. It accords with one of the indicators of good youth policy outlined by the European Youth Forum according to which governments should promote an active learning process for young people outside the school system.
- It promotes the training of youth mentors who could contribute to raising awareness on youth entrepreneurship and entrepreneurial related skills.

Aspects to be developed

- The scheme could be further developed to contribute to the future prospects of those not enrolled in education.
- Some funding could be provided to enable the programme to deliver a more comprehensive package of support to certain groups of young people that are either unemployed or that are just about to finish their courses in the education system.

Youth Education Centre: Serbia

The NGO Civil Initiatives has participated in the implementation of the *Youth Education Centre* project in two areas of Serbia: Aleksinac and Zajecar. The project has a broad focus, from training and encouraging young people to become actively engaged in seeking jobs, to encouraging self employment and entrepreneurship among these young people. This project involved 300 young people, between the ages of 17 and 28 (European Commission, 2005b). It involved young people acting as educators and supporters of their fellows and is a good example of how self-improvement can be encouraged amongst young people and their social position improved. Seminars focus on motivational training, meeting legal regulations and business planning, while workshops encourage self-assessment by the trainees in order to see whether they have entrepreneurial skills and the basis upon which to prepare a business plan.

Taking into consideration the motivations behind self-employment and entrepreneurship, the Civil Initiatives NGO established a close partnership with the National Employment Service and started a pilot project to encourage youth entrepreneurship in September 2005. The aim of this pilot project is to equip young people with skills relevant to self employment as well as establishing consultancy services for them. There is also the provision of grants for start-ups for young people in the two pilot cities of Aleksinac and Zajecar. Thus, young people will have a chance to apply the knowledge they have acquired and actually become self-employed.

Positive aspects of the scheme

- This initiative provides young people with a package of services needed to establish their own business.
- It has a particular focus on two cities and tries to address their youth problems.
- It is based on the active involvement of civil society and government structures, which might imply that the project is based on clear objectives.

Aspects to be developed

- The initiative could work better if young entrepreneurs were supported by mentors in their first years of business activity.
- Partnerships with NGOs in other cities could be developed in order to raise awareness of the programme amongst youth organisations and, if possible, to replicate this project.

POLICY RECOMMENDATIONS FOR YOUTH ENTREPRENEURSHIP IN SEE

A review of the programmes that have been designed to encourage youth entrepreneurship in SEE countries showed that youth entrepreneurship is an under-explored area. Governments in these countries have great difficulties in harmonising the actions of different ministries which have responsibility for youth at a national level. Moreover, strategies often lack a regional focus and fail to reflect the priorities of different regions in terms of youth problems, or to design and fund programmes which support youth entrepreneurship. At the same time, in the majority of SEE countries the business environment is not conducive to entrepreneurship, which adds to the problems related to youth entrepreneurship. The unfavourable business environment could compromise the efforts directed towards the design and implementation of any initiatives to support youth entrepreneurship. Nevertheless, the potential for youth entrepreneurship should be considered in the context of the economic realities of the countries in question in order to avoid unrealistic expectations or wrong choices. In this respect a number of policy recommendations can be derived from the above discussion:

1. Youth unemployment is a major concern in the countries of SEE, which might imply a need to develop actions in support of youth entrepreneurship as a viable employment option in these countries. EU membership of some SEE countries has been accompanied by differences in actions at a national level. Nevertheless, the problems seem to be the same in both EU and non-EU SEE countries. The idea of creating a youth employment strategy is not new. As Curtain (2000) notes, if well developed, it will build on young peoples' views on what can be done, and it will benefit from the propensity of many youngsters to take risks and to exploit new economic opportunities. Youth problems are not, on the whole, very well incorporated into employment strategies and policies which these governments have undertaken. The review shows that in many of these countries, employment strategies have only been designed in recent years and do not have any particular focus on youth entrepreneurship. Youth problems are tackled through the same structures that have been created for the rest of the adult population.

   Governments in these countries should enforce inter-ministerial and departmental co-ordination and design policies and programmes that consider the specific problems of youth. The exchange of experience on youth entrepreneurship from other countries is important and, as outlined above, has taken place to some extent. Nevertheless, the success of a programme is higher when it is specifically suited to the local conditions and circumstances.

2. Some SEE countries are confronting difficulties with the processes of decentralisation. Therefore, it is important that a particular focus is directed at strengthening all governance levels. While strategies in many cases are designed at a national level, they should be regional in focus since it is the regional and local authorities that are more knowledgeable of the local population needs, including those of young people.

3. None of the programmes on youth entrepreneurship will be successful unless governments work on creating an enabling environment for investment and enterprise creation as essential for growth and employment. Of great importance is the improvement of the institutional infrastructure for entrepreneurship. In many SEE countries entrepreneurial activities in general are hampered by a non-favourable regulatory framework, poor access to finance, a lack of skills and the inadequacy of other forms of support.

4. The majority of the initiatives that involve funding have been designed by international organisations or donors, based mainly on the experience of other countries, as the case of Youth Business Programmes showed. It is of paramount importance that a strong partnership between the relevant government structures and international organisations is created in order to work together to identify which of the more acute problems will be addressed by a donor programme. Strong links with the government and other national, regional and local level structures are important in order to identify the objectives of the government in terms of entrepreneurship

development and youth entrepreneurship and to identify what programmes are already in place. This will ensure that overlaps between programmes are avoided, since such overlaps have been a common feature of business support programmes in many post-communist economies (Xheneti, 2005). Most importantly, this will make sure that initiatives on youth entrepreneurship are based on clear objectives and represent real priorities.

Governments in all these countries should be more proactive in their approaches to promote youth entrepreneurship. Countries such as Bulgaria or Romania should make better use of the EU programmes which address youth issues. SEE countries could be more creative in terms of the programmes that can be funded under the CARDS programme.

Another implication of the fact that a majority of programmes on youth entrepreneurship are run by international organisations is the strengthening of civil society and NGOs in SEE, and the potential for them to play a more active role in tackling the problems of youth.

5. As has been made clear throughout this chapter, programmes which offer a package of services to young entrepreneurs are more successful than those that do not. Their success reflects the fact that they address those issues that make young people a risky target for enterprise creation. These programmes offer support for young people in acquiring the skills which they might lack, offer mentoring during the first years of their activity, as well as finance for the entrepreneurial business idea. The development of such programmes to support youth entrepreneurship in SEE countries should be encouraged.

6. Another issue of concern is related to microfinance. Firstly, no microfinance institutions were identified in these countries as focusing only on young entrepreneurs. Secondly, while microfinance has been used satisfactorily in many countries as a means of reducing unemployment and supporting the disadvantaged, experience has also shown that microfinance institutions may deviate from their original target group or region in order to remain sustainable. This means that particular attention should be directed to the identification of the groups that are going to be addressed through microfinance institutions and to less restrictive lending conditions.

7. Linkages between education, employment and business development appear to be weak; this highlights the need for strengthening them. If well developed, the link between the three can result in encouraging different types of entrepreneurship amongst young people rather than only necessity-induced entrepreneurship. Thus, young people who are already equipped with certain skills will find it easier to seize new opportunities offered by the market. This type of entrepreneurship is more likely to have externalities in terms of job creation which fulfils one of the most important roles played by entrepreneurial activities.

8. The majority of the programmes are only active for a short period of time; programme continuity should be ensured. Although it is important that effective programme evaluation procedures be developed so that their advantages and disadvantages can be taken into account in the design of other programmes. It is usually the case that the funding bodies of a programme do the evaluation of the programme too. However, quite often programmes consider their success in terms of the number of people that have been involved in training activities which does not say much about the future prospects of these young people. Assessing performance against

established benchmarks is a valuable way of making progress (Storey, 1994). Knowledge about what works and what does not work in terms of the relevance, effectiveness and efficiency of policies and programmes on youth entrepreneurship is important in ensuring the success of programmes in the future. Programmes should also develop some form of counselling services for young entrepreneurs that have failed in order to assist them with their future plans.

9. An important conclusion is that youth entrepreneurship policies and programmes should complement broader youth employment strategies and entrepreneurship and business development policies. It is of paramount importance to develop policies and policy instruments which are flexible and selective enough to ensure that the majority of young people are provided with an appropriate set of skills and relevant experience prior to their entry into the real world of business. Considering the growing flexibility of economies, the rapid pace of technological change, the pressure of competition generated by globalisation, and the challenges SEE countries face to join the EU, it is increasingly acknowledged that to avoid the risk of large-scale marginalisation, societies should encourage the development of entrepreneurial skills amongst their younger members.

   The problem for many countries of the region rests in the fact that entrepreneurship is not very well understood (European Commission, 2005). It is linked mainly to management training instead of being considered as a process of acquiring attitudes and a spirit of entrepreneurship. Various courses in business administration and management, economics, problem-solving etc. have been introduced into the school curricula to promote a culture of enterprise and the idea of self-employment as a career option. Attempts have been made to make professional education in business management in further and higher education less academic and more linked to the needs of the business sector and local communities. Similar efforts have been made to expose secondary school students to the realities of business. These efforts will ensure that young people come to be seen as a resource. However, such solutions are by necessity long-term rather than 'quick-fix', ad hoc answers to short-term problems.

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CHAPTER 6:

MAIN ENTREPRENEURSHIP POLICY CHALLENGES IN SOUTH EAST EUROPE

by
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OECD LEED Programme

This paper identifies some key overarching messages from the publication. It starts by underlining the South East European context. It then presents policy recommendations relevant to all the themes of the publication.

THE SOUTH EAST EUROPEAN CONTEXT

The countries of South East Europe have gone through a recent process of rapid economic, social, and political adjustment from a socialist economic system to a market system. However, its local framework conditions in terms of local business regulations, access to finance, access to premises, access to trained labour and so on still fall short of providing a favourable environment for entrepreneurship and SME development. Furthermore, its local entrepreneurship and SME policy instruments and its institutional delivery of these policies could be strengthened further towards international best practices. The potential to intervene to strengthen the local entrepreneurship environment in South East Europe is highlighted in each of the areas examined by the papers in this publication.

Firstly, SMEs in South East Europe still perceive access to finance as the main impediment to the development of their business. Far from a mere impression, this perception is borne out by the statistics of the IFC Investment Climate Survey, which shows how internal finance largely remains the main source of finance for new investments in the region. For example, in the former Serbia and Montenegro and in Albania, roughly 80% of firms' new investments are financed through internal funds or retained earnings, while in Romania this percentage exceeds the 70% threshold. Difficulties in SME access to credit are not new, nor peculiar to South East Europe. What is specific to the region, however, is the extremely high value of collateral needed to secure a bank loan. IFC work suggests that when calculated as percentage of the loan value, the value of collateral needed easily approaches the 200% threshold in countries such as Bosnia and Herzegovina and FYR of Macedonia. This situation is often made more difficult by banks asking for land or property, rather than moveable assets, as collateral.

There are many local approaches to improve access to finance in OECD Member and non-Member countries that can be applied to address these problems. Whilst policy makers often focus on the supply of investment capital, for example venture capital or and micro-credit provision, potentially some of the most effective approaches for South East work either on the demand-side or on intermediation. For example 'investor readiness' programmes provide advice and support to new and small firms to help them assess their best financing options and prepare themselves to access this finance. Similarly, various types of mutual guarantee schemes and integrated finance initiatives help bridge the gap between SMEs and potential investors.

In the field of internationalisation South East European SMEs often face many hindrances. Some of these barriers are internal to the firm, while others are external in the local business environment. Problems meeting the costs of internationalisation (legal and export counselling, translations, foreign market analyses, etc.), insufficient networking, and limited language skills belong to the first group, whereas poorly developed financial markets and a cumbersome legal framework are examples of the second. Again, advice and consultancy can be an important response. It can help firms to assess their international competitive position, understand how to strengthen that position and access relevant policy support. Indeed, a range of measures exist to strengthen firm access to international markets. What is important in applying them is to target closely to those firms with international potential and provide them with integrated and tailored support. Local knowledge and proximity can be important to effective delivery of this support and guidance and capacity building of local policy organisations may be required to reach best practice internationally.

The proximity of the South East Europe region to the European Union and indeed the EU membership of some SEE countries (Bulgaria and Romania), provide an enormous opportunity for SME internationalisation, not only in terms of export opportunities towards the EU, but also the possibility to enter value chains led by EU multinationals. For this to happen in a sustainable way, however, SEE competitiveness cannot rely only on cheap factors of production (low labour cost or eased access to raw materials). Price-based competition is fierce and the cost advantage of the SEE region is already increasingly being eroded by the advance of lower labour cost countries and regions such as India, China, and South East Asia. It is evident then that the issue of SME internationalisation is closely linked to that of innovation, since firms that are able to innovate in terms of differentiated products or increased efficiency are better able to withstand competition in domestic markets from overseas and to export themselves. In the move from a regional competitiveness based on cheaper factor costs to another founded upon greater added value functions, sound public policies in the fields of technology and innovation play a crucial role. The type of innovation policy approach used however must fit the needs of the businesses concerned and the localities in which they operate. There may be a temptation to develop strong technology supply driven approaches based on certain university research strengths and creation of science and technology parks. These have their place in the innovation policy environment, particularly around the best centres of science strength in SEE countries. However, even more important is the upgrading and diversification of the more traditional SMEs that make up the bulk of the business base. Skills and management development initiatives are critical as well as efforts to encourage firms to collaborate together and with other organisations in innovation activities.

Overall, strong attention needs to be placed on building skills and motivations for entrepreneurship. This may seem to be a difficult challenge to meet given the legacy of socialist times when entrepreneurship was not a strongly valued social trait. However, there are some positive signs and trends in South East Europe concerning entrepreneurship attitudes and culture. Attitude surveys, for instance, show that people in the SEE region are less risk-averse and thus more willing to undertake entrepreneurial ventures than in most other countries of the EU. Fear of failure is also less of a concern, even though this can be the result of lack or poor quality of opportunities as wage-earners. In this region, finally, a career in business is highly regarded socially. Generic measures to strengthen entrepreneurial culture, such as entrepreneurship education in schools and promotion of entrepreneur role models, are useful in South East Europe, just as in other regions. However, what is even more important is focusing these efforts towards encouraging a certain type of entrepreneurship based on innovation and the continual search for high value added. For whilst there are many entrepreneurs and potential entrepreneurs the real gap is in developing and supporting those entrepreneurs who can innovate, export and generate new income for the countries and localities in which they are located.

Finally, it is interesting to turn to the question of youth. Ironically at the same time as youth as a group is strongly subject to unemployment problems and difficulties accessing the labour market it also contains some of the most dynamic and skilled entrepreneurs capable of supporting wider economic development. Whilst young entrepreneurs can access standard support for adults it is often the case that they respond better to tailored local initiatives specifically focused on their concerns and difficulties, for example recognising the greater efforts youth needs to make to achieve credibility and to secure finance. There are examples of some promising youth entrepreneurship programmes in South East Europe that could usefully be scaled up. They should also make efforts to follow up and monitor the businesses they help to set up over a longer period of time to help young entrepreneurs not just start businesses but also foresee and respond to the potential dangers of failure.

OVERARCHING POLICY RECOMMENDATIONS

The enabling and facilitating role of public policy

The role of public policy with regard to entrepreneurship promotion and SME development is not one that limits itself to business subsidisation or that pretends to impose top-down strategies. Instead, government at its different levels (international, national, local) is called on to implement a twofold strategy. On the one hand, it should strive to create an enabling environment that – by improving and simplifying business regulations and fine-tuning a wide range of policies (education, trade, innovation, etc) – allows SMEs to start up and expand. On the other hand, whenever this is not sufficient to generate a flourishing SME sector, it should take on a more proactive role by developing the sorts of entrepreneurship and SME policies explored in this publication.

An example of the first type of strategy involves facilitating the access to credit of SMEs not only through bank finance but also through an array of other tools. Particularly suited to the needs of the SEE countries seem to be mutual credit guarantee and microfinance schemes. The former have the merit of reducing information asymmetries and thus the transaction costs experienced by loan providers, in so far as the screening costs of the project viability are borne by the scheme, which also provides guarantees in the event of loan default by one of its members. The second presents the advantage of giving out readily usable sums of money without the demanding collaterals and the stringent rules associated with traditional bank loans. That is why for microfinance to continue being successful, it is imperative that lending regulations be kept slim and flexible, at least as long as funds come from donors and not depositors. Similarly, in the field of business internationalisation, the creation of an enabling environment will involve the setting up of a tax regime that does not penalise venture capital profits and a finance system which encourages internationalisation through such instruments as export credits and export guarantees.

Local development agencies, on the other hand, epitomise the second, more proactive, strategy that policy-makers may be required to put into practice to foster entrepreneurship and SME development. Such agencies may undertake various actions, for example: stimulation of technology transfer; provision of advisory services; provision of business incubators and encouragement of inter-firm networks. These interventions may be needed at certain times to address evident market failures. However, in the long run government should seek to involve the private sector in delivery of the appropriate services. So, for instance, the match between demand (SMEs) and supply (banks) in the financial market can be initially eased by a government-supported business development agency, which in the longer term may leave this role to business angels' networks or, in the best scenario, national or regional stock exchanges.

SME market segmentation and tailored policies

Another point that emerges compellingly from many of the papers regards the segmentation of the SME sector. SMEs are not a homogeneous group and their attitudes towards issues such as internationalisation or innovation differ greatly. Different types of SMEs have different needs and policy success is likely only insofar as such needs are taken into consideration.

The paper on SME internationalisation suggests that less than half of the overall enterprise population show some interest in internationalising its business. The majority has never really considered this option and contents itself with supplying local markets. Even among the 45% of firms interested in foreign markets, only 15% proactively pursue full-fledged business internationalisation strategies, while a greater 30% limit their international activities to importing/exporting, more often as a reaction to concrete orders than as a deliberate export strategy. The needs for public policy interventions consequently vary, depending on the targeted SMEs or the type of SMEs targeted. In some cases the focus needs to be more basic dissemination of information on export finance and foreign markets whilst in others the focus needs to be on provision of connections with potential partners abroad or support for the finance necessary for exporting more sophisticated products.

Similar issues are highlighted in the chapter on innovation policy, where SMEs are broken down into "first ring" and "second ring" according to their attitude toward innovation. Firms belonging to the first ring are those that seek to improve their competitive position by constantly scrutinising current opportunities (financial aid, potential partnerships, etc.) in the surrounding environment. Basically, they are characterised by a high degree of pro-activeness. Firms in the second ring, conversely, have little focus on innovation for cultural or organisational reasons and tend not to access more sophisticated programmes. In their case interventions that seek to increase competitive awareness and business and technology skills can be important in supporting increased innovation activity and competitiveness.

SME market segmentation also concerns the motivation underlying the start-up, it being possible to divide entrepreneurs into "opportunity entrepreneurs" and "necessity entrepreneurs". The former are those who set up a business because of an opportunity they identify and for which they are willing to take a risk; a perfect example is given by spin-off processes in which an employee quits his/her job to start up a business in the same industry. The latter are those who go into business mainly as a result of lack of opportunities as wage-earners. The business survival rate is strongly affected by these start-up motivations as is the type of implied policy intervention. The stronger focus should go to opportunity entrepreneurs, who are more likely to provide social benefits from their growth and are more likely to be faced with problems of growth. More generic support should be provided to "necessity entrepreneurs", with an eye to ensuring that displacement of other local market oriented firms is not excessive.

As for business start-ups, there is also a case to consider enterprises led by young people as different from others. Youth lack the networks, work experience and skills that more mature entrepreneurs have secured over time and this makes them more vulnerable. At the same time, youngsters are more eager to go into business than older generations and more inclined towards those risk-taking behaviours which are so important for entrepreneurship success. At the policy level, this suggests that sound youth entrepreneurship programmes should always provide for counselling and mentoring.

Policy decentralisation

There is also a case for some greater decentralisation of policy design and delivery from national to local levels in South East European countries. Much of the early transition effort rightly focused on establishing conducive national framework conditions for entrepreneurship and business operation. However, as these conducive framework conditions are secured, the policy focus needs to shift to more targeted interventions that address more tightly defined market failures. These often vary significantly between localities.

The specific training interventions or finance packages required to support entrepreneurship, for example, are likely to differ significantly between a peripheral rural area, a high technology cluster and a metropolitan city. Policy design therefore needs to take account of local differences, both in terms of the broad type of locality concerned and in terms of specific local economic conditions within each locality type. Similarly, the design of innovation policy, needs to adapt to the different scale and nature of existing science and technology assets, knowledge networks and innovation capabilities in different localities. An effective innovation strategy will take account of such differences, identifying and delivering interventions that can support existing sectors where a locality may have a national or international competitive advantage and building new activities where national or international competitiveness could be built up by upgrading traditional sectoral strengths and shifting into related activities.

It is also important to acknowledge that many services, such as business incubation, advice and consultancy and firm network creation, need to be delivered in reasonably close proximity to the small business client. This implies a need for local delivery of many entrepreneurship policies.

Increased local policy design and delivery responsibilities nonetheless go hand in hand with the need for capacity building with policy makers at local level. The OECD LEED Trento Centre for Local Development offers support in this respect through its reviews (National Reviews of the Local Dimension of Entrepreneurship Policy, Entrepreneurship and Local Innovation Systems reviews and Local Entrepreneurship Reviews) and its entrepreneurship capacity-building seminars.

Entrepreneurship skills and culture

The theme of entrepreneurship skills has repeatedly been raised throughout the volume as crucial to sustaining the long-term competitiveness of SMEs in the South East Europe region. Thus teaching of leadership and decision-making skills as well as an improvement in the knowledge of foreign languages appears essential to generating an entrepreneurial mindset more open to innovation and internationalisation. In the field of finance, as well, SMEs need to master the principles of business planning and financial reporting so as to make a better case for the viability of their projects and thereby improve credit access. Business plans are still the main formal documents that banks examine when making decisions on loans and these in particular need to be strengthened in many SMEs. Vocational education and technical skills also remain important for upgrading the innovation capabilities of South East European small firms.

There is also evidence that people who have been taught the general principles of business start-ups and management are less risk-averse and more prone to start up an entrepreneurial activity at a later stage. People exposed to the concept of entrepreneurship are also more likely to accept it in other people and thereby to contribute to the creation of a more entrepreneurial culture in society as a whole. It is therefore also recommended that entrepreneurship should become a standard topic of university curricula and included in school education programmes.

Networking and clustering

The issue of the development of inter-firm networks and clusters is another that underlies much of the discussion in this publication. Clusters can be seen as networks of interdependent firms, knowledge producing institutions (universities, research institutes and technology-providing firms), bridging institutions (e.g. providers of technical or consultancy services) and customers, linked in a production chain which creates added value. Firms within clusters benefit not just from formal networking with others, for example for sharing of knowledge on technologies and markets or for joint purchasing and sales, but also from various externalities to do for example with increased specialisation of labour, suppliers and transfers of technologies. Participating in a cluster can therefore help SMEs in securing finance, in innovating and internationalising and in creating entrepreneurial spirits.

In a glimpse, networking and clustering assist SMEs to overcome many of the drawbacks deriving from their size. Firstly, SMEs can reach economies of scale that would not otherwise be attainable on an individual basis: they can save on bulk purchases or on business development services jointly used (e.g. legal counselling, training, etc.); they can attain optimal scale in the shared use of expensive machinery and equipment; they can, by joining production forces, reach out larger markets. Secondly, clustering fosters labour division and firm vertical specialization, which results into greater productivity and innovation. Thirdly, innovation is also boosted at the horizontal level by the knowledge sharing associated with joint action, which is facilitated in a cluster milieu by reduced transaction costs and information asymmetries as a result of geographical proximity. Fourthly, entrepreneurship is encouraged by the presence of role models and spin-off processes.

There is strong scope to strengthen entrepreneurship in South East Europe by promoting clusters and inter-firm networks where the basis for cluster activity exists. This may involve increased networking among indigenous SMEs or it may involve building supply chains around larger firms and inward investors. At the same time it is not appropriate to seek to build clusters where the critical mass and opportunities for success do not exist whilst other support for firms outside of clusters should not be neglected.

An integrated policy approach

The importance of an integrated policy approach is the last and, perhaps most important, of the lessons coming out of this volume. SME finance, internationalisation, innovation, entrepreneurial attitudes and youth entrepreneurship, have been analyzed individually for the sake of clarity and convenience. But it appears evident throughout the entire volume how these issues are closely intertwined. Export finance goes a long way in boosting SME business internationalisation; SMEs' access to value chains heightens regional innovation potential; innovation and entrepreneurship are positively affected by social and cultural values which reward risk-taking behaviours; availability of finance eases barriers young people face in starting and running their own firms. These are just a few of the many potential examples that highlight the importance of an integrated policy approach in entrepreneurship promotion and SME development.

ANNEX 1: ABOUT THE AUTHORS

Belen Barroeta has worked as responsible of the area of innovation and development of INFYDE since 1989, where she has managed and coordinated research work. She has collaborated with national (Central Government, Autonomous Communities, etc.) and international bodies (mostly with the EU and OECD), providing technical assessment for defining instruments and launching new programmes in the areas of Technology Parks, Regional Strategies of Innovation, Innovative Regions and evaluation of Structural Fund programmes. During the last years she has developed a broad range of studies related to regional development policies and instruments in the fields of Innovation and Technology Development.

Jaime del Castillo Hermosa is professor of applied economics at the University of the Basque Country since 1992. He is President of INFYDE (Information and Development) since 1987. He has a longstanding experience in the fields of Innovation and Technology Development, such as: definition and design of policies of innovation and technology transfer promotion, establishment of co-operation networks and assessment in the creation, management and animation of technology parks. He is specialised in the design of territorial development strategies in regions affected by development problems. Prof. del Castillo has a wide knowledge of procedures and instruments of European regional development policy in general and the European structural support in particular. He has worked in several occasions for the EU, OECD, BID, CEPAL (UN) and for regional and local governments in Spain, Portugal, France, Italy, Greece and Bulgaria.

David Irwin is a social entrepreneur - and a consultant in enterprise and economic development working with clients such as BT, Royal Bank of Scotland, Middlesbrough Council, ONE North East, Shell LiveWIRE, Enterprise Northern Ireland, InterTradeIreland, Department for International Development and North East Workspace Ltd. He is now executive Chairman of Cobweb Information Ltd, a business which researches, publishes and markets business information. He has written a number of books (on financial control, planning, strategy and performance measurement) and papers (the most recent on strategy mapping in the public sector).

Anne Kovalainen is professor of entrepreneurship at Turku School of Economics and Business Administration. Previously, she had held professorial posts at the Swedish School of Economics and Business Administration, Helsinki, and Abo Academy University, Turku, both in Finland. She has been a visiting researcher at Stanford University, US, and visiting fellow at London School of Economics and Business Administration and at Bradford University, UK. Economic sociologist by training, her research interests have been, among other things, on entrepreneurship, paid employment and atypical work relations. She has led and participated to several research projects on issues of entrepreneurial activities, economic change and restructuring, quasi-markets on public sector and women's employment.

Marco Marchese is a Policy Analyst in the Local Economic and Employment Development Programme of the OECD. He works in the fields of entrepreneurship and the evaluation of local economic development policies. He is currently undertaking work on identifying and assessing local development tools and instruments in OECD countries and preparing LEED publications on foreign direct investment and entrepreneurship policies.

Jonathan Potter is a Senior Economist in the OECD, heading the policy analysis and advisory activities of the Organisation's Local Economic and Employment Development Programme in the fields of entrepreneurship and the evaluation of local economic development policies. He currently manages a series of OECD multi-country review studies in the field of entrepreneurship, including the Local Entrepreneurship Reviews, National Reviews of the Local Dimension of Entrepreneurship Policy, Entrepreneurship and Local Innovation Systems Reviews and Reviews of Foreign Direct Investment and Local Development. He also acts as Project Development Advisor to the OECD LEED Trento Centre for Local Development.

Karen Wilson founded GV Partners in 2004 with the goal of supporting the creation, evolution and sustainability of ventures. Projects range from working directly with start-ups and new initiatives to addressing the broader entrepreneurial and private equity/venture capital environment, including in the areas of policy and entrepreneurship education. Prior to founding GV Partners, Karen Wilson worked in the venture capital industry. Previously, she worked as part of the senior management team at the World Economic Forum in Geneva, Switzerland and, before that, served as the Executive Director of the Global Initiative at Harvard Business School.

Mirela Xheneti is a Researcher in the Small Business Research Centre (SBRC) at Kingston University, UK where she is currently working on an EU project on the challenges and prospects of cross border cooperation, whose aim is to investigate threats and opportunities for entrepreneurship, formal and informal cooperation in various border regions, and their policy implications. Prior to joining SBRC, Mirela was awarded a Ph.D. at the School for Policy Studies, Bristol University, UK, worked as a lecturer of Business Administration in the University of Tirana, Albania, and undertook MBA studies at Staffordshire University, UK. In the past six years Mirela has had a particular interest on issues of entrepreneurship and small business development in post communist economies from and institutional perspective, and has worked with well known names in the field of entrepreneurship studies in transition economies such as Professor David Smallbone, Will Bartlett and Iraj Hashi.