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CONTACT

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20934

Consultant. James KEDDIE
Bod. Sec. off. M. Bousal
HEPD/SHE

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SMALL AND MEDIUM ENTERPRISES PROGRAMME

STRATEGY DOCUMENT

Preliminary Draft

I. INTRODUCTION

SMEs have long been, and continue to be, massive contributors to the economies of most developing countries. They contribute a high proportion of total employment in these economies, and long-term evidence from the successful NICs of East and South East Asia indicates that this contribution actually grows with increasing prosperity and economic development. Moreover, SMEs also make equally notable contributions to output and incomes. For example, in China by the beginning of the 1990s, they accounted for more than 30 per cent of national industrial output and more than 25 per cent of the country's foreign exchange earnings.

These 'traditional' economic roles of SMEs are well-known and have been extensively documented and commented upon over the years. However, during the last ten years, a new dimension has been added. It has become recognised that, given appropriate opportunities, *SMEs can play an important role, together with LSEs, at the forefront of modern industrialization and growth as essential components of advanced production systems.* Accordingly, SMEs have taken an increasingly central role in the industrialization strategies of developing countries.

This change in perception has gone alongside, and is indeed a major element in, a shift towards primary emphasis on the private sector as the engine of industrial and technological growth in developing economies. It represents a fundamental shift from a long-held practice of considering large fully integrated plants (often largely in the public sector) as the key instrument of industrialization, employing mass production technologies and techniques.

Real primary growth could only come, it was generally believed, from efficient large-scale producers. Technological progress was seen as embodied in hardware, automation, and continuous cost-reduction through large-scale production of standardized products. SMEs were, at best, thought of as mere staging posts towards themselves becoming large integrated producers. At worst they were simply allotted a 'secondary' role - mopping up unemployment through low productivity activities.

However, a number of trends, including technological changes and the globalization of trade and investment, have altered the conditions of industrialization of the developing countries. On the one hand, easier and wider access is being provided to know-how, capital, and markets. On the other hand, competition is stronger and increasingly based on non-price factors such as quality, product customization, delivery times, and after-sales service.

Accordingly, the industrial growth of developing countries is becoming less based on low labour costs, alleged scale-economies, and abundant natural resources. Instead, it increasingly rests on the capacities of enterprises of

all sizes to acquire and adapt existing technologies to local conditions, and to organize a continuous process of 'learning by doing' to up-grade design and product quality and the efficiency of production processes, i.e. engage in continuous product and process innovation. With these developments, increasing scale is no longer the only path to industrial productivity and competitiveness. These new 'scale-neutral' tendencies are also at work in the advanced economies, where SMEs are taking on an increasing role in the overall production system shared between them and the larger enterprises.

More than anything else, it has been the ability of SMEs to respond flexibly to change, that has thrust them into a key role in the dynamics of development of production systems. Increased diversity of demand provides SMEs with opportunities to operate in specialized product markets, and new organizational methods and production technologies enable them to produce small quantities efficiently. Both factors give SMEs wide opportunities to operate at the leading edge of productivity growth. There is thus *inter alia* a marked tendency for the organization of production systems to include networks of smaller and specialized establishments which can combine efficiency, flexibility and innovation.

Exciting as it is, this full SME potential is not yet realised in most developing countries. The SME 'track record' to date exhibits vast discrepancies in performance, which has indeed been generally well below potentials. A number of striking success stories, in Asia and to a lesser extent in Latin America, provide dramatic demonstrations of SMEs operating at the leading edge of industrial and technological growth. However, the general experience in developing countries is that most SMEs continue to compete at the bottom of the market on the basis of low costs, low prices, and low quality. They have not generally been very innovative; and have achieved only slow upgrading of their levels of quality and productivity.

Thus, the challenge remains. In general, achievement levels have not come close to reflecting SMEs' industrial and technological potentials. The essence of UNIDO's SME programme is a focused contribution toward meeting that challenge.

II. DIAGNOSIS OF THE PROBLEM

The problem diagnosis centres on the key factors which enable SMEs to achieve their full potential and maximize their contribution to industrial modernization, to upgrade their productivity and competitiveness through continuous learning and product/process innovation.

The SMEs themselves remain the principal actors. They are the engine of growth, and the focus of attention. All efforts must be judged in the last analysis according to their effectiveness in upgrading the behaviour and performance of the enterprises. The successful SME is one which has:

- identified a profitable and growing market, and formulated an overall strategy covering all the essential business functions, for meeting its requirements;
- adopted and internalized an approach of continuous upgrading of operations, products and processes through learning-by-doing, and

- achieved in practice an emphasis on the progressive upgrading and expansion of the skills of the enterprise's work-force.

If a large proportion of SMEs match this pattern, the sector will have achieved its potential and will be at the cutting edge of industrial modernization and productivity growth.

It is becoming recognised that the proportion of SMEs meeting this pattern of the successful small enterprise, is related to the environment and business system in which they operate.

In this connection, it is increasingly acknowledged that whilst appropriate 'pure macro-policies' - for example, primary reliance on market mechanisms to set prices and direct investment; opening the economy rather than isolating it from the rest of the world; macro-economic and fiscal stability to promote sustainable growth; controlling inflation; and balanced regional and sectoral development - are helpful, they are not in themselves sufficient for the development of a modern thriving SME sector.

Also required, are 'friendly' conditions prevailing in the more immediate techno-economic meso-level environment in which given populations of SMEs trade and produce from day to day.

In an SME-friendly meso-environment, the following conditions apply:

The SMEs should have access to essential resources. Prominent among such resources are: know-how and information about relevant technology and market conditions; appropriate skills widespread in the workforce; supporting physical infrastructure, related to energy, transport, etc.; and appropriate financial facilities for bankable projects and smooth operation of enterprises.

The SMEs are commercially well-linked with their essential trading partners in the economy. Transactions costs are generally low, in terms both of money and time/effort. A well-developed and diverse network of commercial relationships exists between SMEs, their suppliers, and their customers, including large or specialised enterprises in manufacturing, commerce, and services. The developed system of commercial linkages contributes powerfully to the process of SMEs' continuous learning-by-doing. They learn from their trading partners, and in turn improve on what they have learnt.

The positive effects of linkages outside the SME sector may be enhanced by constructive competition and inter-firm rivalry between SMEs. An is' process of cumulative and fruitful competitive product and process innovation - with one enterprise acting as a model today, another one tomorrow, and a third the day after that. Such rivalry acts as a spur to productivity, far-removed from cut-throat competition based on low quality, price, and costs.

The regulatory and incentive environment provided by government promotes productive small enterprise rather than stifling it. Policies, regulations, and administrative procedures in such fields as taxation, land zoning and access, provision of connections to infrastructure, and

registration and licensing, are fair and do not discriminate in practice against SMEs.

Taken together, these conditions set up a mutually supporting synergistic system which maximises the development of productive SMEs, and realises the potential of the SME sector to contribute to industrial productivity and growth. Without this synergy provided by a friendly meso-environment, relatively few SMEs can muster within themselves the resources to enter on the path of successful growth through continuous learning and upgrading.

In contrast, in most developing economies this friendly and synergistic meso-environment simply does not exist for most MSEs. They face instead a weakly-organized and often even hostile environment - without adequate access to resources, without well-developed commercial linkages or constructive inter-SME competition and rivalry, and without a fair regulatory and incentive framework - which individually they are powerless to improve. ✕

This explains the poor general track record of SMEs, which stands in such stark contrast to the exciting and significant success-stories. Most SMEs are cut off from realising their potential to develop into modern continuously-upgrading enterprises. In a word, they are 'stuck'.

III. THE RESPONSE REQUIRED

It is fair to say that most past responses to SME promotion have been dominated by top-down government-mounted attempts to plug gaps and shore up weaknesses from outside, often bedevilled by a 'social' view of the SMEs as intrinsically weak economically and primarily valued as employing people albeit perhaps at low productivity. The responses have not been based on a recognition of SMEs' full potential for contributing to industrial growth and competitiveness, nor on building up the meso-environment with emphasis on the capacities of the enterprises themselves and participation of private sector mechanisms and institutions.

Although there are exceptions, these past responses, based on the provision of services by public sector institutions such as small industry development agencies, development banks and other subsidized loan schemes, marketing assistance programmes, formal technical training centres, and technology development institutes, has not in general been very effective in developing countries. The services provided frequently suffer from quite limited outreach to SMEs; over-centralization; severely restricted operating funds, staff mobility, and institutional capacities, which are inadequate for ambitious objectives; and poor quality and incentives of staff. These institutions are typically controlled and retarded by bureaucratic pressures, as opposed to being demand-driven by SME customers and the participation of the commercial private sector.

In contrast, in the industrialized countries most SMEs, like other enterprises, are commercially serviced by private sector banks, professional firms and consultants, training schools and institutes, and suppliers of various types of inputs, or by the enterprises' own organizations in the form of trade and industry associations, whether sectoral or general. Where necessary, these private sector networks are complemented by public sector intervention, whether in direct service-provision or (more normally) by supplementary public financing of services delivered to SMEs by private sector

bodies. Moreover, the public policy, regulatory, and incentive environment usually supports these patterns of service-provision. In short, a favourable meso-environment for SMEs generally exists in the industrialized countries. A new response is required to provide such an environment in most developing countries.

Simple reliance on market mechanisms is not the be-all and end-all of the required new response. Freer markets and appropriate broad macro-economic policies will help, but work is also needed to build up appropriate institutional and meso-policy/regulatory frameworks. Minimalist approaches based only on improving general trade conditions and SMEs' access to financial services, may be insufficient to realise these enterprises' full potential for intensified innovation and upgrading. Learning to trade is different from learning to produce efficiently.

New approaches are emerging to support SME dynamism and efficiency, based on measures which help the SMEs to help themselves, and on cooperation between the public sector and private institutions. A major aim is fostering inter-firm commercial cooperation, both amongst SMEs and between them and larger enterprises. Such cooperation co-exists with competition in the marketplace. It strengthens SMEs' commercial linkages with their markets and suppliers; increases their capacity to play mutually complementary and specialised roles in market-cum-production systems; and to participate in the shared delivery and/or receipt of various sorts of services - production, technological upgrading, market access, policy dialogue with public authorities - which upgrade their productivity and competitiveness and provide enhanced opportunities for continuous learning. The institutional vehicles for promoting such cooperation include, but are not limited to, industrial and sub-sectoral associations representing the SMEs themselves.

Within the new approaches, the first vital strand is development or strengthening of institutions and institutional mechanisms capable of delivering real services to SMEs on a widespread and cost-effective basis.

A long-term objective should be maximization of private sector provision of services to SMEs. Such provision would be as far as possible regulated and self-financed by demand and supply operating through market mechanisms. However, experience even in the industrialized countries indicates continuing scope for public-sector supplementation of these mechanisms; whether through market-led direct service-provision to SMEs by public agencies, or by cooperative public/private financing of private service-provision.

This market-driven paradigm may be set as a long-term policy-cum-institutional goal, but the choice of routes towards it is still by no means fixed. All the concerned parties (including the private sector and the SMEs themselves) are still feeling their way towards effective mechanisms of institutional progress. Much trial and error, and learning from varied experiences, should be anticipated in the years to come: and in this process, UNIDO plans to play a major role. However, it is already possible to indicate some areas of good promise.

In the developing countries, a wide range of private bodies has become increasingly and constructively involved in the promotion of SMEs. These include general and sectoral associations of SMEs; cooperative institutions; and private-sector banks. All these, together with private commercial

enterprises and professionals, will gradually evolve into the major providers of services to SMEs in the developing world.

Apart from the larger banks, these private bodies are generally flexible in their operations, and often decentralized and rapid in their decision-making. Many of them are relatively small and localized, with local independence or autonomy of direction and management. The staff tend to be adequately remunerated and well-motivated, which features are linked to the fact that there is no assurance that staff will keep their jobs unless they perform adequately.

This incentive-structure is a characteristic of the wholly commercial private firms, which have to earn profit to survive, but also applies to private non-profit bodies such as associations which are dependent on continued financial support from their own members. They are essentially contractors who are obliged to perform adequately in order to secure extension of existing contracts or win new ones. Therefore, whether profit- or non-profit-making, private bodies tend to be motivated, which is reflected in the strength of their field operations and their closeness to the problems of their SME customers and clients.

Among these private bodies, industrial associations represent SMEs' interests in policy and regulatory matters. Often, too, they can form or promote linkages with specialized public or private marketing, financial, technology, or training institutions, to make markets work better and improve member-enterprises' long-term access to resources. For example, they can share out subcontracts arranged with larger private firms, and promote savings and loans schemes among their members, which can then progressively build up relationships with local banks; They can also bring the combined expertise of members to training and technology needs, thus more precisely identifying the problems where further linkages with outside specialized institutions are most needed. Their advantages in these respects probably increase in SME clusters, particularly those with strong inter-firm cooperation.

Private non-profit bodies such as associations and resource centres - and indeed public sector service institutions as well - should aim to sustain themselves as much as possible on a fees-for-services basis, in the same way as commercial enterprises. For technical and market services and business training, it should be possible for them to raise income received directly from members and other local SME customers. Promising sources of such income are fees for: use of machinery in common facilities centres; specific technical or market information or consultancy services; factoring fees for arranging subcontracted or export orders; fax services; and payments for training courses. Significant revenues have been raised by some non-profit private bodies in these ways, and some of them are well on the way towards financial self-sufficiency from fees.

Fee income could be further increased if national or local governments agreed that private bodies - whether non-profit, or commercial for-profit firms - could contract to provide specific services, such as training programmes or technical consultancy, which could be paid for in part by the public authorities on a monitored performance basis. Service contracts of this type could also be used to promote technical research and development (R&D) links. In some developing countries, these have grown up based on cooperation between sub-sectoral associations and public agencies such as universities and

R&D institutes. Under this type of arrangement, the SME associations pay part of the R&D costs, while the remainder is publicly funded.

As a complementary measure, tax or other incentives may be employed to intensify larger commercial private firms' business linkages with SMEs, particularly their subcontractors, to the significant benefit of the latter.

There is also potential for progressive revitalization or rationalization of at least some of the public sector institutions. It has already been noted that they, too, may move towards sustaining themselves on a fees-for-services basis. Apart from the often much-needed increase in revenue this would generate to finance their operations, it would tend to make the services more market-driven, because SMEs are extremely unlikely to pay significant fees for services they do not regard as useful. A parallel approach may focus on organizational and financial reviews of institutions to rationalize their roles and privatize - either completely, or on a joint-venture basis - many of their functions.

Much may also be gained from greater cooperation between public and private efforts in direct service provision to SMEs. For example, private commercial firms can produce and sell equipment developed in public sector institutes, on a profit-sharing basis. Such cooperation, particularly at local levels, will probably stimulate the public institutions to develop more local expertise and decentralized decision making. Thus a major possible benefit of direct cooperation may be the stimulus given to reform of the public agencies themselves.

The other vital strand within the new approaches is full recognition of the stimulatory role of government to provide a helpful regulatory and incentive environment for SMEs. Such an environment should generally include as many as possible of the following features (among others):

- taxation regimes (including tariffs) should be monitored, and periodically amended where necessary, to ensure that they do not effectively discriminate against SMEs. Direct taxation procedures should be uncomplicated whilst reflecting the probable economic status of the enterprise, and should be administered in ways which facilitate payment by the SMEs (e.g. local collection, assessments payable by installments);
- zoning and public land auction/allocation procedures should not exclude SMEs from acquisition of, and/or access to, sites dispersed in suitable areas, especially in cities and towns. Building and site development procedures might permit progressive compliance by SMEs of the full requirements, thus allowing investment over time, financed from the enterprises' operating cash flows;
- policies affecting innovation and rights and access to technological information, and the development of inter-enterprise linkages, partnerships, and investments, should likewise be formulated and administered in ways which do not discriminate against SMEs. Incentives should also reflect this principle. For example, larger firms might receive incentives to use Training Levy funds to upgrade the skills of their SME subcontractors, and

- registration and other regulatory requirements of starting and operating a business, may be streamlined and simplified. The number of regulations applicable to SMEs should be reduced to the minimum compatible with their own protection and that of the public, and then strongly enforced. This process may be assisted by reviewing and consolidating the body of law pertaining to sale, contract, and tort (or their equivalents in Roman-law or other legal systems). In addition, the principle and procedures of using public funds to partly-finance the provision of some sorts of services to SMEs by private service-contractors, might be formalized in enabling legislation and regulations.

Whilst the above-outlined new approaches at the service/institutional and policy/regulatory levels offer promise for realising SMEs' full potential, the transition is difficult. Old habits and interests die hard. This is true both on the side the enterprises, who have normally learnt to conduct their external relations on the basis of lobbying and short-term protection rather than on contributing to the development of real services: and on the side of the public sector, where bureaucracy and attachment to self-conceived and self-operated remedies still often prevail, as opposed to real cooperation to build up the capacity of private or cooperative institutions and service-mechanisms. Significant and well-focused efforts will be needed to break the logjam, and the UNIDO SME programme is designed to contribute significantly to these efforts.

IV. OBJECTIVE

The SME programme is a key element within the core of UNIDO's overall mandate and objectives and is closely linked with and supported by the other programmes of the Organization.

The objective of the programme is improvement of SMEs' contribution to industrial and technological growth, through building up environments and systems increasing SMEs' capacity for a continuous process of learning. Their productivity will be raised by market-led upgrading of product design and quality and the efficiency of production processes.

The programme will focus on ~~enterprises engaged in manufacturing and manufacturing-related services.~~

The programme will make the following contributions to UNIDO's overall development objectives:

Industrial and technological growth and competitiveness

The fostering of a continuous process of learning and upgrading within the SMEs, will materially contribute to productivity increase and overall industrial and technological growth, as the SMEs more fully achieve their potential both to compete and to cooperate in the marketplace alongside larger enterprises.

Development of human resources for industry

The continuous learning and upgrading process fostered in the SME sector will powerfully contribute to the overall development of human resources for industry. In this respect, the SME programme's particular emphases will be improvement of the general management skills of the entrepreneurs, and upgrading the technical skills and know-how of the personnel employed in the SMEs.

Equitable development through industrial development

However progressive, SMEs are always likely to be major providers of employment. Therefore the programme's contribution in general to the SMEs' continuous upgrading, will progressively raise the widely-dispersed incomes associated with such employment. Furthermore, as a specific sub-programme, the upgrading of rural industrial SMEs will contribute significantly to increasing agricultural productivity and incomes in rural areas through fostering of forward and backward linkages between rural industrial and non-industrial sectors. This sub-programme will employ approaches to SME development which are specifically adapted to maximize this contribution.

Environmentally sustainable industrial development

In theory, production in small establishments has considerable potential - as yet, unfortunately, very unevenly realised - for contributing to environmentally sustainable development. In practice, SMEs are often among the worst industrial polluters in developing economies, due to lack of technical advice and ill-adapted systems of environmental regulation and incentives. By helping to evolve systems and instruments to remedy these defects, the SME programme can make a major contribution to the objective of environmentally sustainable industrial development.

International Cooperation in Industrial Investment and Technology

The SME programme will contribute significantly to this objective, by promoting inter-firm cooperation across borders, including joint-ventures, between SMEs and larger enterprises. These initiatives will link developing country SMEs with export markets, and will also provide incoming foreign investors - mostly larger manufacturing firms from the developed countries with production systems in which they can cooperate with local SMEs to the mutual benefit of both sides, rather than, as in the past, remaining largely isolated from the national and local economies in which they operate.

Diagnosis of the Problem

Strategy of the UNIDO SME Programme

The introduction to the strategy of the programme may be focussed on three related aspects, viz:

- areas of concentration;
- means of execution, and
- partners in the programme.

With respect to the first aspect, the primary areas of concentration of the programme will be:

- assisting the design and effective management of overall strategies and programmes for building up the SME-friendly meso-environment. Governments will be major players in these strategies and programmes, but they will need to be developed in partnership and constructive consultation (minimising tendencies toward short-term lobbying and the defence of narrow vested interests) with the private sector;
- enhancement of institutional capabilities to offer innovative services, to be based as far as possible on, or in jointly-responsible partnership with, the private sector including the SMEs themselves, and
- improving industrial partnership relationships with and among SMEs, focussing on the development of cooperation and linkages among SMEs and between SMEs and larger enterprises, further assisted by improving SMEs' access to technological and market information and know-how.

Alongside, and associated with, these primary concentration areas, the programme will also include two specialised sub-programme initiatives in the fields of:

- sub-sectoral development linked with clusters of SMEs, and
- the industrial SME contribution to rural development (rural industrialization and its linkages).

Each of these five *operational programme elements* includes an interrelated range of advisory, information and training services, supported by action-oriented research and case studies. In each, the specific methodologies of intervention are continuously evaluated and upgraded.

The overall SME programme is supported by an *SME observatory and research network* which contributes to the analysis of, and exchange of experiences about, key SME development issues, including the contribution of SMEs to the dynamics of industrial modernization and productivity growth; the comparative efficiency and impact of various types of SME-related strategies, policies, and institutions.

The entire programme and its several programme elements will, as an integral part of the strategy, be subject to ongoing evaluation, and when necessary, reformulation and reorganization, in order to ensure the programme continues to contribute in the most effective manner possible to its overall objective, viz. the improvement of SMEs' contribution to industrial and technological growth through fostering a continuous process of learning and upgrading within the SMEs.

Turning to the second aspect, the SME programme's means of execution involves:

- contact with, research into, and monitoring of, effective innovative approaches within the fields covered by the five operational programme elements, and

- development of methodologies for transfer of these approaches - suitably adapted where appropriate - to developing countries and areas not yet utilizing them.

This research, monitoring, and development process will be coordinated and supported by the observatory and research network within the SME programme.

Among the principal means of transfer of the innovative approaches will be:

- policy advice missions and consultancies;
- technical assistance aimed at building up the capability of appropriate institutions;
- a publications programme, with particular attention paid to the active marketing and dissemination (including user-friendliness of modes and formats) of the 'publications';
- high-level training programmes and workshops, and
- promotion of exchanges of experiences, partly through study-tours; but also, and particularly, by direct involvement of institutions (such as local governments, chambers of commerce, industrial research associations, etc.) with relevant experiences, in the transfer of those experiences to counterpart institutions elsewhere.

With respect to the third and final aspect, an integral strand of the SME programme is its system of networking partnerships. The programme will not attempt to render its services in a self-sufficient and isolated manner, but in cooperation with a wide range of partners.

In the first place, the SME programme will fully utilise the technical expertise available in the other services and units of UNIDO itself. For example, it will cooperate with the divisions, units, and programmes concerned with: the various industrial sectors; industrial strategies and policies; human resource development; investment promotion; systems of information on technology; quality management; etc.

Secondly, the programme will work in close cooperation with other assistance and development institutions, multilateral and bilateral, which are significantly involved in SME promotion and its financing.

Thirdly, it will further develop and catalyze specialist inter-institutional partnerships. UNIDO already maintains long-term relationships with hundreds of institutions, private and public, in dozens of countries. The SME programme will further develop these relationships in complementary ways. Within each country, the programme will encourage forums for the exchange of experiences between national SME-related institutions and associated donor agencies. Further, in each country from amongst these institutions, 'UNIDO correspondent institutions' will be selected and assisted to act conduits for communicating the most promising and potentially transferable experiences internationally.

This mechanism will be complemented by the direct development, under the auspices of the SME programme, of an international network of cooperation between world-renowned institutions with general or particular functional expertise in industrial SME development. The network will comprise about a

dozen institutions from both the developed and the developing worlds: for example from Europe and North America, from Asia and Latin America. These institutions will themselves profit from the enhanced mutual contacts promoted by the UNIDO-sponsored network. Also, the SME programme will act as a partner and conduit for transfer of their particular expertises where they are most needed in other parts of the developing world. This international network of world-renowned institutions will thus, at one and the same time, function as:

- a major resource cooperating with UNIDO in the execution of the five above-listed operational SME programme elements, and
- the institutional basis of the observatory and research network, which supports the operational programme elements through the analysis of key SME issues.

Programme Elements

Introduction

The following presentations of the several elements of the SME programme each identify the element's main thrust, and then identify the key or core services which will be rendered by UNIDO under the element in question. In following these presentations, it should be implicitly understood - even where it is not explicitly stated - that:

- the services to be rendered by UNIDO are by no means the only ones to be rendered to the SME sector or to the institutions serving it. Many complementary services in each field will be rendered, by other agencies and institutions, both national and international. UNIDO's services are to be seen as specialist contributions within a cooperative network;
- UNIDO's services will be rendered by many units of the Organization, as noted above under 'Strategy'. The great bulk of the ultimate enterprise-clients (that is, the target-sector) of the whole of the Organization - not merely the SME Branch - are in fact SMEs, and
- although each programme-element has its own focus, they complement each other. In many situations, they will work together, with parallel and complementary contributions being made to the SME sector by several elements. A specific example is currently provided by UNIDO's work in Madagascar, where services are already being provided under the 'strategies, policies and programmes' and 'industrial SME contribution to rural development' elements, and further services are now requested under the element 'industrial partnership relationships with and among SMEs'.

Primary Areas of Concentration

1. Strategies, policies and programmes for the promotion and development of the SME Sector

The main thrust under this programme-element is to strengthen the capabilities of the developing countries to establish a policy-and-institutional environment for promoting the SME sector and its contribution to the dynamics of industrial growth, modernization, and competitiveness.

The key services to be rendered by UNIDO fall under the following headings:

- promoting partnership and cooperation between governments, industry associations, and private and public technical and financial institutions, in the first instance towards greater knowledge of the SME sector and building new awareness of its potential to contribute to modern industrialization and productivity growth, and subsequently to capitalise on the potential through appropriate strategies, institutional arrangements, and services;

- assisting governments, working with its above-noted partners, to formulate national strategies to improve the contribution of the SME sector to the dynamics of industrial growth. The basic underlying principle is the integration of SMEs and of policies especially relevant to their development, into the general industrial and economic development strategy and policies of the country;

- in selected fields, contributing to efforts to improve the policy and regulatory meso-environment in which SMEs operate. In some fields - for example - trade and taxation policies, and financial-sector policies and regulations, or policies affecting land-access and use - other agencies will take the lead, and UNIDO will assist merely in developing information about the concerns and needs of SMEs under these policy-headings. In others - for example, policies affecting innovation and rights and access to technological information, and the development of inter-enterprise linkages, partnerships, and investments - UNIDO may take on a leading role in advising governments and their national institutional partners;

- assisting governments with institutional policy, i.e. to develop policies, new or amended legislation, regulations and incentives to promote appropriate demand-driven institutions to service and support processes of continuous learning and innovation in SMEs, and

- assisting governments and their national institutional partners to develop mechanisms to ensure the effective implementation and continued development of strategies and policies, including cooperation between institutions and the effective interaction of industry associations with government on policy and regulatory matter. This is a vital field, where there are no general tried-and-true solutions. UNIDO will observe, and work to develop further, various mechanisms in collaboration with its partners, including an emphasis on building up the strength of bottom-up decentralized systems which may meet and cooperate at the national policy level.

2. Enhancement of institutional capabilities to offer innovative services

The main thrust under this programme-element is to strengthen the capabilities of institutional to offer innovative services to SMEs. Such institutions will be based as far as possible on, or sponsored and managed in jointly-responsible partnership with, the private sector including the SMEs themselves. They will typically be specialized, decentralized, and connected in networks.

The key services to be rendered by UNIDO fall under the following headings:

- assistance in building up services to increase general management skills among the small and medium entrepreneurs. These skills are needed among successful modern SMEs. They include business strategy formulation, and adopting and effectively managing an approach of continuous learning and upgrading of skills. The institutions whose services in this field will be built up, include private management consultancy networks and industrial associations;

- assistance to improve the capacities of specialised institutions to work effectively with SMEs. This will emphasise assistance to such bodies as chambers of commerce and human resource development institutions, enabling them re-orient and/or diversify their services - for example, in the fields of export promotion, market information, quality management, etc. - to SMEs on a demand-driven, sustainable basis which evolves with the continuously upgraded needs of the SME target-group. It will also include restructuring of SME development agencies, using methodologies for diagnostics and encouraging networking. And

- assistance to the set-up of business incubation programmes. Such programmes for SMEs in their start-up years, bring together advisory/training and networking services with the provision of space (premises) and common services (secretarial, communications, etc.). According to the particular SME target-group, differing emphases will be placed, within the package of incubation services, on 'infrastructure', 'technology' and 'management'. There will also be an associated entrepreneurial development programme (EDP) component to be provided by UNIDO in cooperation with sponsors of established and proven international programmes in this specialised field.

3. Industrial partnership relationships with and among SMEs

The main thrust under this programme-element is to assist the strengthening of SMEs' networking and industrial partnerships, both among themselves and with larger firms. This is among the crucial factors for realising SMEs' potential for contributing to industrial growth and competitiveness through continuous learning and upgrading; and SMEs and their service-institutions attach particular value to UNIDO's role as an impartial adviser and intermediary in this field.

The key services to be rendered by UNIDO fall under the following headings:

- assisting the set-up and further development of subcontracting and partnership exchanges (SPXs). The SPXs act as clearing-houses for industrial subcontracting and outsourcing, and for partnership enquiries and opportunities, involving SMEs; and can also link SMEs with specialized institutions providing technical and marketing information, financial services, etc. UNIDO has extensive experience in the field, having helped to establish 40 active SPXs in 22 countries. The SPXs may be autonomous bodies with boards representing public and private institutions; or attached as a 'service' of a chamber of commerce and industry, or of a public industrial promotion agency. Either way, they finance themselves through contributions from member-SMEs, industry associations, public institutions, and their own fund-generating activities such as profits from participation in trade fairs etc. Besides the provision of general experience and advice to SPXs, UNIDO helps to link different SPXs across national borders, and provides specific methodologies and procedures for SPX operation further supplemented by computer programmes for management of their data-bases (UNIDOSS);

- through cooperation with UNIDO's Investment Promotion Service and its network of offices, increasingly linked in future with the SPXs, the programme-element help promote industrial investment partnerships between SMEs and other, mostly larger, enterprises. Such partnerships help to link SMEs strongly into world markets, and promote international cooperation in industrial investment and technology;

- both subcontracting and industrial investment partnerships are also assisted through cooperation with international fairs for industrial sub-contracting, suppliers and partners;

- in association with the above services, and in cooperation with UNIDO's industrial and technology information Services and data-banks, the programme-element improves SMEs' access to global sources of technological and marketing information, and

- assists the institutions in the field of industrial partnership, such as SPXs and chambers of commerce and industry, to strengthen their abilities to form well-informed and constructive links with government on the relevant policy-fields, e.g. tax and customs regulations pertaining to sub-contracting relationships, policies on the indigenization of supply of parts and components to large foreign companies established in the country, and incentives to large enterprises to 'decentralize' their production through subcontracting and outsourcing. Services of this type may sometimes be rendered in cooperation with those noted above in the 'strategies and policies' programme-element, this being an example of synergy and mutual support between the several elements of the SME programme.

Specialized Initiatives

4. Upgrading sub-sectoral clusters

The main thrust under this programme-element is to assist the formulation and implementation of cooperative service-programmes in sub-sectoral clusters of SMEs. These programmes will contribute to inter-enterprise specialization and commercial cooperation; and to upgrading the quality of the SMEs' products; improving the efficiency of the production and distribution processes in the clusters; enhancing the SMEs' managerial and technical skills; and strengthening their linkages with buyers, suppliers, and specialized (e.g., technical, financial) institutions.

The key services to be rendered by UNIDO will assist the SME clusters and local institutions to develop such cooperative service-programmes. This is a fast-developing field, in no institutional or service 'blueprints' are yet fixed for widespread application. However, the following general mechanisms and activities need to be initiated or further strengthening in developing cluster service-programmes:

- formulation of a market-cum-technical strategy for the cluster upon which inter-enterprise cooperation and stimulation is to be based, allowing for internal and external capabilities and constraints. A

factor in the strategy is the SMEs' imitative capacity. If this is high, it will be possible to concentrate on 'vanguard' SMEs. If it is relatively low, upgrading and direct networking efforts may be based on a wider spectrum of SMEs within the cluster;

- establishment of a focal point for the service-programme. Depending on circumstances, this may be a new 'institution', but will often be attached to, or form a unit of, one of the local representative or specialized institutions. The focal point may limit itself to promoting networking of mutual cooperation and service-provision among the SMEs and the relevant local institutions; or it may in addition provide some substantive services itself, e.g. common production or purchasing services, or technical or marketing information. In the latter case, it functions as a resource centre for the SMEs, but almost certainly only for a part of the range of services available in the programme from various specialized institutions. To promote closeness to the SMEs themselves and the 'self-help' principle, the focal point/resource centre may be based on their SME association, but this is initially advisable only if the association is representative and reasonably dynamic;

- establishment of relations with, and cooperation between, the SMEs themselves, with emphasis where possible on the 'vanguard' firms whose practice may be expected to spread through the cluster. The areas of cooperation and services include: upgrading product design and quality; promotion of specialization of production between firms for greater collective efficiency and competitiveness; technological advances and skill-upgrading; common production and/or purchasing agreements and services; linkages with trade fairs and other marketing mechanisms of joint interest to enterprises; and collaborative learning mechanisms, such as regular consultative meetings and organized circulation of information;

- as already implied, the development - coordinated or catalyzed from the focal point - of the SMEs' access to a network of specialized technical, financial, and other institutions, which in most cases will provide the bulk of the services within the programme, possibly including new ones made possible by the strengthened inter-enterprise cooperation, and

- strengthening of the abilities of institutions, in particular the SME representative associations, to form informed and consensual links with local and national government on the policy and regulatory environment, for example in the fields of infrastructure, taxes, training, public support of private service-provision, etc.

Depending on local circumstances, UNIDO assistance-services may be required in establishing or strengthening any or all of the above activities and mechanisms. However, the underlying principles are that: (i) UNIDO will complement local abilities and institutions, with the objective of rendering the local SME/institutional networks and service-programmes sustainable and self-upgrading as soon as possible; and (ii) UNIDO may further focus its assistance-services if further experience indicates that its complementary function may generally be achieved without its assistance across the entire above-described range of cluster-promoting mechanisms and activities.

5. Industrial SME contribution to rural development

The main thrust under this programme-element is to contribute to the creation of rural non-farm employment and income-generating activities and to the promotion of backward and forward linkages between the industrial and agricultural sectors: thus not merely promoting continuous learning, upgrading, and productivity growth in the rural industrial sector (overwhelmingly SMEs), but also leading to the improvement of agricultural, particularly small-holder, productivity and incomes.

The programme-element is implemented in cooperation with other units (sub-sectoral, technological, human resource development, etc.) in UNIDO, channelling their technical expertise and also monitoring and disseminating lessons to improve the effectiveness of their activities. It is aimed at improving the rural business environment (policies, support services), working with central governments, the provincial authorities, representatives of rural business communities, and local private sector agencies. Whilst including specific sub-sectoral foci, it embodies a cross-sectoral area-based approach to growth and the improvement of productivity.

The key services to be rendered by UNIDO fall under the following headings:

- promotion of and participation in studies related to industrialization and rural development, and the exchange of experiences between practitioners; and production of methodologies based on these, aimed at building up the capacity of policy-makers and institutions;
- assistance to reviews of legal, fiscal, administrative, and other policies, to eliminate constraints in the business environment of rural SMEs and resource flows against the interest of the rural sector;
- assistance to service and representative institutions to improve national and local capabilities in providing financial and other support services accessible to SMEs in rural areas, and
- strengthening national and local capabilities to provide technological and business-support inputs and advice assisting SMEs in rural industrial sub-sectors having especially strong linkages with the expansion of agricultural markets and improvement of agricultural productivity, i.e. the processing of agricultural produce, and the production of agricultural implements, tools and chemical inputs, appropriate to the needs of smallholders.

Overall Supporting Component

6. SME observatory and research network

The main thrust of this supporting component of the programme is to assist the continuous upgrading of the services of the whole SME programme, and indeed of those of a world-wide cooperative network of relevant institutions, through promotion of research into key issues, observation of developing practices, and exchange of information, throughout this network.

The key services to be rendered by UNIDO fall under the following headings:

- observation of, and organizing exchanges of information about, best practices in industrial SME promotion, through sustained contact with institutions worldwide, including a core network of world-renowned institutions from both the developing and the industrialized countries. This services will provide UNIDO and its partners, including international development agencies, with continually updated information on the efficiency and impact of various types of strategies, policies, institutions and mechanism for SME promotion;
- organization of and participation in action-oriented research on specific topics of general interest relating to SMEs and industrialization, primarily in cooperation with the network partners;
- convening and organizing specialised workshops on key industrial SME issues, to be attended by experts and representatives of institutions relevant to each topic, on world-wide or regional bases;
- based on and associated with the above services, issue of a regular Newsletter on SMEs and Industrialization;

The operational elements of the SME programme will draw support from the above services in their development of methodologies for the transfer of innovative approaches to specific aspects of SME development.

The activities of the Observatory and Research Network will be guided by regular consultations and meetings with a high-level Advisory Group. The membership of the group will be drawn largely from the core network of world-renowned institutions, supplemented by independent experts of outstanding repute.

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