

PART II

KEY POLICY ISSUES IN ENTREPRENEURSHIP AND SME DEVELOPMENT

Part II of this report is structured in six thematic chapters. Each chapter starts with a summary of main findings from the local case study areas by the OECD. In the following paper, both theoretical and practical aspects of policy action are discussed in light of new policy approaches and options. References are made to good practice initiatives in East Germany and other regions in OECD member countries. A chapter concludes with the OECD policy recommendations presented as a 'Checklist'. Along with a selection of international learning models and good practice examples in East Germany, this final section of each thematic chapter aims to inspire policy innovation and the development of local approaches to strengthen entrepreneurship.

CHAPTER 2

MODERNISING AND DIVERSIFYING EXISTING SMEs

MAKE EXISTING COMPANIES THINK ABOUT THEIR GROWTH

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Introduction

Fostering entrepreneurship and business growth is clearly important for job creation and economic development. When a planned economy transforms to a free-market system, the importance of entrepreneurship is emphasised, since such a tradition did not previously exist in the business culture. In most cases, the transformation includes privatisation of publicly owned property and therefore, changes in ownership structures in the economy. Several challenges exist in changing ownership structures in an optimal fashion. Appropriate physical and institutional infrastructure will be needed to attract private investment, and well-defined strategies and policies should be introduced to provide a welcoming environment for businesses. As Smallbone and Welter (2001a) state, transformation is much more than an economic process. It also includes social change.

The main goal of regional or local economic development is to stimulate local employment opportunities in areas that create prosperity for the community using existing human, natural, and institutional resources (Blakely and Bradshaw, 2002). Strategies for regional development to stimulate and maintain business activity and employment include increasing entrepreneurial behaviour and improving entrepreneurial culture, encouraging new ventures, innovations and start-ups, attracting businesses and investments, and developing and expanding existing businesses.

The business environment includes cultural, demographic, political, and technological factors and natural resources that deviate between and within countries. It is quite evident that in transition economies, the major problems in fostering entrepreneurship can be derived from the cultural background and a non-existent entrepreneurial heritage. However, during the transformation period, a lot of potential can be created for opportunity development. There may be a hidden innovation and growth potential in existing firms that can be unleashed by introducing incentives and initiatives to improve business skills and know-how, increase entrepreneurial spirit, and promote an expansion mentality and an entrepreneurial culture. However, such efforts should not focus solely on innovations and growth. The diversity of local firms and the jobs they create should be appreciated, too (Stark and Brown, 1997).

SME policy from the perspective of modernisation and diversification is totally different in transition economies, since before the collapse of the centrally planned economic system, privately-owned small businesses were nearly non-existent in these areas, except in Poland (Konopielko and Bell, 1998). Thus the development and expansion of existing businesses was not as appropriate a strategy in the early 1990's as it could be today.

This chapter focuses on modernising and diversifying of SMEs in East Germany. Thus the chapter will concentrate mainly on policies designed to retain and expand existing firms, leaving strategies and measures to foster start-up businesses mainly outside the scope of the chapter. The main research question is: what kind of policy measures and characteristics could be connected with modernising and diversifying SMEs in East Germany?

The chapter is organised so that first, previous studies will be reviewed and the definitions of the key concepts will be described. Thereafter, areas for policy intervention will be introduced and appropriate policy responses in selected OECD countries and their relevance to East Germany will be discussed.

Modernising and diversifying SMEs – some theoretical aspects related to East Germany

Small and mid-sized enterprises

In Germany businesses are categorised as SMEs if they employ less than 500 workers and produce smaller than 50 million Euro annual turnover (FMET, 2006). In spite of a different definition compared with many other European countries, the distinction between different definitions will not be made in the chapter. Following the above definition, SMEs represent 99.7 % (about 3.5 million) of all businesses in Germany and they provide more than 70 % of all jobs, producing about two-fifths of the taxable turnover. According to FMET (2006), SMEs are the key vehicle of economic development in East Germany.

Modernising and diversifying

Policy issues and approaches on modernising and diversifying SMEs is challenging since the content of the concepts is not unambiguous, and previous studies of these processes are very scarce. Modernising and diversifying SME's includes both the creation of new ventures in order to revise the structure of the economy and transformation of existing businesses. Policy for modernising and diversifying structure of the economy (distribution of the businesses) could include measures and instruments that create potential for new industries and discourage entrepreneurship in traditional sectors (e.g. in agriculture and fishing). The focus of this chapter will be mainly on existing SMEs in traditional and tradable sectors meaning that policy measures intended to change the structure of economy will be paid less attention.

Malecki (1997) argues that the pace of modernisation is slower in small firms since they lack awareness of new manufacturing methods and opportunity to acquire hands-on experience with new technologies. This argument, even if not more than 10 years old, contrasts with that of Blakely and Bradshaw (2002) who state that technology moves easily around globe and people have virtually global access to information. Faster dissemination of information has shortened the cycle tremendously. Information access for SMEs has become easier, and the shortened life cycle generates new opportunities for them, since SMEs are more flexible than large businesses. But at the same time, tighter competition will introduce new challenges for SMEs.

Modernisation could be interpreted as introducing entrepreneurship and innovations in existing firms. Boime (1976) states: "The entrepreneur, insofar as his activities transform the physical nature of the environment and thus the conditions of experience, creates what I call the entrepreneurial ecology. The term as used in this chapter expresses *the changing character of the contemporary world through material signs of modernity*. Not only do entrepreneurs furnish conspicuous evidence of change, they are the first to call attention to it by their lifestyle." This approach emphasises the entrepreneur's role in the transformation process. Boime (1976) highlights the reason why we believe entrepreneurial talents are crucially important – an entrepreneur's activities transform the physical nature of the environment. He introduces an interesting ingredient to entrepreneurs' roles, stating that entrepreneurs may also act as early adopters on the consumer side.

The start-up rate in East Germany boomed in the early 1990's at the transformation stage from a planned economy to a market economy (Irsch, 2005). The Kreditanstalt für Wiederaufbau (KfW) and

Deutsche Ausgleichsbank (DtA) are two quasi-public credit institutions which channel public funds for venture capital investment for eastern states using regional criteria (Sunley et. al., 2005). These funds have been much more directed at early-stage investment than, for example, what has been the case in the UK (Sunley et. al., 2005). In order to increase their competitiveness, the surviving East German firms mainly modernised their plants and equipment at the transformation stage. Fixed assets of East German firms are still relatively high and their modern capital stock affords the East German enterprises an advantage (Irsch, 2005). That is why modernisation of plants and equipment will not be emphasised in this analysis.

Penrose (1959) observes that diversification is perhaps the most inadequately treated characteristic of business firms in economic analysis. She notes that diversification is sometimes called spreading of production or integration which seems to accompany the growth of the firm. This means that diversification is clearly connected with business growth. Thus, policies to promote diversification in SMEs will be closely connected with policies to foster business growth. Porter (1985) deals with diversification strategies in the context of large businesses, noting that in the 1980's the diversification strategy of businesses changed so that they emphasised diversification to the branches, which is close to the core of the business. Penrose (1959) suggests that utilisation of excess capacity of human capital is the trigger that drives corporate growth and diversification. Rumelt, Schendel and Teece (1994) propose that in order to realise economies of scale, diversification requires resource sharing and/or skills transfer between two or more otherwise distinct businesses. The exploitation of underutilised resources most often involves internal growth, as opposed to acquisitive growth.

A more modern approach to diversification introduces a product – market matrix which describes the newness of a product or service in relation to the newness of markets. Product diversification means the supply of new products to the existing market, whereas market diversification represents the opportunity to sell existing products to new markets. Diversification may take place with new products in new markets. In this case, innovation content is especially high since innovation in all cases presupposes new knowledge whether this knowledge is connected with new products, technologies or markets (Afuah, 1998). In radical innovations, the knowledge required to exploit innovation is competence-destroying, whereas incremental innovation means that the needed knowledge is competence-enhancing (Afuah, 1998). Deakins and Freel (2003) tie diversification strategies to marketing strategy, suggesting that successful diversification requires careful analysis of the market e.g. through a feasibility study. After identifying the need for change, focused strategy for diversified development should be introduced. They emphasise that a successful diversification strategy requires both planning and the education and training of entrepreneurs to foster needed change.

At the firm level, recognition of new opportunities, R&D activities, innovation policy, technology base, knowledge of technology and business, and business skills link diversification with changing internal and external circumstances which affect the productivity of the firm (c.f. Penrose, 1959). These forces both promote diversification and limit the degree of freedom to modernise and diversify. Thus these dynamic changes (modernisation and diversification) are closely related entrepreneurial processes. Iacobucci and Rosa (2002) argue that an important reason for establishing new companies is the need for organisational differentiation induced by entrepreneurial diversification of activities. Diversification could be either geographical extension or entering into new sectors (Iacobucci and Rosa, 2002). If diversification includes the formation of a new company by the same entrepreneur, he could be called as portfolio entrepreneur (Huovinen, 2007).

Driving factors and challenges for modernising and diversifying SMEs

What are the driving forces and challenges which spur SMEs to modernise and diversify? Blakely and Bradshaw (2002) identify four attributes as driving forces of the economy. These forces create new challenges and opportunities. They suggest that driving forces are globalisation, accelerated pace, knowledge base, and networks. On the other hand, we could argue that the overall trend is globalisation, which follows from and includes several different phenomena. The driving factors for the need for modernising and diversifying are:

- accelerating pace and faster dissemination of information and technological development (knowledge base) which lead to a shortening of product life cycles;
- the demand for (low-cost country) outsourcing because of the need to maintain competitiveness. This leads to a mobility of resources and affects small and mid-sized subcontractors of large firms;
- the need for a widening resource base through networking;
- harmonisation of norms and regulations (e.g. Single Euro Payments Area);
- increased demand for safety because of tensions between different cultures and religions.

In addition to globalisation, one trend is digital development which affects the appearance of new opportunities (Malecki, 2003). However, the benefits from digital development, and especially the development of telecommunication infrastructure and technology in remote areas, are controversial. If there is access to the networks and such facilities as broadband, they may create new opportunities for ventures in remote areas and create possibilities for distant work. But as Malecki (2003) suggests telecommunication is not a 'quick fix' solution for development in remote areas, and the desired improvements will be limited to a fraction of remote places. He notices that telecommunications technology cannot make up for human capital deficits. Malecki (2003) argues that a more fruitful approach would be to build and enhance the capabilities of local firms and to attract a share of experienced entrepreneurs who are not willing to live in urban areas.

Corporate social responsibility is sometimes presented as a response to, and sometimes as the result of, new challenges created by economic globalisation. CSR is at once viewed as a response to the crisis of the welfare state producing a new model for social governance and as a framework linked to national competitiveness. The greenhouse effect and changes in climate are increasing concerns and have created the trend of sustainable development. The demand for sustainability of business may be in conflict with some of the above trends, but it creates new opportunities in renewable energies. Demand for sustainability will be extremely important in modernising waste management and may require diversification from energy producers. It will also generate R&D processes and serve as a platform for innovations. For example, the new technology creates opportunities to produce energy and fuels from biomass. The driving forces for this kind of development are the norms and directives which demand carbon-free production.

According to the IBM CEO Study 2006, two-thirds of CEOs are going to make fundamental changes to their business because of intensified competition, escalating customer expectations, unexpected market shifts workforce issues, technological advances, regulatory concerns, and globalisation. Current trends in business are open-source innovations, new business models and the outsourcing of R&D activities. In the IBM (2006) study, those businesses which had grown faster than market expectations used 30% more outside sources of ideas than their competitors. Two-fourths of

the respondents recognised business partners and customers as the best sources of new ideas. Ginni Rometty, the director of IBM consultant services, states that: "You should be able to understand the new opportunities hidden within new business models, operative processes as well as planned changes in management practices."

This means that in addition to human and physical capital, businesses are more and more dependent on social capital. Social capital includes structural dimension (networks, network ties, contacts, interaction and organisation of networks), relational dimension (trust, norms and obligations) and cognitive dimensions (language, codes, narratives, and shared norms) (Nahapiet and Ghoshal, 1998). Open-source innovations and the outsourcing of R&D would benefit from a firm's strong social capital, such as networks and network relationships, but also from a firm's ability to reach consensus with its partners.

How can policy makers support SMEs in their effort to follow and adapt to these changes and trends as they develop their business opportunities? Education and training as well as other forms of dissemination of information could be used to raise the level of awareness and knowledge. But it could be argued that the role of business know-how and commercialisation processes should be emphasised regardless of industry in order to foster regional development, regional entrepreneurship and all its connections.

One potential question is: should we change regional innovation systems framework to a more focused framework for business know-how and skills? The current practice in many countries is to build environments which support technological development, for example technology centres, science parks and incubators. These facilities provide excellent input in the innovation process, but they need suitable context (e.g. connection with R&D activities) in order to flourish. Moreover, they do not focus on business opportunities. The development of an opportunity-focused innovation support system could begin by identifying the producers, brokers and users of business know-how, analysing their needs and introducing tailored programs for their business development (Virtanen and Heimonen, 2006b).

Obstacles for modernising and diversifying SMEs

Dubini (1989) argues that disadvantaged areas possess environmental shortcomings that could be counted as market failure and thus there may be need for some kind of intervention. Dubini's (1989) deficiencies are: 1) lack of entrepreneurial culture and values, 2) lack of networks and support services, 3) lack of tradition of entrepreneurship and family businesses in the area, 3) absence of innovative industries, 4) weak infrastructure, 5) weak capital markets, 6) few effective government incentives. These deficiencies are obstacles for entrepreneurship in general, not specifically obstacles for modernisation and diversification.

Obstacles for modernising and diversifying SMEs could be connected to the resources required in the process and situational factors. Resources include human, physical and social capital. Lichtenstein and Lyons (1996) summarise the obstacles to entrepreneurship to include 1) obstacles to use resources, 2) availability of raw materials, 3) availability of work force, 4) information about the resources (visibility), 5) costs, 6) delivery problems, and 7) capacity problems. The majority of these problems are very concrete and mainly operative

Comparing the characteristics of small and large firms, Malecki (1997) points out that the principal disadvantage faced by small firms is the shortage of resources, especially financial resources available for large businesses for expansion and diversification. Diversification as a development strategy has been mainly a concern of large firms where the causes of diversification and its

consequences on firms' performance have been the focus of the analysis (Iacobucci and Rosa, 2002). Wright, Westhead and Ucbasaran (2007) state that many small private SMEs need to address liabilities relating to "smallness" and "inexperience".

Several authors have emphasised that access to financing is one hindrance for SME development (e.g. Malecki, 1997). Public support could be allocated to reduce the impact of market deficiencies (negative externalities) or to improve the level of knowledge and technology and to promote internationalisation of businesses (positive externalities). However, public support should be planned so that market disturbances could be avoided. Thus, support measures should be more focused on support given to the firm against payment. Promotion of positive externalities produces fewer market disturbances and thus encourages the development of measures to induce positive externalities that will be more appropriate in fostering innovations and knowledge-intensive businesses.

Already Modigliani and Miller (1958) noticed the different status of small and new enterprises in capital markets and suggest that some kind of equity gap could exist. However, their conclusion – that the entrepreneur's unwillingness to share the business would be a reason for a shortage of equity capital – requires more profound analysis. This unwillingness to share (control aversion) may lead to an equity gap. However, the evidence of equity gap is not so self-evident since the quality of the business projects seeking equity funding may be too low from the financiers' point of view. Virtanen (1988) studied discrimination in the Finnish business loan market by regressing customer revenue with independent variables including company size and age. He found that the smallest customers in the Finnish business loan market are not discriminated against. The existence of financing gaps in some areas leads to consideration of a correction of this "market failure" by using public support. For example, in Germany public support is allocated to venture capital funding (Sunley et. al. 2005). It is important that this is limited to a minimal and market-failure-correcting intervention. Otherwise, in the long run, generous financial support will probably be disastrous as it may lead to crowding-out effects that could lead towards the undertaking of low-risk projects with low profits. The most destructive potential result of this kind of behaviour would be the flight of private equity to investments where the return on capital will be higher.

Promoting entrepreneurship and SME development

Entrepreneurship, SMEs, and innovations

Malecki (1997) defines entrepreneurship broadly to embrace new firm formation, small firms, innovation as well as regional and local development. He argues that the formation of new firms is especially essential for regional and local well-being. However, focusing on changing existing firms could be a more efficient way to obtain results quickly. The creation of new jobs depends on business in the region. Rajan and Zingales (1998) found that existing businesses generate two-thirds of industry growth, whereas one third comes from new venture creation. The result is parallel with Storey (1994) who discovered a similar relationship between established and young firms.

Many expectations will be placed on entrepreneurs and their businesses when society is changing. These include innovativeness and a new wave of development in the society where the different guidelines and programmes are based (Koskinen and Virtanen, 1998). But these expectations may be overestimated because of the wide diversity of entrepreneurs and businesses. Research on the origins of business ideas has suggested that we should not overlook seemingly mundane business opportunities (Bhide, 2000; Vesper, 1991). Recent data from the US shows that even so-called "gazelles", i.e., fast-growing SMEs, are not only in high-technology but equally also in services and trading.

Stark and Brown (1997) point out that between 40 to 70 percent of the changes in small-town employment result from decisions made by existing businesses. They conclude that preserving and building the local economy is achieved by keeping local firms healthy and happy, and encouraging their future growth. Stark and Brown (1997) quote Larry Ledebur, who coined the term "backyard development" in the 1980s. This means that communities make efforts to generate jobs in their backyards by improving the business climate for existing firms and by fostering an entrepreneurial spirit or expansion mentality among current business owners. The policies should include proactive measures such as development of retail facilities and services in order to prevent outflow of purchasing power (c.f. "magnets of attraction", Murphy, 2006).

Transformation from centrally planned to market economies requires economic and social restructuring, and in this process the development of small and mid-sized enterprises (SMEs) plays a central role. Smallbone and Welter (2001a; 2001b) note that SMEs may contribute to employment, innovation, diversification of economic structure and sectoral restructuring, development of a supply base and the overall transformation of the system. Contribution to employment includes also a motivation push since small businesses may also provide a means of "self-help" for those without a job. Development of a supply base includes changing centralised systems to more flexible ones where SMEs serve the needs of larger firms (Smallbone and Welter, 2001b).

Challenges for transformation economies in developing their market systems include sparking the motivation of individuals and organisations to be productive and create innovations (Behrman and Rondinelli, 2000). Especially radical innovations mean that the knowledge required to exploit innovation is competence-destroying (Afuah, 1998). Schumpeter (1943) recognises the importance of knowledge in an entrepreneurial process when he states that entrepreneurs have an ability to attract supernormal brains. This is especially important for high-tech ventures but currently also in other sectors since new knowledge and innovations are more and more connected with new business models and markets (c.f. Afuah, 1998) Schumpeter's (1943) definitions of entrepreneurship that describe it as a dynamic process of creative destruction deal mostly with the process of existing enterprises. The Schumpeterian approach emphasises the creation of something new as an important function of an enterprise. Baumol (1993) states that these creation processes serve as impulses for the motion of a market economy and thus could be seen in existing firms as processes to modernise and diversify businesses.

SME's should also follow the overall development of innovation systems and new forms of co-operation. More and more innovations are currently the so-called open innovations where experts from several businesses may have been involved at the development stage. On the other hand, commercialisation process should be seen as a continuum from idea generation to market launch. The most important issue will be to mobilise sufficient resources at critical stages of the process (Jolly, 1997). From the SME policy perspective, the open innovation paradigm is interesting since it may create new opportunities for SMEs in subcontracting research and development activities (IBM, 2006).

Growth and internationalisation

How can public authorities most effectively support business growth? In most countries the emphasis of policy programmes has been on creation of new businesses whereas existing traditional businesses have usually attracted attention only at a reactionary stage of the local economy. Thus more rigorous knowledge of growth characteristics should be available for policymakers to help them design focused policy measures for those companies which have growth potential.

Endogenous growth has been one of the major approaches in regional growth studies (Nijkamp and Stough 2000). Endogenous growth theories explain growth from a micro-theoretic perspective so

that consumers maximise their utility and firms their profit with respect to their budget constraints. In the framework of endogenous growth, the development of human capital and new technology play a remarkable role, and that is why the use of this theoretical background is appropriate for studying regional growth, where one perspective is public input in R&D activities.

However, even if the endogenous growth theory starts from a micro-theoretic perspective, it mainly analyses the growth of a certain region as an aggregate-level, macro-theoretic phenomenon. This kind of approach may be problematic because some businesses also grow in regressive regions and branches of industry (e.g. Pasanen, 2003). But as Dabson (2006) proposes, the focus should be on identifying local and regional assets and converting them into entrepreneurial activity.

According to contingency theory, the growth of firms and the ensuing diversification cannot be examined in isolation from their specific situation and environment (Gilad and Levine, 1986; Littunen, 2000). Contingency theory notices changes in situational factors, for example the firm's strategies, which are important in explaining dynamic phenomena such as growth, modernisation and diversification.

The characteristics of growth businesses and their success have not been studied widely but it will be assumed implicitly that high growth correlates positively with success. Birley and Westhead (1990) point out that one limitation in previous research is the assumption that performance and growth are not only interlinked but used as a surrogate for each other. They add that this kind of correlation is not supported in the literature. Pasanen (2003) states that SME success is not related only to high-growth industry sectors, but that successful firms could also be found in other sectors.

Almus (2002) compared fast-growing firms in Eastern and Western Germany by analysing a sample of approximately 2000 observations from manufacturing, construction, trade, transport and telecommunication, and services. He differentiates between technology-intensive businesses in manufacturing and business-related services from non-technology-intensive businesses. Almus (2002) proposes that construction, transport and communication and not knowledge-intensive business services have had higher probability for rapid growth than trade in Eastern Germany. He summarises that there are no signs that firms in technology-intensive manufacturing branches or in knowledge-intensive business services have better chances to grow quickly than firms in other sectors. According to Almus (2002) the rapid growth in Germany overall during the 1990s owes much to the fast growth in Eastern Germany due to the re-unification. Economic development may change the situation quite rapidly but the result suggested by Almus (2002) parallels that of Heimonen and Virtanen (2007). They propose that fast growth and high success is not concentrated in high-tech businesses and may have different characteristics in different parts of the country. However, it will be quite evident that the development of knowledge-intensive business services and trade will increase in importance when the basic entrepreneurial infrastructure is well established.

Virtanen and Heimonen (2006a, 2007) and Heimonen and Virtanen (2007) studied the role of innovativeness and regional differences in the growth and success of existing firms in Eastern Finland. Virtanen and Heimonen (2007) defined fast growth as more than 30 % annual growth continuously in the three-year period and high success by using performance index constructed from financial data. They found that only 12 % (12 firms) of the growing businesses in rural areas (Eastern Finland) were both fast-growing (FG) and highly successful (HS). The distribution of FG and HS firms included only two manufacturing firms and only two that could be classified to include some kind of high-tech in their products and services. The others represented included the construction industry, basic services, and trading. The implications of their study suggest that policy makers should carefully consider the allocation of inputs to innovation activities. From the point of view of job creation, growth and success it may be reasonable to concentrate on traditional branches of industry. The allocation of funds for

fostering innovation should also be reconsidered and more emphasis should be placed on incremental innovations in business know-how including diversification into new markets and development of new business models.

From a policy perspective, it will be essential to be able to differentiate fast-growth businesses. Littunen and Virtanen (2005; 2006) proposed that among the growing firms, the presence of positive situational and "pull" factors were important motivating and precipitating factors in the creation of a new business – meaning that entrepreneurial motivation differentiates growing firms from non-growth companies, so that growing firms are more opportunity-driven (Shane and Venkataraman, 2000; Littunen and Virtanen, 2006). Among the founders of other firms, the motivating factors were more often unemployment or fear of redundancy, and internal motives. Littunen and Virtanen (2005) discovered that the most of those factors that differentiate growing ventures from non-growth companies could be taught and learned. But most of them depend on strategic and operative choices by the entrepreneur. Thus, effective policy response to these issues should be indirect, e.g. dissemination of information, education and training.

Fischer and Reuber (2003) concluded that high-growth firms preferred advice from their peers compared to external resource providers. They studied how firm owners, external resource providers, and public policy advisers evaluate the role of management, external resource providers, and governments in supporting rapid growth (Fischer and Reuber, 2003). Moreover, firm owners preferred controlled growth compared with rapid growth because of the management challenges connected with high growth. According to their results, they propose a networking approach based on the active participation by high-growth firm owners as a solution to support these businesses. The network *Innovators Alliance* will be presented as one of the best practice solutions in this chapter.

Internationalisation is one part of growth strategy, and thus the growth process will be a dynamic one where we may identify similar internal decision-making characteristics and situational factors. However, in the internationalisation process, we will probably not be able to lean on resources from the firm's headquarters, and instead have to rely on external agents as distributors, subcontractors etc. SMEs (and entrepreneurs) have to invest in networking activities to ensure that the appropriate resources, knowledge and learning are accumulated to provide a positive platform for internationalisation (Wright, Westhead and Ucbasaran, 2007). Thus internationalisation demands a widening of the resource base through building social capital. In the internationalisation process, networking, which belongs to the structural dimension of social capital, is important, but relational and cognitive dimensions, are significant as well, because of the mixture of different cultures and normative environments (Nahapiet and Ghoshal, 1998).

Wright, M., Westhead, P. and Ucbasaran, D. (2007) encourage policy-makers to provide more balanced and refined policy support if they are seek to facilitate private SME internationalisation. In some branches of industry, businesses should be born to be global (Virtanen and Pellikka 2004) but in traditional and tradable branches, the majority of the firms follow a process of internationalisation by stages. In that case, policy support may include aid in accessing information, advice on market analysis, and other measures.

Education, training and counselling

Modernisation and diversification of SMEs creates demand for management and business skills in order to reorganise existing businesses, and to develop and implement new business models. Manager training and education to raise the level of intellectual capital of existing SMEs could be a cost-effective way to promote local economic growth and welfare (Heinonen 2006). Heinonen (2006) suggests the following areas which could be addressed by training: surviving in the first critical years

(death valley), developing new opportunities (growth), widening understanding and knowledge of markets (growth, internationalisation) and business transfer (succession). The increased importance of such cognitive knowledge and the skills needed for its acquisition are placing education and lifelong learning at the centre of governmental policy initiatives in modern economies (Lloyd-Reason, Muller, and Wall, 2002). Radical innovation means that the knowledge required to exploit innovation is competence-destroying. The substitution of different memory devices is a good example of competence-destroying innovations. Magnetic tapes and discs were replaced by mini discs and diskettes and later on, diskettes were replaced by memory sticks. In all these cases, capacity has increased tremendously compared with the size and usability of new devices.

Lussier and Corman (1995) found out that successful firms used more professional advisors and their owners' parents owned businesses, whereas the owners of failed businesses had higher education and did not have problems in acquiring workforce. This could be interpreted to mean that owners of failed ventures seize riskier opportunities and are not cautious enough in recruiting personnel.

Areas for policy intervention

Why will local and regional policy will be needed?

What are the problems which demand that local and regional policy foster modernisation and diversification of SMEs? Market pull is the main driver of regional economic development. Because of powerful market dynamics, public policy intervention have only a limited influence on regional economies. Public intervention is usually not needed as an instrument of economic policy in a competitive, well-functioning market (Wright, Westhead and Ucbasaran, 2007).

Public support could be seen as reducing the level of welfare through distortions in competition from the effects on relative prices and the costs of products and services. In those markets where market deficiencies, i.e. negative externalities, will be observable it may be possible to decrease market failure and to foster economic development. The improvement of market functionality and the elimination of market failures should be the basis for sound economic policy. The European Union has emphasised the importance of reducing and redirecting the general level of state aid. However, there will always be some market deficiencies, and thus some public support will be needed. In order to avoid market disturbances, support measures should be more focused on support given to the firm against payment. Promotion of positive externalities produces fewer market disturbances, and thus it will be more appropriate in fostering innovations and knowledge-intensive businesses.

Market failures may be caused by deficiencies and asymmetries of information, business location or previous economic development. Information deficiencies will be typical characteristics, especially in start-ups. They do not have an established history, and thus they will not be able to get external financing from the market with normal funding terms. In the case of modernisation or diversification, typical start-up problems do not exist. Market failures caused by business location may be alleviated through regional policy and support systems. Business may be driven to crisis because of overall poor economic development, and then economic policy will demand special reengineering measures. An example of this kind of crisis is the banking crisis in Finland in the early 1990s. Adverse effects of the crises could be – and in this case also were – mitigated by granting public support for businesses in crisis. Market failures relating to imperfect and asymmetric information, externalities and incomplete property rights, imperfect market structures and poor regulation can constrain SME development (Wright, Westhead and Ucbasaran, 2007).

The tools for local and regional business development which have been used worldwide include both measures that have a direct impact on stimulating business as well as instruments which

indirectly affect local development. The overall purpose of these tools can be summarised as the improvement of entrepreneurial climate and culture in the focus area (Blakely and Bradshaw, 2002). Encouraging the creation of new ventures, innovations and start-ups has raised the most interest. The most widely used measures include making financial instruments and support funding available, e.g. venture capital, R&D funding support, and start-up grants. Small business development centres, incubators, technology villages, and science parks are examples of organised environments to support business development. These environments use synchronised programmes in strategic emphasis areas to promote strategic clusters (Blakely and Bradshaw, 2002; Adamek, 2007).

To summarise, local and regional policies are needed to support the changes in SMEs, since there exist market failures (negative externalities). The objectives of local and regional policy are to improve overall economic development by fostering entrepreneurial behaviour, innovations, growth and internationalisation in area businesses.

The role of government and effective policy

The demand for SME policy as a part of industrial policy and especially interest in competitiveness has arisen from the rapid growth of newly industrialised countries (Wren, 2001). In the short run, policy should focus on information, skill development and opportunity recognition which facilitate entrepreneurs' actions (Acs and Szerb, 2006). Wren (2001) concludes that the change of UK industrial policy from sectoral to horizontal had led to much more complex policy which is focused on smaller established firms with growth potential. He considers that the boundaries between science and technology, small firm and regional components have diminished, leading to a narrower set of policy instruments.

Smallbone and Welter (2001b) point out that government legislation has a different impact on firms of different sizes. Legislation which demands the preparation and delivery of documents where expert assistance will be needed creates compliance costs which will probably pose a greater burden for SMEs, since they do not usually have such resources on their payroll. On the other hand, for example, the costs of social security contributions may vary according to firm size, and this can be an advantage for small businesses.

Hofer (2006) concludes that regional diversities make the local tailoring of policies and programmes designed at Land level a prerequisite for their effectiveness. It will be important in terms of integrating policies that programmes and initiatives have undertaken, e.g. in the fields of modernising existing SMEs, general workforce development, strengthening the local and regional science industry base, and supporting entrepreneurship amongst groups with limited business ownership representation, that are clearly linked to each other and are also part of an overall strategy (Hofer, 2006).

What can be learned from localities elsewhere?

What kind of measures should be introduced to generate modernisation and diversification of SMEs in East Germany? Case studies of discussion papers have been used to introduce some applicable learning examples and recommendations for specific areas and specific circumstances. However, it should be noted that the diversity of different areas within a country requires careful analysis of situational factors and tailoring of policies according to these particular characteristics. Agglomerations of knowledge and technology-intensive businesses need different policy measures compared, for example, with rural areas with abundant natural resources. However, both areas may benefit from new ways of doing business in new markets, i.e. modernisation and diversification.

Creating "transformation agents", Celemi Sweden is an excellent international learning model that can be applied to modernise and diversify SMEs. The purpose of this model is to help organisations implement large-scale change and create teams of transformation agents who deliver results (Kuhle, 2007).

An international learning model from the Czech Republic suggests that public support is not necessarily concentrated on branches of industry that are "in fashion" but encourages the identification of and concentration on areas where relative competitive advantage and chances for success are highest (Adamek, 2007). This implies that chances for success could be identified in traditional branches of industry, too. But this most probably presupposes modernisation and/or diversification of the activities to gain a sustainable competitive advantage.

Del Castillo (2006) describes a project called *Barneekintzaile* in Catalonia, Spain, which is designed to stimulate and favour the promotion of entrepreneurial activity in existing businesses (intrapreneurship). This programme encourages the development of ideas leading to new product lines or the creation of spin-offs to produce new products in existing companies. *Barneekintzaile* combines the performances of different programmes and institutions in a single project with successive phases (Del Castillo, 2006).

The importance of market forces and dynamics on public policy intervention should be recognised. The development of local and regional economies is driven by markets which operate quite independently of public policy (Walburn 2007). As Walburn (2007) states, incentives to increase an already beneficial pattern of commercial activity are much more likely to produce results than those incentives which seek to change market fundamentals, ignoring existing patterns of supply and demand.

One challenge in the transformation stage is the transfer of resources from the old regime to the new one. In order to have effective policy, there will be a need for effective exchange of information and the transfer of resources, including experience, from the obsolete organisation to the emerging venture (Lussier and Corman, 1995). Smallbone, Baldock and North (2003) report that two thirds of Business Link respondents would prioritise raising awareness among small rural firms of the services offered, such as better access and use of ICT facilities. The first item could reflect a need to be more proactive in adapting to future development.

Taking into account the diversity of characteristics of different regions, clear visions of development of different Länder and regions, as well as development strategies for these areas should be formulated (c.f. Hofer, 2006). Careful analysis of local assets as well as "magnets of attraction" (Murphy, 2006) should be conducted in areas where policy measures will be allocated. This analysis could be done through in-depth case studies selecting key sectors of development.

Recommendations given in case studies could be classified in three main categories including a) education, training and counselling, b) innovations, and c) financing and investments. Moreover, networking activities, access to external markets and a pilot high-growth programme can be presented separately. The measures suggested in the recommendations include training, counselling, and coaching services at different stages of business development. These services should increase business know-how, management and marketing skills, and exploitation of growth opportunities.

Propositions to foster innovation consist of measures to support technology development, promote business-to-business mentoring, encourage innovation in agricultural and food industries, basic industries and services and in smaller, less capital-intensive companies. Collaboration between other SMEs as well as with larger companies, higher education institutions and neighbouring districts

were recommended. One purpose of such collaboration would be the creation of innovation support infrastructures and the encouragement of SME innovation and export activity. Financing and investment measures included recommendations to assess the firm's own investment readiness and seek the involvement and advice from business angels. Improving the level of knowledge about their own growth and return potentials and financing methods was also suggested. Other proposed vehicles to foster development were suggestions to increase penetration of external markets and piloting a high-growth programme.

Training courses, seminars, workshops, role-playing exercises, mentoring and advice, and assistance with raising private investment were suggested as measures to seize the above propositions. Matching firms and angel investors could be one way to increase access to capital and to advice from peers and experts.

Networking could be used to widen the information and resource base of businesses. For example, Moreno and Casillas (2007) point out the importance of external resources in widening of the resource base through networking to generate growth. Dandridge and Johannisson (1996) propose that in order to make policy successful, effective exchange of information and the transfer of resources, including experience, from the obsolete venture to the emerging one should be introduced. They consider that government's role should be making information available to existing networks, or facilitating the inclusion of new entrepreneurs in existing networks. Fischer and Reuber (2003) note that effective policy programs must be customised to segments within the population of all firms. Depending on the purpose of program, various tailored measures could be used to spur local businesses to improve their performance in all levels (Fischer and Reuber, 2003).

An excellent case of successful networking where public authority has been a facilitator is Innovators Alliance, in Ontario, Canada. Ontario, Canada, was presented in Pike's (2006) article as an international learning example. Innovators Alliance initiative is the more focused approach to this case area, originally seeded and supported by the Ontario government. It began in the late 1990s with the establishment of the Ministry of Economic Development and Trade's one-day forum, The Wisdom Exchange. Innovators Alliance was designed to facilitate the exchange of business knowledge and experience among CEOs of Ontario's fastest-growing companies. It has expanded its activities from organising one annual event to running a full-time service organisation which operates throughout the year. Launched in 1999, the IA currently has more than 100 members.

According to different research results, peer-to-peer advices are highly valued. As Smallbone and Welter (2001a) state, in an unstable and weakly structured environment, informal networks often play an important role in mobilising resources. Even if the environment in Eastern Germany is currently more stable, role models and benchmarking of activities with peers will probably be highly appreciated. In the recommendations given in discussion papers, training and counselling delivered by peers and experts were raised as one example, and the proposed form of networking would contribute to peer-to-peer advice and mentoring.

"Small Business Charter" is an example exercised in UK (Walburn, 2007). Walburn (2007) states that including a reference to the existence of such a Charter in international marketing efforts might increase the attractiveness of the borough as a business location by highlighting the local administration's commitment to working effectively with small business. This means inward internationalisation, i.e. attracting of foreign direct investment. From the perspective of indigenous growth, it is important to develop such business, as it may bring access to international markets.

Anaika Group Oy Ltd and UPM-Kymmene PLC in Finland is an excellent example of the co-operation between large global business and creative SME. UPM Timber is a division in UPM-

Kymmene PLC with a turnover of 530 Mill. EUR and a staff of 1450. Anaika Group Oy Ltd. is an SME currently employing 50 people, with a turnover of about 2 Million euros. Anaika Group refines lambeams for Japanese market. Lambeams will be sold using the Wisu brand of UPM-Kymmene. UPM-Kymmene produces sawmill products that will be refined by Anaika Group which has acquired the quality certificates for Japanese market. Anaika Group has been supported by government organisations in R&D activities as well as the public financing institution Finnvera with an equity loan. This kind of SME – large business collaboration in an international market – could be recommended since large businesses have the distribution channels and networks, whereas small businesses may be superior in development of niche production systems.

New Zealand Trade and Enterprise (NZTE) is a good example in both growth business support and internationalisation efforts. NZTE's objective is to encourage a positive attitude toward business success, encourage risk-taking and embrace creativity. The purpose is to foster the culture that supports entrepreneurial activity and business growth, since they play a vital role in a country's economic development. The organisation works in partnership with business, higher education institutions, and the private sector to develop attitudes that support and honour entrepreneurship. The activities include Business Development, Export Services, Sector Development, Regional Development, and NZ Success sections. All these sections include several items, so NZ Success includes the Enterprise Culture & Skills Activities Fund, Export Awards, New Zealand New Thinking, World Class New Zealand, and Event Support.

The approach is very well applicable to East Germany since the activities listed above cover almost all the areas presented in the recommendations of case studies. Sectoral development items focus on both new technologies and traditional branches of industry. Regional development initiatives and export promotion are included, and different funding schemes have been considered.

The recommended activities proposed in case studies include workshops, role-playing exercises, information and advice about intellectual property rights, value chain analysis and scenario planning, market research activities, mentoring and advice, and assistance with raising private investment, promotion of small firm-large firm partnerships, external help in business know-how, and training courses and counselling. The most concrete recommendation for policy makers is establishing or supporting a specialised agency with in-depth technology and business awareness to scan latent intellectual property in large businesses. Small business-large business co-operation was referred to in several answers. Activity which could support business angel involvement is the so-called matching services.

Other themes include collaboration between businesses and higher education institutions. This is extremely important in developing business embryos (Virtanen and Laukkanen, 2002), but it also aids existing businesses since new business know-how should be available for all businesses. Currently, the so-called Triple Helix cooperation (private – public – HEI) is the prevailing situation in many regions in OECD countries.

One recommendation is to further emphasise the generation of indigenous growth. However, the most important suggestion would be to identify measures that generate growth. It should be recognised that growth and success are not surrogates. All growth businesses are not successful firms if we do not use the same definition as Smallbone, Leigh, and North (1995), who used a sample where high-growth firms were associated with good performance. Moreover, local development often depends crucially on stable local businesses (retailers, bakeries, restaurants etc.) which offer jobs and whose workers generate taxable income (Stark and Brown, 1997).

In the case study in Mittweida and Altenburg, it was suggested that more concentrated support should be provided for growth enterprises but without abandoning other SMEs (Murphy, 2006). Murphy (2006) proposed that strong, tailored measures to support a small number of growth enterprises whilst simultaneously providing lower cost or more standardised support to other SMEs. Murphy (2006) suggests also the establishment of a special Task Force to develop service sector strategy. This should be considered as a first step in developing a district and local strategy. This Task Force should ideally have representatives of responsible ministries, agencies and especially expert representatives from service business companies (both domestic and international) (Murphy, 2006). All these suggestions are worthwhile and could support modernisation and diversification very well in a wider context in any region. However, authorities should be careful when establishing new institutions (Task Force) in order to avoid too heavy governance mechanisms and a waste of scarce resources.

From the perspective of modernising and diversifying SMEs, a good recommendation is fostering grass-roots innovations. Recommendation proposes the encouragement of innovation in agricultural and food industries, basic industries and services and in smaller, less capital-intensive companies. This argumentation will be supported by Dabson's (2006) demand for focusing and identifying local and regional assets and converting them into entrepreneurial activity. Policy should support the access to R&D and market information and to help in creating contacts with enthusiastic agents and distribution channels in international markets. This kind of policy support for open-minded producers helps develop opportunities and create access to international markets. A good example is Just The Berries Ltd.¹ which produces functional products using black currant as its raw material. The research and testing of the characteristics of black currant were carried out by the respected New Zealand government-owned research laboratories, Crop and Food Research. Cooperation with a large Japanese company has opened the wide Asian market and the prospects are very good for future growth.

In this article, transformation economies and specific case studies have been referred in several contexts. It should be noted that SMEs in East Germany develop in a totally different environment than in other transformation countries because of the support of West Germany. However, there exist similarities with respect to entrepreneurial culture and the attitudes towards entrepreneurship and business development. Case studies and recommendations which are referred should be evaluated in the context where they are proposed to be applied. There probably does not appear such an SME policy initiative which could be generalised to cover the whole country because of the wide diversity of both SMEs and the regions within the country. But the recommendation to take advantage of opportunities arising from modernisation and diversification could be included in different SME policy measures.

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¹ www.blackcurrants.co.nz

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FINDINGS AND POLICY RECOMMENDATIONS FROM LOCAL CASE STUDIES

OECD

The local case studies stressed the need for more opportunity entrepreneurship across the whole population of entrepreneurs. Independent of their size, companies must constantly develop their skills base. This is critical not only to their survival, but the availability of the right skills is also one of the main drivers for modernising and diversifying existing companies. Business survival and growth depend not only upon SME leadership and management, but also upon the skills and motivation of their staff. In the local case study areas a great variety of training offers exist for SMEs provided by public and private-sector institutions. Selecting the best suitable option, however, can be time-intensive and difficult for the user. Public subsidised offers are often free or with limited charges; attendance is sometimes obligatory to qualify for certain support programmes. The discrepancy between offer and demand increases at a later stage of business development as cost and time factors become more relevant. On the demand side, the prevalent belief of entrepreneurs and small business managers that training costs time and money, accompanied by a lack of awareness of, and access to, training offers, as well as a lack of incentives and financial support structures, all need to be addressed as barriers to enhanced skills development for SMEs.

Existing SMEs in the local case study areas will need to focus more on skills development and business performance if they are to survive and grow in an environment characterised by increasing domestic and international competition. Developing tailored skills-development schemes can help increase interest in attending training programmes. It is important to identify topics of particular relevance for local businesses, such as accessing external markets, increasing innovation in production and service delivery, and managing and financing growth. The "e-Learning Marketplace" initiative of the German Chamber of Industry and Commerce is a good practice example of introducing multi-media in learning processes. It also helps overcome the barrier of separate training and work places. Professional re-orientation, widespread in East Germany, needs to be adapted to the needs of local labour markets in order to help supply local business with appropriately skilled workers. In some local case study areas, out-migration and the changing career wishes of young people makes it difficult for companies to recruit appropriate personnel locally. The existence of individualised training schemes and a close co-operation between training providers, as seen in most of the local case study areas, can be considered good practice.

With their geographic advantage of a central European location, and the substantial investment that has been made in infrastructure, all local case study areas are well-positioned to be competitive centres for traded goods and services. It seems, however, that in most local case study areas, many local companies with traditional products do not have adequate access to export markets. The Chambers play an important role in supporting SME internationalisation activity. The services provided are that of standard support in facilitating the internationalisation of business activities. In addition, in some of the local case study areas, locally designed projects exist with the aim of increasing local traditional company responsiveness in international markets. Overall, however, there seem to be only little horizontal focus, and systematic approach in fostering the internationalisation of locally invented knowledge.

It is important for public and private business support organisations to foster close relationships with potential growth companies when devising and implementing their support strategy towards these companies. OECD good practice shows that providing SMEs with a tool that enables them to understand and assess their training needs and their growth potential helps companies identify and address the factors

with the greatest impact on company survival and growth. Simple-to-use approaches, with on-line interfaces, help support agencies identify where they can best direct interventions to assist in the growth of firms.

Young technology-oriented companies often have difficulties with diagnosing and reacting to end-users' needs profiles. They also tend to underestimate the costs and time requirements for market entry and survival. In order to help young companies survive and to grow, public support schemes for coaching and training activities during the post start-up phase should also be reconsidered for the local case study areas. Although young companies tend to be less interested in such schemes, as their daily work in running the business often does not leave enough time, these kinds of services provide valuable support. Experience with post start-up coaching programmes in other OECD countries shows that the relationship between entrepreneur and coach, built up during the pre-start-up and start-up phases, has the potential, if carried on to the post-start-up phase, to provide helpful assistance that allows new entrepreneurs to recognise upcoming difficulties at an early stage. Tailored services at the local level could be used for maintaining direct interaction with previous clients in the post start-up phase by continuing the initial one-to-one interactions established during the pre-start and start-up phases.

Experiences from other OECD countries and regions reveal that programmes designed to help firms assess their own investment readiness have raised the level of deal flows. Such programmes enable firms to assess their own investment readiness, obtain feedback on their strengths and weaknesses, their ability to access equity finance, and increase investor interfaces with underinvested sectors. Key programme features include intensive work with each company; highly interactive workshops based on role-play exercises and delivered by experienced industry experts like accountants, lawyers, business angels, clearing banks, venture capital firms and corporate finance firms; and a free diagnostic investment-readiness tool. Across the local case study areas, in addition to public and private business support organisations, local SME associations are also organising mutual advice and counselling in the form of "Help for Self-Help" on issues of company growth and survival amongst its members. Apart from these offers, it seems that the limited equity and liquidity of many companies reduces interest in using cost-liable coaching and consulting services.

OECD research shows that on average, SMEs are less likely to conduct research and development than larger firms. The average enterprise size in most of the local case study areas makes it difficult to foster internal business research and development activities. One area where most of these places have been strong is in their technology foundation, and in the variety of efforts to promote and support new innovation. There has been some successful utilisation of federal programmes to enhance the innovation capacity at regional level. Yet the challenge is to further develop those innovative activities that could serve as a support for modernising the productive fabric. Creating, exploiting and managing network relations is important to achieving economies of scale and rationalisation of costs and time as well as accessing new knowledge, in particular knowledge related to access to resources and markets, exchange of technology and know-how, and exchange of information regarding technology development processes. In all the local case study areas, projects to develop networking and clustering are being implemented. In those local case study areas with the presence of a university in the wider region, the innovation system seems to be stronger. Here, the university is central to the knowledge generation subsystem and also plays an important role in knowledge exploitation, benefiting from long-term strategic core competences in both basic and applied research. For all firm sizes, the presence of a university can stimulate growth intentions, and be a source of innovation. Universities and research institutes are, however, not the usual interlocutors of firms. Even high-technology and growth companies direct, in the first place, a request for support or interaction to the Chambers and business associations. Within the existing innovation infrastructure, an increased co-operation between universities, research institutes and the Chambers is therefore needed to reduce distance and barriers and to facilitate the exploitation of knowledge and technology through a wider group of firms, both within and outside the local economy.

Infrastructure for innovation is a complex system of physical, human and financial resources, including competences, capacities, capabilities and networks that support innovative firms in processes of knowledge commercialisation. The regional innovation infrastructure must include facilities and associated support services tailored to the different strategic needs of companies throughout firm formation and growth processes. The local case studies revealed a risk of over-dependence on public funding for continuation of the current technology-based entrepreneurship initiatives. In some places, massive public investment has contributed to the establishment of top-class physical infrastructure for technology-oriented firm creation and development. Further, public funding is available for start-up operations and incubator firms. A number of technology parks and business incubation facilities exist within the local case study areas or in their geographic proximity. These are mostly for technology-oriented companies, but not exclusively. They seem to be well established and connected with key local economic sectors, such as electronics and electrical engineering, laser technology and specialised machinery. International linkages exist and are expanded. Strong co-ordination is evident amongst local agencies to ensure tenant firms will stay local after incubation and relocate within the district's territory. However, an ongoing challenge in the future will be to maintain the flow of new company tenants. Here, more could be done, using existing federal and land initiatives to stimulate inter-district and inter-municipal co-operation in establishing and running technology parks and business incubation facilities. This would also support the development of economic regions and cluster building across jurisdictions.

For the majority of local case study areas, abundant supply of available industrial sites and a mix of business facilities with attractive rent rates and adequate infrastructure can be considered strengths. In urban areas, where demand for land and buildings for new and expanded economic activities needs to be met initially from an existing stock of space, characteristics like aggregated quantity, quality and relevance and flexibility to diversify according to changing needs, are relevant for location questions. There is a large amount of high-quality office, commercial, and industrial space available at far lower costs than similar space in most Western German localities. Subsidised rent is also available for start-ups and existing SMEs. However, in some places, property market imperfections, caused by regulations and a preponderance of public sector led site development and insufficient demand, has resulted in vacant public subsidised business facilities and a reduced engagement of private developers. In places with low occupancy rates, image problems are listed as causes, amongst others. In all local case study areas, a number of policies aiming to stimulate entrepreneurship development and attract job-creating investment have been initiated. Urban regeneration projects and the creation of modern and vibrant shopping and leisure centres seek to improve the image of places – both internally for inhabitants and existing firms, and externally for visitors and potential investors. In addition, e-government mechanisms are being used, and positive results in reducing bureaucratic burdens in land use issues have been achieved.

The local case studies in East Germany brought to light a number of policy recommendations that can be taken up by national and local governments and organisations active in developing and strengthening entrepreneurship and local economic development, operating locally and across different levels of government. Despite their local provenance, the policy recommendations reveal a certain relevance for other localities in East Germany and elsewhere. Hence, the following list of recommendations should be considered and consulted as checklist for policy makers and local organisations when innovating entrepreneurship policy and developing new local activities that aim at increasing the motivation for and actual activities of modernising and diversifying existing SMEs.

Policy recommendations to enhance modernisation and diversification in SMEs

- Run public campaigns to strengthen interest in and demand for SME training and counselling services.* Business survival and growth depend not only upon leadership and management in SMEs, but also upon the skills and motivation of their staff. The prevalent belief of entrepreneurs that training costs time and money, accompanied by a lack of awareness of, and access to, training offers, as well as a lack of incentives and

financial support structures, need to be addressed as barriers to enhanced skills development approach for SMEs. The use of successful training schemes for marketing and participating companies as role models could be a way to increase the interest of SMEs in making use of training and counselling services. Such initiatives may also help to enhance co-ordination between training providers, chambers, business associations and the labour office and could offer additional incentives for quality increase. Business networks could be used to support and to run campaigns to increase awareness of such programmes.

Enhance co-ordination, transparency and quality checks of counselling, training and coaching services.

- Existing offers and services should be subject to strong evaluation, quality control and benchmarking exercises. Information should be transparent and easily accessible. This information should be used to support SMEs and public agencies in selection of the most appropriate training providers.

Include training for enterprise development in business start-up programmes. More emphasis should be placed on developing business management and development skills within start-up support programmes. Existing training should be expanded to cover identification of wider markets, business sustainability issues and the identification and exploitation of future growth opportunities.

Support training for existing SME managers. Promote high-quality training programmes for SME managers to support their business development skills, especially opportunity recognition, marketing skills and knowledge of markets. These may be publicly or privately delivered and in the form of in-house training or outside courses. Activities should offer opportunities for exchange of experiences and co-operation with the aim of helping entrepreneurs to identify changing needs of their businesses and ways to meet these needs. Such activities should target in particular growth oriented entrepreneurs.

Intensify business network initiatives. Networking can be stimulated by undertaking value chain analysis and scenario planning with the appropriate stakeholders of these industries. A key to initiating such networks is to pose and attempt to answer a central question: By co-operating how can we move this local industry from being a price-taker to being a price-maker?

Continue support during post-start-up phase. In order to help young companies to survive and to grow, public support schemes for coaching and training activities during the post start-up phase should also be reconsidered. Very often young companies do not realise that their current business capabilities and know-how are insufficient and that external help would be an advantage. Experience with post start-up coaching programmes in other OECD countries show that the relationship between entrepreneur and coach, built up during the pre-start-up and start-up phases, has the potential, if carried on to the post-start-up phase, to provide helpful assistance that allows new entrepreneurs to recognise upcoming difficulties at an early stage. Tailored services at the local level could be used for maintaining direct interaction with previous clients in the post start-up phase by continuing the initial one-to-one interactions established during the pre-start and start-up phases.

Access external markets. It is important to increase penetration of external markets in order to create demand for local goods and services. Market research activities help to understand and forecast potential demand and allow for tailored responses.

Promote business-to-business mentoring. Larger companies can play an important role in encouraging SME innovation and exporting by making available expert managers to SMEs for short advisory sessions. This can be very effective and valuable to many companies at the early stages of their development.

Seek the involvement and advice of knowledge and business angels. A developed venture capital system needs individual investors as well as venture capital funds. 'Angels', that is people who are prepared to invest in individual companies and frequently bring knowledge of the sector or other strategic advice to companies, are common in most OECD countries. They may be people who successfully started a company in the past and may have a series of companies in which they have invested. Often this type of investment is accompanied by mentoring where the individual investor or another nominated person acts as a counsellor to the entrepreneur and business. This is particularly important to business that are seeking to tackle international markets or where they have ambitious growth plans and could benefit from business advice and networking to other potential financiers, market contacts or expert advisors.

Expand technology support and activities. Given cost structures, SMEs in OECD countries increasingly need to compete on technology or other added value features that give them competitive edge on international markets. The establishment and further development of external R&D services could help local SMEs to innovate. It might be that the Districts perceive themselves as too small to create by themselves the innovation support infrastructures necessary for SMEs. In this case, collaboration with neighbouring Districts or thematically related higher education institutions should be sought.

- Pilot a high-growth programme.* A high-growth programme could be piloted at local level. Such a programme would identify young and existing companies with a minimum growth potential (based on employee numbers and/or turn-over), co-ordinate public support, provide bespoke mentoring and advice, and assist with the raising of private investment. Such a programme would only focus on a small cohort of start-ups over a two year period (given the size of the economies, perhaps only twenty companies a year would be recruited). This could be particularly valuable in regions where the entrepreneurial climate is close to national average but quality issues are evident.
- Promote high level innovation.* Existing good practice initiatives should be sustained and lessons applied to other industries. Brokering relationships between larger regional companies with latent intellectual property and SMEs with the capacities to use it should be seen as another potential route for stimulating higher level innovation. The smaller company could buy, licence or pay a commission for the intellectual property. The approach requires a specialised agency with in-depth technology and business awareness to scan for such brokering opportunities and to initiate and facilitate dialogue.
- Foster grass roots innovation.* More should be done to encourage innovation in agricultural and food industries, basic industries and services and in smaller, less capital-intensive companies.
- Exploit innovation through a wider group of firms.* The existing innovation infrastructure should be used more intensively to foster collaboration between HEIs and local companies of all sizes as well as with large companies located elsewhere but with relevance for the local value-chain. Multinational companies located locally or elsewhere represent an opportunity for local economies to accelerate and scale-up commercialisation processes because of their strong access to markets. Such links could help to test innovative products and services in market-like conditions and positively influence time-to-market relations. However, attention must be paid to the protection of intellectual property when building value release strategies.
- Help firms to assess their own investment readiness.* Programmes should be designed to address a perceived lack of investment readiness in certain sectors by improving the level of knowledge in firms about their own growth and return potentials and methods of financing. Such programmes have proved to raise the level of deal flows elsewhere. Key features would include intensive working with each company; highly interactive workshops based on role play exercises and delivered by experienced industry experts like accountants, lawyers, business angels, clearing banks, venture capital firms and corporate finance firms; and a free diagnostic investment-readiness tool. Such programmes enable firms to assess their own investment readiness, obtain feedback on their strengths and weaknesses, their ability to access equity finance, and increase investor interfaces with underinvested sectors.

Box 1. Being inspired from good practice in growing existing SME

[SuccessPotential check \(SPOTcheck\) programme – Ireland](#): Providing SMEs with a tool that enables them to understand and assess their training needs and their growth potential.

[Growth Firms Network Programme – United Kingdom](#): A survey tool to identify potential growth companies locally, combined with intense and tailored public support for product and market development.

[Sustaining Profitable Growth \(SPG\) – United Kingdom](#): A 15-month strategic leadership development programme for SMEs.

[Ready for Growth Programme – United Kingdom, Spain, and Greece](#): Addressing a perceived lack of investment readiness in digital content SMEs across Europe.

[Knowledge Transfer Partnerships \(KTPs\) – United Kingdom](#): Introducing suitably qualified graduates in local companies with the aim of improving turnover and gaining market share, intellectual property and a competitive edge.

[Enhancing opportunity entrepreneurship: GO initiative in Mecklenburg Western Pomerania – Germany](#): Providing tailored expert assistance for growth oriented companies.

[Business networking in industrial districts – Marco-lotto No. 1 – Italy](#): Providing a tailored joint service as a strategic advantage that attracts companies to settle in a developed industrial area.

[Modernising existing SMEs: INNTex and InnoSachs Networks in Saxony – Germany](#): Pooling local SME potential and improving international competitiveness through joint marketing and innovation.

[LUCHS – a network for skills development in Brandenburg – Germany](#): Contributing to local firm development by extending knowledge resources and facilitating access for SME managers and their employees.

[Local approaches in stimulating a culture of innovation in small enterprises in Mecklenburg Western Pomerania – Germany](#): A local innovation and change award recognises that cultural barriers to innovation were just as important as financial barriers to innovation.

[Incubation and technology support at local level – PITZ and NUKLEUS initiatives in Mecklenburg Western Pomerania – Germany](#): Networking in a high profile physical, focal point local companies with wider regional, national and international knowledge and innovation opportunities.