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Session III

SUPPORT TO THE PRIVATE  
SECTOR AND INDUSTRIAL  
PARTNERSHIP DEVELOPMENT

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SME Development in Countries  
of Central Asia (Kazakhstan, Kyrgyzstan and  
Uzbekistan): Constraints, Cultural Aspects  
and Role of International Assistance

UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION

**SME Development in Countries of Central Asia  
(Kazakhstan, Kyrgyzstan and Uzbekistan): Constraints,  
Cultural Aspects and Role of International Assistance**

*by Wojciech Hübner*

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UNITED NATIONS  
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## Executive summary

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The paper draws a multidimensional picture of the small and medium-sized enterprise (SME) sector in three countries of Central Asia. Different subjects of economic and political life have different expectations connected with development of the SME sector. Potentially, the sector may become the major catalyst of economic development of particular countries and in the whole region. The present realities, however, are still often different from earlier expectations and purely theoretical analysis.

The paper attempts to formulate key guidelines for international donors' assistance targeted at SME development in transition economies. They include understanding of existing barriers, understanding of the cultural premises and context of the process, as well as better coordination of donors' activities within a national and regional framework.

The paper discusses the barriers that hinder SME development and the cultural aspects of developing entrepreneurship in transition economies. The three countries of Central Asia are in a search for the optimal model of SME development, however no universal recipe could be formulated for all transition economies, especially in the area of entrepreneurship development—sensitive to historical and other cultural factors.

The success of particular transition economies in SME development seems to originate in adequate systemic solutions applied within three distinct areas: (a) macro-economic conditions that provide incentives to develop business and in which main SME development barriers are minimized, (b) ability to properly train people and develop their entrepreneurial skills and (c) ability to create conducive financial and support infrastructure for SMEs.

Finally, the paper looks at SME development issues from a regional perspective. In this context, the focus shifts from a national framework to the regional one, where development of SMEs, has to be implemented parallel to acceleration of the regional integration processes. The author concludes that new United Nations SME projects and programmes should reach beyond national borders, just like the integration processes do. United Nations technical assistance could become another important dimension for the build-up and strengthening of the necessary infrastructure for both: SME development and the regional integration.

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# 1

## SME sector in transition economies: what is expected?

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For many years now, expectations concerning small and medium-sized enterprises (SMEs) have been growing rapidly across the world, both in developing and developed countries. After a distinct period (1960-1970s) of a considerable fascination by expanding globally Multinational Corporations, the world economic literature together with economic and political leaders around the world have been pointing in recent years at the importance of the SME sector for both advanced market economies, as well as economies in transition. The formal recognition has come even from the G-8 Group, which, in its 1997 meeting in Denver, indicated the considerable contribution of small and medium sector to employment and economic dynamism in the most industrialized countries and stressed that the best practices in this area can be used as positive examples for rapid development of the emerging economies (Bianchi, 1997).

One of the main reasons for such reorientation has been the new way of thinking by managers and economists in developed market economies and a new perception of opportunities of economic success. The importance of standardized mass production lost its weight already some time ago on the account of the quality orientation in management and ability to tailor production to individual and changing needs of ever-stronger customers (Dobyns 1991; Jenner and Hubner 1994). Smaller enterprises proved to be more flexible in responding to the customers needs, capable of an authentic customer focus, faster in adapting to and learning from changing world market situations, more risk prone in introducing new technologies and new creative methods of management.

Economic theory has brought a revival of the *Schumpeterian* approach (importance of the "gifted few" who can innovate and dismantle traditional, routine structures, "the entrepreneur as the *persona causa* of economic development") and schools of business around the world have been thriving on the cult of entrepreneurship. Theory of firm has become divided into static and a dynamic one. Static theory of firm proves that large firms are efficient because they focus on the status quo; the dynamic theory suggests that small firms are efficient since they focus on change. New, small start-ups introduce change into the economy. The implications for the public policy has become therefore to implement policies that encourage the entry of new firms, support their survival, and promote their growth.

In a natural way a small or medium enterprise is closer to the contemporary vision of a new, flat and lean, horizontal company (Womack, Jones and Ross 1990), which has created a new role model among enterprises around the world, the type of an enterprise which can succeed in present competitive markets, in times where leading giants are struggling to minimize losses after years of neglecting challenges from the domestic and foreign competitors.

It has been noticed that an economic success, even in such complex areas as an export expansion does not have to be a result of a successful policy of gigantic corporations (e.g. the case of Italy in the 1980s).



In general, new tendencies in thinking have been limiting the importance of traditional economies of scale of big enterprises, on the account of profit gains from market and innovative flexibility, larger ability to adjust and better focus on customer needs of the small and medium-sized ones.

Not only have the SMEs been developing quantitatively in many leading economies, but they also have been pioneering in introducing new technologies and management methods. It is estimated that employment in businesses with less than 100 people ranges from above 40 per cent in the United States, 60 per cent in Denmark and 70 per cent in Italy. With regard to businesses employing less than 500 people, their share varies from above 60 per cent in Belgium, to 70 per cent in Japan and almost 80 per cent in Portugal (Griffin, 1997).

In the case of United States, entrepreneurship development and competitive environment generated through the presence of strong SMEs are quoted to be the leading factors behind the country's recent success in the rivalry with Europe and Japan.

Analysts indicate three important cases within the American success story:

- ❑ Big companies, such as e.g. General Electric, adapted/re-engineered themselves (including the shedding of labour), became leaner—with the sales and profits raising sharply;
- ❑ New, small high-tech start-ups have been expanding—from traditional industrial sectors (such as e.g. Nucor Steel), to Internet based and e-commerce (such as Amazon.Com, Netscape, AOL, E-Bay and virtually thousands of others);
- ❑ Thousands of new, micro and small firms have been founded, many by women, minorities and immigrants (Zsoltan Acs, 1999)—which is probably the most valuable observation from the point of view of lessons learned for transition economies;

Changes, which started in 1970s, have lead to a situation where SMEs represent a large, diverse and important part of the United States economy. In the second half of the 1990s, firms with less than 500 employees accounted for over 50 per cent of private sector employment, nearly 50 per cent of sales and more than 50 per cent of value added generated in the private sector. It has become clear that both small firms and entrepreneurship are necessary for macroeconomic prosperity even in most advanced market economies.

In transition economies, the interest in the SME sector stems generally from both the various needs of the transition process itself and from an understanding of the strength of small and medium-sized companies in the target market economy. However, particular groups of subjects of political and economic life perceive the importance and role of the SME sector in their specific, distinct way, sometimes very different from the perception of the others.

For politicians and governments the SME sector is important first of all due to the fact that it can replace the government in the difficult task of job creation, which is one of the most sensitive issues during the transition period, when thousands of people lose their jobs. Also, SMEs are important, since gradual development of the sector leads in future to creation of the new, prosperous middle class—the best-proven factor of a country's long-term stability. Another important consideration for the governments (usually overemphasized) is the potential for additional fiscal income creation by the SME sector.

For macro-economists, researchers and academia the SME sector is perceived in the context of the complex tasks of systemic change under transition, development of the private sector, restructuring and a possibility of more efficient allocation and utilization of resources. Centrally planned economies of the past, with their links of vertical subordination, were always systemically prone to economic development based on a fundament of huge production units, seemingly capable of delivering planned quantities. The government support, including various forms of direct subsidizing, concentrated on these biggest units and was offering them, almost as a rule, a monopoly-like position at home and protection from foreign competition.

In the target model of a market economy, towards which transition economies are heading, the most important and valuable mechanisms are expected to be launched through a competitive market with horizontal ties among a myriad of diversified producers. In the target model, some of the traditional functions performed, or attempted, by centrally planned economies' governments (such as, e.g. job creation, determination of national specialization, improvement of international competitiveness, etc.) are expected to be better fulfilled by the private business sector and by the SMEs in particular.

The macroeconomists tend to see the fulfilment of these functions in a broad context of the whole, newly created economic system. Under the new set-up of the national economy, the SME sector is perceived as a decisive force, which can launch many valuable economic stimuli (e.g. through the multiplier mechanism), can contribute to important technology transfer or disseminate entrepreneurial culture in the society.

For the SME business community the perceptions of its own sector and the expectations are multi-layer and have been changing over time. Generally, members of the community (new entrepreneurs and those who had began business earlier, under conditions of partial reforms) are glad that the private sector, with its capability of autonomous decision has replaced the old style, centrally planned bureaucracy and that potentially enormous opportunities were created for them. In a 1992 SME survey conducted in Poland (Kondratowicz and Maciejewski, 1994), the majority of respondents stated that their decision to start a new business resulted from the need to secure a decent standard of living for themselves and their families. Since the beginning of the systemic transformation, the entrepreneurs have been looking forward to expansion of their own businesses and the sector as a whole, since most of them rapidly got used to a new style of work and life so much, that it would be difficult for them to readjust.

At the same time, experience shows that many of the transition entrepreneurs perceive their duties, especially at more mature stage of transition, as a permanent struggle with unfavourable elements. In this context, they are rapidly acquiring the characteristics (which creates an almost universal challenge for all governments) of their counterparts from mature market economies in terms of e.g. their contempt for politicians, regulatory bureaucracy, rigid bank demands and procedures. As a result, they often see a refuge in the informal sector. (Gibb, 1995)

After decades of central planning, a considerable proportion of these country's population looked at the emerging SME sector with specific suspicion inherited from the past. For many, SME was perceived as an exotic field of activity, difficult to access and not sufficiently reliable to offer a stable income or job. At first glance, its tough business rules, permanent uncertainty and risk could not add up to a friendly and welcoming environment, especially for beginners. Many assumed that

activities in the SME sector were reserved for some rich, privileged, better informed and connected insiders.

Some negative clichés in thinking about SME were directly inherited from the past. Such patterns of thinking often referred to business in general as not a very “noble” type of activity and not very appropriate for those who would like to earn money in an “honest way”. Along the lines of such thinking, new own-business was often reserved for those who already had accumulated some individual wealth in the past, in a system where everyone was supposed to be equally not very well-off. These negative perceptions came in handy as a sort of internal excuse by those who did not feel comfortable with the new market system and with less protection from the state. In extreme cases, the SME business was seen as having connections to the corrupt component of the economy.

Such attitudes (and expectations connected with it) were sometimes dramatically different from those of societies of mature market economies and people born in different environment, where ubiquitous presence of SMEs was obvious from the first day of consciousness.

The negative perception of business by some segments of the population is changing as the process of transition progresses. It takes, however, usually quite some time before the emerging, market oriented SME sector can be perceived as an entirely positive phenomenon and a serious alternative to the old life style—with its social protection mechanisms and a poorly paid, but certain system of job allocation. Present realities in the transition economies indicate usually a mixture of old attitudes and a new, more entrepreneurial and pro-active perception growing proportionately to the progress done in creating classical market environment.

All in all, in a typical transition economy, we can observe some disproportion (varying in size for particular economies) between the expectations attached to the SME sector and the particular perceptions of the SME importance: from a narrow-pragmatic, to systemic/theoretical, to different shades of specific (often growing) scepticism by the business community, to the initial alienation characteristic of some segments of the population.

Each perspective has some important components and carries an important message for the policymakers. A country, which wants to be successful in using SMEs as the major driving force for development of the national economy, has to be aware of existing inadequacies and dissonance in perception of the sector's role. In this context, creation of a long-term vision and development strategy addressing these issues becomes imperative.

The ultimate success largely depends on the ability of putting the understanding of SME importance to a common denominator. The politicians and governments should see the SMEs in a broader context than job creation and fiscal issues; the macroeconomists and the rest of academia should see the pragmatic aspects of developing business and not only its importance within a purely theoretical analysis. An effort is needed to change the perception of business and its image in the eyes of the sceptical parts of the society. Finally—hard facts have to be created to increase motivation to set up and develop SME business and to change many aspects of prejudice by the own business community with respect to government intentions.

In Central Asia, the SME sector, though important for all the countries, has a different meaning for each individual economy since, despite evident similarities,

the countries differ in many ways. The common denominator for the countries in the region has been created by some common components of old cultural tradition and by the less distant history of command economy and its recent collapse. All countries suffer from industrial decline in "traditional" sectors, from weaknesses of the deeply inefficient agriculture inherited after decades of centralization, from various environmental problems, by-products of forced growth and from numerous disproportion characteristics of a centrally planned economy.

On the other hand, the countries differ among others in the level of endowment in natural resources, in size and the level of dependence on the ties with the Russian industrial complex (Central Asia Survey, Economist 1998).

Population-wise, Uzbekistan and Kazakhstan are big countries of the region and are generously endowed in natural gas and oil, gold, as well as many other minerals. Both have considerable potential in agriculture. However, out of these two countries, Uzbekistan was never closely tied to the Russian industrial complex, it depended and still largely depends on a monoculture of cotton.

Kyrgyzstan is a small country with little population. Without available oil and gas, it relies mainly on gold and prospects of an enormous potential in hydroelectric power and perhaps exploitation of some rare minerals in future.

All these three countries' old, biggest companies are still hampered by the daunting task of restructuring—with only limited results, so far. With the weaknesses of old giants and few successful big companies of the new generation, the importance of the SME sector in the region is more than obvious. At the same time, it has a different relative weight; if for Uzbekistan and Kazakhstan, the failure to develop a vibrant SME sector may be counterbalanced in short- to medium-term by the simple production based on immediately available natural resources. Such an alternative hardly exists in Kyrgyzstan.

Therefore, for all three countries, the role of SMEs is of strategic importance due to the changing role of the government combined with the fact that alternative driving forces in the economy are relatively weak. The economic potential to accelerate economic growth and create new jobs by big companies of the new generation is too limited; at the same time, big companies of the old system still have difficult time in adjusting to new realities. It is often assumed, that expected changes in the real sphere of the economy might come faster from a new generation of entrepreneurs and enterprises rather than from adopting the old ones.

As the investment possibilities of governments in particular countries have been, and will be, largely limited in the foreseeable future, it is more and more expected that the creative forces of human capital will trigger the economic development of national economies. Therefore, the SME sector is perceived as potentially the major catalyst for change in transition economies of the region.

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## 2 SME sector in transition economies: the realities

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Sceptics and critics of the current government and international SME support programmes often say that the realities of the SME sector are far from the wishful thinking of the governments and of the donors dealing with the sector. There are several factors that are contributing to such sceptical opinions. To start with—the picture of the SME sector is very much blurred and comparisons among countries are difficult, as generally the statistics of the sector are rather poor and unreliable. Long-term trends and comparisons among countries are difficult to define since definitions of SMEs are adopted and changed at different points of time. Primary information on SME entities is gathered in various government institutions, particular departments of statistical offices have adequate insights only into selected segments of information and a synthetic picture is not always available. These facts alone technically complicate collection of data, but more important is probably the fact that official information available is often fundamentally misleading. It includes companies that are only registered, but do not operate; at the same time it excludes those which actually operate, create demand and jobs, however only within the unofficial sector—the parallel economy.

Most of the governments are fully aware of existing problems (e.g. the Decree by President I. Karimov of Uzbekistan, April 11 1998, called for an urgent, extra inventory of SMEs operating in some regions of the country) but not always capable of counteracting. Some may not be aware of the consequences of acting on the basis of poor information or intuition.

An example from Kazakhstan gives some insights into the scope of the problem: as of 1 October 1997, there were 16,066 SMEs registered in the Almaty Oblast, including 7,385 legal entities. A required reporting was supposed to be submitted by 3,797 organizations, out of which only 692 (18 per cent) implemented the task, 2,299 (60 per cent) did not indicate current activity, and the remaining 806 units (22 per cent) did not complete the tasks for various reasons.

Some specialists claim that this is one of the reasons why good diagnoses of SME development are rather rare; usually they are carried out in a formal and superficial manner. Therefore, they do not create an adequate basis for the introduction of special government programmes and measures to support the sector. In some countries, statistical data accompanying SME support programmes are so optimistic and show such expansion of the SME sector that indeed the necessity of application of such programmes may be questioned.

Some small enterprises are registered for reasons which reflect general weaknesses of economic systems (e.g. as a second, or third job of underpaid civil servants, or for tax reasons) and, contrary to expectations, are not in fact creating additional jobs in the country.

Many existing SME development problems are presented and publicly discussed in a superficial manner, since some of the problems, such as e.g. corrup-

tion, are of a delicate and political nature. On the other hand, many entrepreneurs are convinced that the government elite usually knows such problems in and out, but are not always interested in their radical eradication. They claim that many systemic inefficiencies remain in place for years, since companies connected to the country's establishment can anyway avoid most of the problems that other average entrepreneurs have to face. It gives the former a specific comparative advantage in a competitive environment. That is why support and development of SME programmes may have a declarative character, and for years many good regulations remain on paper only.

In some cases, correction of existing inefficiencies of important components of the SME development system are left to the powerful organizations, which are part of the system and large part of the problem (e.g. some of the licensing and inspecting authorities in Kyrgyzstan). Struggling for their survival and existence, such organizations can always prove that their protective tasks are of utmost importance for the society and that everything has been done to satisfy the needs of the business community.

Often, SME development suffers from pressures stemming from current budget needs and influential Ministries of Finance. In the absence of strong counterbalancing government institutions that would promote long-term growth (and create a long-term vision-strategy) of SME sector, the current income from taxes seems to be more important than all multiplier effects involved and an eventual increase in the country's wealth.

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# 3

## Technical assistance to SME development: what to improve and how to optimize?

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On the other side of the same coin, technical assistance to SME development by the donor community, though providing us with individual success stories, is far from being perfect. Cooperation among donors is often stronger on the declarative side, there is lack of deeper analysis of the situation before launching projects, and projects disappear after funding is over, together with the structures created. Finally, there is little monitoring of impact and exchange of information on results generated. Strategic, long-term planning among donors is hardly visible. Some projects and programmes are mainly self-oriented, producing reports in isolation from real life and from interaction with local organizations.

Donors' assistance in the SME area could be improved on four fronts:

- ❑ The understanding of the nature of particular development barriers for SMEs and the systemic aspect of the entire problem. Required modification of the development system has to be preceded by adequate identification of existing problems and barriers—proper diagnosis of the situation. Equally important is proper monitoring and assessment of results obtained in removing existing SME development barriers.
- ❑ Coordination of all activities around a common long-term technical assistance strategy in order to avoid unnecessary overlap and inefficient allocation of resources. The above mentioned task of combating SME development barriers is an example, where coordination of activities among donors is often weak. In some countries, e.g. Kyrgyzstan, we have been noticing waves of SME initiatives by different donors, each trying to start their assistance for SME from identification of existing basic SME development barriers and not using materials prepared by earlier projects. As much as the identification task is a very important one, it does not have to be repeated several times in one country.

As new donors are expanding into the SME area, new types of technical assistance activities are being launched, and some projects are being re-profiled—all this requires careful coordination in order to achieve the ultimate synergy effect.

As a result of donors' activity and in cooperation with government and non-government organizations, a target SME development system should be created which can meet requirements of transition economies and provide a full range of business development services (BDS)—as diversified, as the needs of the local business community and of the government itself.

Implementation of the coordination task should include a provision that the SME entrepreneurs' and government's demand for expertise and other business development services is responded adequately and in a sustainable way (Kennedy, 1999)—in all various forms it takes, all integrated into one coherent system. In addition to the policy advice component for the government, it should include decentralized local business

and development centres, business incubators, diverse forms of training, marketing and information centres, as well as systematic study tours, participation and organization of conferences and workshops.

- The understanding of the cultural aspects and the cultural background/dimension of required changes in particular transition economies. Entrepreneurship development and removal of SME development barriers have to be done in a given, concrete cultural context which differs among groups of countries and even from country to country. In assistance to SME development, basic differences between entrepreneurial behaviour and attitudes in transition and mature market economies have to be clearly understood (Scase, 1999; Glinkina, 1999).
- Regional coordination. In the SME area, general constraints and specific barriers, as well as broad development issues to a great extent repeat in all transition economies. Conducted research (Hubner, Central Asia 2010, 1999, p. 119) indicates that government programmes of SME support follow more or less the same pattern. The differences in the rate of SME development stem to a great extent from basic macroeconomic solutions (such as the scope of deregulation, actual decentralization, openness of national economy and convertibility of national currency).

As the SME-related problems are similar, particular government's initiatives are mutually closely watched and most of the solutions applied or emulated, it seems appropriate that technical assistance in this area expanded more and more into a regional dimension. A good regional SME project could be more justified than several national projects, which would deal with same issues in each country separately. The regional project could generate some economies of scale, strengthen integration processes and help better use of available resources. Especially the United Nations system could use this pattern of technical assistance, exploiting existing advantages—in the first place the regional and national experience, which already exists.

The donor community can play an important role in the process of improvement of government SME development policies and formulation of new, long-term SME development strategies. A more exposed role of donors and their more efficient activity in the field of technical assistance and financing require however a better coordination of activities among particular donors, improved dialogue with the Government and more flexible supply of various forms of technical assistance to cover existing gaps.

In some countries of the region, the ties between particular donor organizations have already been strengthened. In Kyrgyzstan, representatives of SME donor organizations meet once a month in order to exchange information, coordinate plans and discuss current activities. A spirit of better understanding of country's needs has been created, as well as more realistic assessment of own possibilities. Speaking in one voice, representatives of donor organizations operating in Kyrgyzstan have prepared a written recommendation on necessary changes in the system of government support to SME. Presentation of this paper should open a series of round-table discussions with the Government (Donors' Forum in Kyrgyzstan, 2000). Independently, similar initiative has been successfully carried out in Kazakhstan (Koch, 2000).

The specific, economic development dichotomy of the transition, known from other economies of other regions, is noticeable also in Central Asia. On the one hand, we may identify in each country a considerable amount of strategically im-



portant (in traditional economic terms), large enterprises that continue, rarely successfully, to struggle with the restructuring problem and with adjustment to the new market situation. On the other hand, a large number of micro to small enterprises has emerged, e.g. in the area of trade and other services, whose presence is crucial for needs of the social and human aspects of development. Their presence increases dramatically the capacity to create new jobs and in general it addresses a broad spectrum combating poverty issues. It responds to many important social needs and expectations, including the ones that have already been created under transition. Their presence is however only beginning to change the internal production and distribution structure. Their weight is not sufficient yet to improve particular country's position in its economic environment and is rarely leading to an emergence of new generations of internationally competitive products.

The analysis of this phenomenon indicates the needs of technical assistance, including United Nations assistance by a modern industrial development organization of UNIDO's profile. Two focal points for technical assistance become clear:

- The need for continuation of technical assistance in the area of restructuring/market adjustment for large enterprises;
- The need for assistance in development of modern and more complex small and medium-size enterprises, capable of creating clusters of firms connecting to leading large units and modern stand-alone SME units—all capable of introducing important economic changes to the national economy from the point of view of its international competitiveness. In this context, a modern SME enterprise should be defined as the one, which is technically competent, environmentally conscious, well connected to information networks, competitive and entrepreneurial.

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# 4 SME development: understanding and overcoming the barriers

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## 4.1 Types of barriers

Experience from various transition economies helps put together a comprehensive list of most common barriers hindering SME development. They could be divided into two major groups: internal barriers within the enterprises themselves and external barriers in their business environment.

Internal barriers refer first of all to limited own resources of entrepreneurs and limited possibilities to identify business opportunities. They are complemented by lack of market economy experience, understanding of modern business and ability to cope with risky and unpredictable market environment.

External barriers stem from the economic and business system surrounding entrepreneurs. In the process of their decision-making, entrepreneurs are not guided directly by anyone, however they try to optimize their criterion functions under given constraints and (mainly financial) parameters, which are given from outside. The rules and norms of taxation, as well as the availability and conditions of credits are usually the two most controversial areas of SME environment, usually interpreted by the business community as major barriers in development of the sector.

## 4.2 Primary barriers

The basic structure of barriers in SME development in the countries of Central Asia is not different from the one indicated above. Bureaucracy meddling in business affairs, frequency of various inspections and the complexity of the licensing/permit system are indicated as other severe obstacles; so is the insufficient development of SME related support services (SME Surveys in Uzbekistan, 1995, 1996; SBDC Network in Kyrgyzstan, 2000; Koch, 2000).

Conducted surveys, direct contacts with entrepreneurs and exchange of information with other business centres in the region, indicate the existence of six fundamental or primary barriers in SME development in Central Asia. They have different proportions and intensity in particular countries, however all comparison among countries are very difficult.

- Burden and complexity of taxes. Various studies in this field show that tax systems in the three countries of Central Asia belong to the most complicated and tax rates to the highest among transition economies (EBRD, 1999 p.157). Tax issues traditionally are indicated as the main barrier in SME development in all transition economies (Koch, 2000; Donors' Forum in Kyrgyzstan, 2000; Radaev, 1999). The procedures of introducing of simplified and other forms of presumptive tax formulae for the SME

sector are long and inefficient (e.g. already the second debate over this issue within the transition period in Kyrgyzstan has been continued for the last two years);

- ❑ Difficulties in receiving all necessary licences and permits for starting, conducting and developing own business. Most surveys and studies point at the seriousness of this issue; despite numerous recent initiatives of particular governments in the region (such as e.g. the Resolutions of the Government of Kyrgyzstan from January-February 2000, No. 39, 47 and 57), the actual burden of the system—as perceived by the entrepreneurs—remains virtually unchanged, though changes its forms (Koch, 2000; Donors' Forum in Kyrgyzstan, 2000);
- ❑ Excessive direct intervention in business operations by representatives of various official institutions and multi-layer corruption of political and economic structures surrounding SME entrepreneurs. Conducted studies indicate that the three countries of Central Asia are close to, or below the average level (5.7 per cent of revenues) of the “bribe tax”, as compared with other CIS countries (EBRD, 1999, p.124). The CIS average is however twice the level reported for countries of Central and Eastern Europe. The frequency of bribes reported for Kyrgyzstan and Kazakhstan is close to the average; the frequency for Uzbekistan is much higher than the average for all transition economies. In general, small firms in all transition economies suffer from the bribe tax much more (with respect to both size and frequency) than large firms.

The burden of time spent with state officials (the so-called “time tax”) affects small, medium and large enterprises relatively equally. However, the time tax for the three Central Asian countries is above the average for all transition economies, with the second highest level for Kazakhstan.

- ❑ Difficulties in obtaining adequate credits to set up and develop business. Despite encouraging declarations by particular governments and various donor organizations, in real life, entrepreneurs are usually exposed to the lack of adequate financial resources, e.g. soft loans tailored to the needs of the SME sector—with adequate sizes of credit, encouraging credit terms (low interest rate, realistic grace period, flexible approach to collateral, etc.). Information on available credits for SME is not easily available and processing of foreign loans is complicated and includes rather lengthy procedures. Most foreign loans include a considerable exchange rate risk. Loans are difficult to obtain in remote and underdeveloped regions—in places where they are most needed.

At the same time a major effort has been undertaken recently in some of the countries, e.g. Kyrgyzstan, by multilateral and bilateral financial institutions and donors (including EBRD and the World Bank), in cooperation with the government, to shorten the distance between the source of foreign funds and their end-users and to lower the final interest rates (by 3-5 percentage points in the case of Kyrgyzstan), at which the SME loans are made available to the entrepreneurs;

- ❑ Insufficient knowledge of business and market economy rules by potential and already functioning entrepreneurs (including knowledge on how to identify business opportunities, how to precisely articulate a new business concept and prepare a viable business plan according to international standards);
- ❑ Difficulties in accessing business information (especially information on foreign markets and potential partners) and various difficulties in establishing business ties with foreign partners.

Insufficient decentralization of development effort, despite recent visible efforts by most of the governments, is another feature of existing models of SME development, which has already become an additional, specific development barrier itself, fettering development of the sector.

It may be noted that the pattern of government initiatives to overcome the existing barriers is formally similar in the three countries (Hubner, 1999). Especially the last two-three years have been rich in legal and organizational initiatives oriented towards easier registration of SMEs, offering tax and custom duty privileges, and new forms of credit. Nationwide, technical assistance to the sector (including consulting services and training activities) has been developing in all the countries, however, with a slightly different focus. Uzbekistan has been developing a national network of business incubators, whereas Kazakhstan and Kyrgyzstan have been relying more on a national network of Small Business Development Centres.

Eventually, the major challenge for the governments in the long-run is to design a stable, truly supportive environment for SME development, an environment in which competing enterprises could help develop desired market mechanisms and flexibly adjust to international standards at the same time generating additional incomes and securing new work places for the society.

In order to develop at an accelerated pace, the SME sector needs to have a perspective of prosperity, certainty and stability (Griffin, 1997). Monetary, fiscal and other regulatory policies should be formulated in a way that would promote SME development and create an attractive image of business activity in the sector.

The SME sector requires a stable economic climate to formulate and execute its investment and saving plans. This should include:

- Stable rules governing property rights,
- Stable and simple rules of taxation,
- Efficient and independent system of enforcement of contract and other legal obligations.

Stability and efficiency within these three components of the macroeconomic and political system could help reduce excessive uncertainty in SMEs activity. Due to the nature of the marketplace, SMEs' functioning in any national economy is full of "natural" uncertainties both on the demand, as well as on the supply side. Successful entrepreneurs can deal with these uncertainties and are rewarded for their success. Uncertainties under a transitional economy are usually much bigger and the entrepreneurs less experienced. Therefore, possible reduction of such uncertainties should become the highest priority of governments, even before they start dealing with other barriers.

The essence of the donors' role with respect to exiting barriers is not only in helping combat individual barriers by providing classical technical assistance in the area of e.g. SME taxation or registration, but also in helping facilitate the systemic approach. A removal of one barrier, or partial reforms in the approach to SME development, cannot be of much help. In general, the required changes must have a systemic character. It would be naive to expect that isolated government initiatives may help reach the critical mass of change and bring the required, qualitative change needed. On top of this, there are some sensitivity and psychological barriers, which make the task even more complex. The changes have to have considerable weight to be noticeable and often the basic confidence of the Government; trust in its intentions have to be rebuilt within the business community.

The required changes have to be seen in the context of the required improvement of the economic system as a whole—most of the successful countries in SME development have had—first of all—efficient economic macro systems and within that framework were adding special incentives for SME. In many countries, where the lions share of the economy is, and will be, SMEs, we should talk about required changes in the whole system, not only within SMEs.

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# 5

## SME development: cultural aspects

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The main thrust of the ongoing transition change in particular national economies has been on the shift from a vertical subordination of economic entities involved to a horizontal interaction among economic partners in the market place. This means a radical change, almost a revolution, from the point of view of entrepreneurial involvement of people and companies in economic and business processes. In the former system, an entrepreneurial and creative effort was reduced to a minimum; in the latter it is absolutely crucial for their success.

The scope of the required change is enormous. Until now, main barriers to a full-fledged systemic transition of particular economies are deeply rooted in the features of the centralized system of the past; however, new barriers have been emerging as a function of the transition process itself.

Table 1, below, shows the dimensions and scope of the problem (Hubner, 1999)—virtually a myriad of major differences at various levels and in various dimensions of the systemic change; each of them has to be dealt with. The residuals in each line (we may call them “systemic residuals”) of the chart, indicate what and how much needs to be done in terms of the learning process of the societies of transition economies. Enterprises and people of transition economies are in the process of adjusting to new, systemic rules of market economy, have been learning how to achieve success under new circumstances, but in many countries considerable tasks are still ahead.

At the same time, the situation is not static. The main challenge (see figure 1) for transition economies is not only to introduce a simple change, in order to repair existing systemic inefficiencies of the economic system. The real challenge is to meet the requirements of the contemporary world economy and highly competitive international environment. The truth is that, despite considerable help rendered, no one is waiting for the transition economies to improve; mature, market economies are permanently developing their competitiveness and entrepreneurial skills.

The basic challenges of transition economies include privatization, restructuring, institutional changes, but the universal ones cover also such issues as the globalization of international business with a growing measure of competition, requirements of the world technical progress and revolution of the information age.

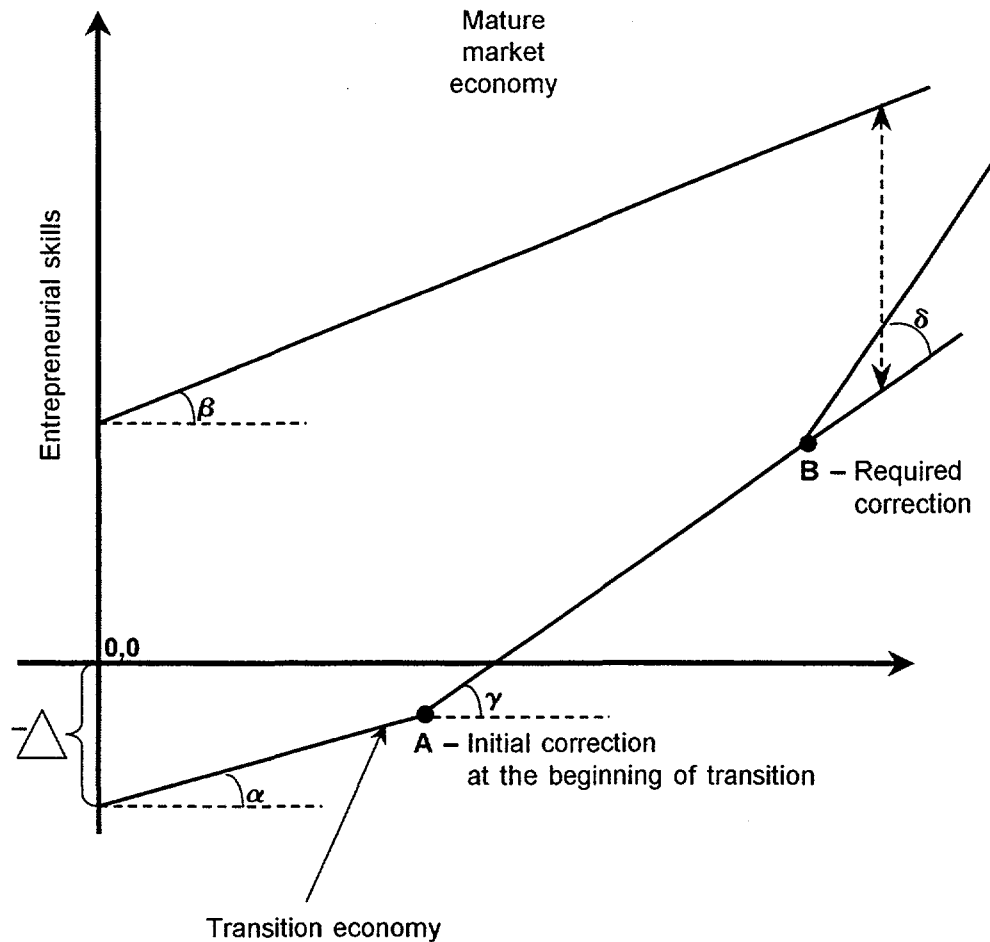
It is possible to indicate four crucial inputs influencing the national ability to develop business creativity and entrepreneurship:

- general cultural premises (the long-term factor);
- recent country's experience (short- and medium-term factor);
- systemic solutions applied in transition process (economic incentives in a broad sense);
- the training and educational systems.

**Table 1. The scope of the “entrepreneurial revolution” of the transition process: systemic differences between the highly centralized and the market-oriented system**

	<i>Environment created by the old, highly centralized system</i>	<i>Requirements of the new, market-oriented system</i>
Organizational structure	1. Vertical, hierarchical structure of communication	1. Flat structure, horizontal communication channels
Communication	2. Isolated channels of communication with diversified information for selected subjects	2. Open channels with identical information for all participating units
	3. Language of communication: commands, quantities, direct allocation of resources, “non-anonymous” information	3. Language of communication: prices, “anonymous” information of the market
	4. Rigid rules of plan implementation, tasks imposed by higher authority	4. Entrepreneur surrounded by opportunities and competing alternatives
	5. Quantitative tasks, focus on technical considerations	5. Qualitative considerations strongly exposed
	6. Passive implementation of imposed tasks	6. Pro-active attitudes encouraged
	External relations	7. Philosophy: closed national economy, autarchy, self-sufficient economy
8. Macro philosophy: how to earn for necessary imports?		8. Macro philosophy: how to promote exports?
Cost	9. Little consideration to production cost	9. Cost efficiency—main condition for success
Consumer	10. Consumer: important, but only in declarative terms	10. Consumer focus crucial
Competition	11. Philosophy: competition is waste of efforts and resources;	11. Systemic mechanism guaranteeing efficiency and best allocation of resources
Marketing	12. Advertising: waste of resources	12. Advertising: information concerning companies’ and consumers’ choices
Quality	13. Internal, domestic standards of quality	13. World-class, internationally competitive products
Producer-consumer	14. Domination by producers of monopolistic position	14. Development tendency: towards stronger position of consumers
Choices	15. Self-generation of shortages	15. Development tendency: towards abundance of consumers’ choices
Financing	16. Soft-budget constraint	16. Stringent rules of the financial system become main guideline for companies’ strategies
Bankruptcy	17. Paternalistic attitude, no bankruptcy, generous subsidies	17. If products not accepted by buyers—realistic possibility of bankruptcy
Reserves	18. Hoarding of product and reserves	18. Lean production, just-in-time (JIT)
Success	19. Orientation towards higher quality and central planning authority; political criteria of success	19. Orientation towards consumers and commercial criteria of success
Risk	20. Exposure to little risk and uncertainty	20. Entrepreneurs functioning in the world of risk, permanent uncertainties and probabilities
Pattern of life	21. Distorted equality among producers and consumers at a low level of income. Tendency to hide material symbols of success	21. Considerable disproportion in income. Material symbols of success often exposed, as they mean personal and business success
Education	22. Formal, massive education	22. Pragmatic approach to training and education

Figure 1. The timeline of entrepreneurship development: transition economy vis-à-vis mature market economy



Other things being equal, the creativity and entrepreneurial skills of the society eventually determine the rate, at which societies move towards the new system—achieve progress in economic and social transition.

The first three factors influencing entrepreneurship development are relatively stable at any given point of time and, especially the inputs associated with the cultural background are difficult to change over a short and medium period. Economic systemic changes are also complex and require time. The most direct intervention into the existing interrelations is through the learning process.

Some of the societies and some individual entities are learning faster, some slower—but there is always a margin of those individual entities, which are completely lost. Education at all levels, integrated into one coherent system with a high quality, permanent training component are the only tools in our hands to help meet the challenge of the new system and the new situation

It is probably rather difficult to precisely assess the real impact of the new, market-era training and education systems applied within particular transition economies on their progress in transition and to-date economic success. That's why the respective impact parameters (see table 2) are marked with an unknown variable "x". One could argue that, at the initial stage of transition, the new type of training and education has been more or less evenly allocated—e.g. in per capita



**Table 2. Factors influencing entrepreneurship development and progress of transition, selected countries**

	Uzbekistan	Kyrgyzstan	Kazakhstan	Belarus	Romania	Hungary, Poland, Czech Republic
1. Cultural roots	++	+	+	+/_	+/_	+/_
2. Recent historic experience	+/_	+/_	+/_	-	-	++
3. System created by transition	+/_	+	+	-	+/_	++
4. Education and training	x	x	x	x	x	x
<b>Progress in transition, as assessed by EBRD</b>	2.09	2.8	2.7	1.47	2.8	3.5-3.7

Key: ++(most conducive) to— (least conducive), author's own assessment; progress in transition assessed by EBRD: 4 -1 scale. See detailed remarks below the table.

*Notes. General cultural premises—the long-term factor* (scale from “++” to “- -”; author's own assessment): e.g. Uzbekistan can be considered a country that has the general cultural background conducive to entrepreneurial development, due to its longer experience as a settled economy with a considerable tradition in trade, as compared to e.g. nomadic Kyrgyzstan.

*Recent country's experience—short and medium term factor* (scale from “++” to “- -”; author's own assessment): there are several facts from recent history, which helped create a positive entrepreneurial climate in Poland, Hungary and the Czech Republic.

In *Poland*, the period of 125 years without independence before the First World War, the Nazi occupation of the Second World War and the period of political domination by the Soviet Union after the Second World War has helped develop “survival” techniques by a great part of the society. This contrasted, by the way, with the long-term historic tradition, where most of the Polish aristocrats, nobility, and petty nobility developed an anti-entrepreneurial and anti-trade cult prevailing in agricultural Poland for many centuries. The pre-war tradition of a solid market economy, partial reforms attempted since 1956, as well as some of the unique political solutions applied under the communist rule (e.g. contrary to other countries, almost three-quarters of the agricultural sector remained in the hands of private farmers after Second World War);

In *Hungary*, the conducive current entrepreneurial climate was developed to a great extent with help of the pre-Second World War tradition and, parallel to Poland, attempts of partial reforms launched after 1968. They included the ideas of decentralization, openness to foreign markets, deregulation of prices, the abandoning of principles of central planning, relatively easy formation of small private enterprises.

In the *Czech Republic*, despite a lack of more radical reforms under the centrally planned system, the pre-war experience of an advanced, developed (more than e.g. pre-Second World War Austria) market economy has played a significant role.

The existence of typical market institutions (together with their tradition and the understanding of its mechanisms) even under the conditions of centrally planned economy, such as e.g. the popular market place—the *bazaar* in Uzbekistan, Kyrgyzstan and Kazakhstan, places these countries in a more privileged position from the point of view of entrepreneurial development as compared to some countries of Eastern Europe and other countries of the former Soviet Union.

*Systemic solutions applied in transition process*—economic incentives in a broad sense to undertake an entrepreneurial effort (scale from “+++” to “- -”; author's own assessment). Consistent, radical market reforms (of different pattern, though)—from the shock therapy of Poland to a gradual approach of Hungary and the Czech Republic, helped amplify the potential propensity to be creative and entrepreneurial in many layers of the society. Many international sources indicate (e.g. EBRD, 1999), that systemic solutions applied in other countries presented in the table created either considerable constraints (Belorus, Uzbekistan—most of the 1990s) for an adequate development of entrepreneurial behaviour in the society, or did not manage to consequently support development of entrepreneurial behaviour with a stagnation (Romania), or slowing down of the reforming effort (Kyrgyzstan—end of the 1990s).

*Progress in transition, as assessed by EBRD*—based on the Transition Report 1999 (EBRD, 1999); points assigned reflect an average from EBRD assessment of progress, over recent ten years of transition, in eight aspects of transition and within the three main fields of reforms: Enterprises, Markets and Trade and Banking Institutions. EBRD classification system based on 1- 4 scale (where: 4 = the highest progress; the + and - signs were added to reflect better the nuances in the assessment; for the purpose of computation of the average, they have been translated here into +/- 0.33)

terms—among particular transition economies. One could argue, as well, that from the beginning, some more “promising” countries, with closer traditional ties to the western world, such as e.g. Poland, Hungary and the Czech Republic, have been attracting more attention of the donors and were getting some preferential treatment.

Perhaps more important than arguing about the past, is a precise needs assessment concerning the future. The challenge of today is to be capable of

sufficiently re-allocating resources and training support to the most needed societies. The bottom line is that the entrepreneurial training and education are often still the only tool in our hands that can help utilize existing economic systems of the transition period and reduce the existing differences visible in the final transition results. This is an important message for the international community on the rationale of training resource allocation and of support to creation of comprehensive systems of training and education that can deal with entrepreneurship development.

This does not mean that training and education conducive to entrepreneurial development can do wonders in any economic and political environment. Within certain range of systemic solutions, they can, however, help utilize the existing possibilities. What's more, they can create necessary pressures on acceleration of countries' changes. Yet eventually, they can be fully effective only in a clear context of a conducive economic system that creates sufficiently aggressive motivation to generate the entrepreneurial effort.

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# 6

## How to use the understanding of cultural aspects?

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Technical assistance provided by donors not only should be professionally competent and theoretically correct, but—being addressed to a system deeply embedded in a concrete cultural system—in every step of the way, should be culturally sensitive. An important distinction should be made between stimulating development of the SME sector in mature economies and the transition ones. Cultural differences should be seen between particular transition economies. Training and educational development by donors should be fine-tuned to the needs of particular transition economies, and not to the immediate area of experience of particular experts from developed market economies.

The famous observation of Geert Hofstede (Hofstede, 1980, 1983) was that national culture explained more of the differences in work-related values and attitudes than did the position within the organization, profession, age or gender.

Hofstede integrated the results from many earlier research initiatives, among them that of Laurent and others. In a 40, and later 60 country-study, he interviewed 160,000 managers and employees from multinational corporations. He found highly significant differences in their behaviour and attitudes. In addition to this, these differences were not changing significantly over time, as proved by the second survey. He found that the managers and employees vary on four primary dimensions: individualism/collectivism; power distance; uncertainty avoidance; masculinity/femininity.

In the process of transition, cultural characteristics of each country have been changing and may be expected to change. One direction of new entrepreneurship development oriented training and education should be to help amplify and accelerate changes in cultural characteristics of managers and whole societies—the pool of potential new entrepreneurs. The most important direction in this area is the relationships between uncertainty avoidance and individualism/collectivism (see figure 2).

The size of the vector and the angle  $\alpha$  depend on numerous factors, including:

(a) Factors inherited from past, relatively stable in long-term:

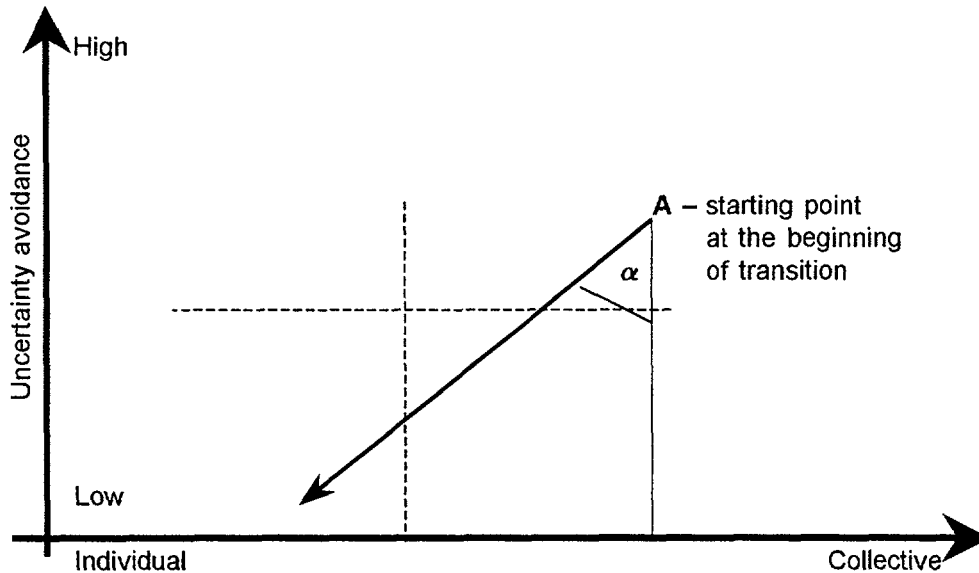
Inherited general logic of the cultural system,  
Society's recent historic experience,

(b) Interrelated factors changeable in medium term:

Progress in transition processes,  
Educational and training inputs.

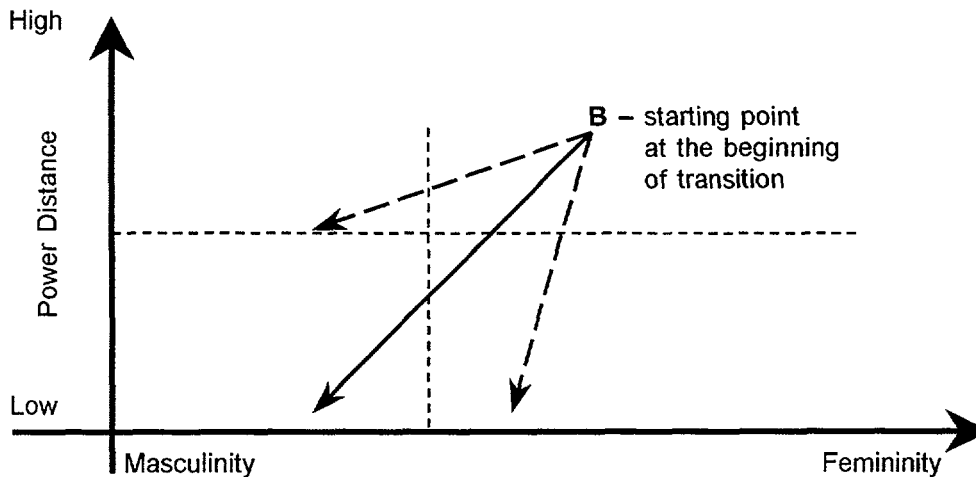
In this area, the correction to training and educational programmes under transition could almost have a universal character. The essence of targeting of these inputs towards acceleration of the change and transition processes would boil down to applying effective programmes encouraging individual business creativity and risk taking.

Figure 2. Uncertainty avoidance—individual/collective relationship: required change under transition



The direction of change under relationship power distance—masculinity/ femininity is less certain to be predicted in transition economies and more depended on the set of cultural factors (see figure 3). Training programmes applied should be therefore of less universal character and have to be fine-tuned to existing cultural premises and tailored to the individual needs of particular countries. The ongoing change can be more determined by other parameters than the logic of transition itself.

Figure 3. Power distance—masculinity/femininity relationship: the change under transition.



Development of entrepreneurial spirit in particular national economies has many important parallels to the development of national systems of innovation (Jenner and Hubner, 1993), where a universal model, which could be directly emulated by other countries, has never existed. At the same time, many national economies (such as, e.g. United Kingdom, Germany, Japan or United States) at

given points of time, could apply very effective solutions to massively disseminate the “innovation epidemic”—all done in their own, specific way. As a rule, such processes were opening the way for them to become economic and political leaders of some kind. Most successful innovation systems were usually stemming from creative interpretation of countries’ tradition and culture and could be applied only within a conducive environment and within a specific time range.

The mechanisms of transition processes combined with the heritage (long-term, as well as less distant) of cultural and historic experience have created unprecedented opportunities for many emerging market economies.

Finally, apart from theoretical models showing the intellectual framework for what needs to be done, we should try to formulate some practical hints for their implementation. How could we help develop entrepreneurship? The donor community has been doing a lot in particular countries, but the results are not always satisfactory.

The way we work should differ with respect to with whom we deal. We have seemingly fewer limitations and more similarities to same processes in mature market economies when we deal with new, youngest generations of potential entrepreneurs. At the same time, tasks in front of us are sufficiently complex. The whole process should start much earlier than it is the case of Central Asia now and it should be consequently continued later on. Not losing the generally high academic standards, the primary and secondary educational institutions should be reformed to amplify entrepreneurial development without watering it down in the old teaching routine. Pupils should be motivated to be creative, resourceful and full of their own initiative. Leadership and entrepreneurship should be taught in theory and practice; a system of modern projects in leading subjects should be introduced to allow students to compete in resourcefulness with each other and should gradually substitute for compulsory, old-fashioned tasks. The old, rigid and authoritarian school systems, with a largely underpaid teaching body, should be replaced by systems, which allow for choosing own, flexible paths of studying and shape individual talents.

When dealing with the older generation, still mentally shaped under the former system, the major task is to overcome numerous psychological barriers and propensities from the past. They have to become convinced that entrepreneurial skills can be taught and learned, not only born with and inherited. They have to be exposed to the world of multiple opportunities, which have to be identified and used in the world full of risk and uncertainty. Eventually they have to be used to and even appreciate a different environment than that known from the former system. Now, nothing around them is certain or secure and no one is protecting them in a way they know from their own past experience. Many of them will never be convinced that the new rules are better, but have to be convinced how much different they are. All this means a considerable revolution in people’s minds; a test of suitability to the new conditions, some of them may never pass.

How to help identify new and attractive business ideas? There are no simplistic recipes, but an inspiration to find an attractive business idea is extremely important since exactly here lies the beginning for the ultimate success.

The customers needs and their satisfaction, the notion of the customer focus should be at the centre of our attention and should be the foundation for the new philosophy, when working with potential entrepreneurs and encouraging them to undertake own business.

One of the reasons for the collapse of the centrally planned economic system was the fact that many decisions were done at the central level and were never, or too late, verified by real life. The central planning authority was usually more than certain that it knew better than the people themselves and what was needed by the consumers. In addition to that, the central planning office could react rather slowly to a changing situation and adjust its production and distribution commands only with a delay. This observation should be contrasted with the realities of the new environment of the market economy, which is giving plenty of new, though very demanding opportunities. The entrepreneurs can replace the government and its planning authority in providing people with needed products and services.

In mature market economies, children are taught and trained from early childhood how to be entrepreneurial and creative in order to survive and be successful in this environment. They are born in an environment where the rules of market economy are the bread-and-butter of everyday life. In transition economies, it is not the case. The older generation was brought up and educated under different systemic circumstances, in a system with a completely different role of the government. Most often, the youngest generation is in the hands of educators who have been shaped by the former system.

Our understanding about the status of entrepreneurship development in transition economies is often largely distorted. Sometimes we think that only very little has been done so far; sometimes, especially when we look at the official data provided, we get an exaggerated impression about the accomplishments. The truth, as usual, lies between these two extremes. There is some considerable progress in many transition economies, however all processes of entrepreneurship development are long-term, and their rapid accelerations are hardly possible. At the same time, most of the official information provides us usually with quantitative data on education and training, which is rarely useful in our assessment. All of us, who work long-term in the field, see a major difference between such information and the real life situation.

There is usually very little coordination, basic information exchange, not to mention permanent networking, among the donors' community. A modern systemic approach is lacking. Training initiatives are usually a patchwork of various short-term activities, reports of which may satisfy the headquarters of international organizations, but rarely can meet the needs of particular transition economies.

Very often a universal and standard training approach is used, coined in the environment of advanced market economies, with little understanding of the realities of the transition process itself and understanding of the cultural differences in the field of entrepreneurship and managers' typology in mature market countries vis-à-vis transition economies (Scase, 1999; Glinkina 1999). Many transition economies (e.g. those of Central Asia) still lack good teaching materials, especially containing the real life case studies, which should be the basis for entrepreneurial training and education.

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# 7 SME development systems in countries of Central Asia

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The systems are described along the pattern of three interrelated components:

- (A) Parliaments and various government institutions, which take care of policy and strategy of SME development;
- (B) Banking and financial infrastructure, which provides SME financing;
- (C) Institutions, which operate in the area of technical assistance to the SME sector.

## 7.1 Kazakhstan

### ***Component A. Policy and strategy: leading institutions***

*Republican Agency for the Regulation of Natural Monopolies, Protection of Competition and Support of Small Business* created last year in the way of extension of competencies of the former Agency for Small Business Support. The Agency is the central executing government agency, whose main tasks, with respect to SME sector include:

- Drafting of legal acts to create a conducive environment for the SME sector;
- Coordination of activities aiming at SME support by central and local authorities;
- Analysing of SME development tendencies;
- Controlling function of the implementation of legal acts devoted to small business protection;
- Participation in formulating of credit, investment, trade and privatization policy with respect to small business.

*Kazakh Small Business Development Fund* has the following main functions:

- Preparation and implementation of state programmes aiming at financial support of the SME sector;
- Crediting of the SME sector (including physical entities) on a competitive basis;
- Support in creation of new jobs in the SME sector;
- Issuance of credit guarantees for SME entities to be used in the commercial bank network;
- Support in establishing of business centres and small business incubators, consulting, training, leasing and other market institutions.

*Chamber of Trade and Industry*—with the following main functions:

- Issuance of certificates of origin in export activity;
- The rendering of various consulting services, including a search for foreign partners, or local partners for foreign investors,
- Organization of presentations of business opportunities in Kazakhstan and various exhibitions at home and abroad.

### ***Component B. Financial support***

Major SME oriented credit lines include:

- EBRD credit line in cooperation with the Kazakh Small Business Development Fund;
- Credit lines from the Central Asian –American Enterprise Fund;
- Credit lines from the Asian Development Bank, in cooperation with the Small Business Development Fund;
- World Bank credit lines (crediting of farmers in the first place)

Domestic credit lines include credit lines by the National Bank (mainly connected with the agricultural sector) and leading commercial banks.

### ***Component C. Technical assistance***

Foreign organizations and NGOs providing technical assistance usually in combination with financial support to SME include Mercy Corps International, USAID (implemented by ACDI/ VOCA), HIVOS, EuroAsia Foundation, the Soros Foundation, British Know-How Fund, European Union (Project for New Independent States Kazakhstan Business Services), Peace Corps USA.

Domestic organizations involved in assistance to SME include Congress of Kazakh Entrepreneurs, Kazakh Centre of Entrepreneurship Support and Development, Kazakh Training Centre, Women Entrepreneurs of Kazakhstan.

## **7.2 Kyrgyzstan**

### ***Component A. Policy and strategy***

In Spring 1998, the main task of determining SME policy was given to the Ministry of Industry and Foreign Trade; however, until present significant policy inputs are still being provided by the State Fund for SME Support, the key Government organization in this area until 1998, which operates a domestic, soft credit line for SMEs.

Recently, new organizational structures that deal with SME development support have been established at the central and local levels. This includes units set up at the Prime Minister's Office and in practically all of the ministries (both sector ministries, as well as the functional ones, such as the Ministry of Finance), in the



Anti-monopoly Committee at the office of the President, as well as at the level of local administration. Therefore, this component of the model has become largely complex and the Government authority dispersed. Recent tasks to prepare the current policy framework was given to the Minister of Labour and Social Protection, and the supervision of planned inspection timetables for the SME sector by Government institutions involved to the National Anti-monopoly Committee at the President's office of the Kyrgyz Republic.

In June-July this year, a major discussion has been opened in Kyrgyzstan to create a new Government coordination centre for SME support and development and to find the most efficient form of such coordination. The UNIDO/UNDP SME project (KYR/97/001) is strongly involved in the ongoing search for the best formula and the operation framework for such a centre.

### ***Component B. Financial Assistance***

The financial and banking network consist of the domestic and foreign components. SME credits are available from:

- ❑ a domestic, soft-term credit line supervised by the State Fund for SME Support at the Government of Kyrgyzstan;
- ❑ domestic commercial sources: SME credits available in several leading commercial banks;
- ❑ Foreign credit sources (for a detailed list see: SBDC Bishkek, Osnovy, 2000) include German credit lines from the Kreditanstalt fuer Wiederaufbau executed and supervised in cooperation with Kyrgyz Goskominvest, the EBRD credit line, World Bank credit lines (executed among others through the Kyrgyz Financial Agricultural Corporation and selected commercial banks); credit lines of the USAID (implemented e.g. through Central Asian—American Enterprise Fund), and other donor organizations, which offer credits of micro- to small-size or micro-credits only (such as, e.g. Swiss Helvetas, the Mercy Corps, United States FINCA).

### ***Component C. Technical assistance***

Already in the second half of the 1990s, several bilateral donors dealt with technical assistance to SMEs. The leading role was played by the governments of Germany, Israel, Switzerland, Turkey and the United States.

Multilateral donors were represented by the UNDP and the World Bank. The latter has become the leading institution in the area of financing of small business development in the agricultural sector. The most important projects include:

- ❑ the German GTZ SME project (the oldest and the most experienced SME project in Kyrgyzstan, discontinued end of 1999); under its activities, the country was provided with long-term international advisers, as well as short-term international and local (macro and micro) expertise in the SME area. For many years, the GTZ project was supervising the allocation of SME credits from the so-called "German small credit line" originating in the KfW. Technical assistance to SME is now provided through a newly established Business Incubator/Business Centre in Bishkek and the Investment and Export Promotion project;

- ❑ the Swiss Coordination Office in Kyrgyzstan has been active in the SME area through technical assistance to selected subsectors and was piloting individual, pioneering SME projects (mainly in the agro-processing area);
- ❑ the UNDP/UNIDO SME Project KYR/97/001, operating at both the micro level (through the national network of Small Business Development Centres (SBDCs) operating with the State Fund and the Chamber of Commerce under the formula of the Integrated Business Centres), as well as at the macro—policy level (through the State Fund for SME Support—its main national counterpart and the Prime Minister's Office, Department of SME Development);
- ❑ USAID SME Projects: important components in several projects, including those implemented by the Carana Corporation (Accounting Reform), Booz-Allen (Trade and SME) and ARD/Checci (Regulatory Reform); in cooperation with the Israeli Government, USAID offers considerable technical assistance to development of SMEs in the agricultural sector (Project Mashaav); another project, with a focus on training and development of business centres is planned for this year;
- ❑ SME Projects sponsored by the Turkish Government: Project devoted to incubation of SME joint ventures between SME entrepreneurs from Turkey and Kyrgyzstan. Opening of a Business Centre (project execution by UNIDO) with focus on information systems which could help connect foreign information sources is foreseen for autumn this year;
- ❑ Peace Corps and Mercy Corp projects, through their volunteers provide assistance to SME development at the Oblast level.

In addition to that, important, short-term technical support has been provided by the Japan Centre in Kyrgyzstan, the Soros Kyrgyz Foundation (mainly seminars, conferences and training events), and UNDP Poverty Alleviation Project (cooperation with KAFC) which has been active in the area of micro-financing at the rayon and village level.

Also, some other new initiatives have been already launched or will be launched this year. SME development constitutes an important component in the recently discussed long term Comprehensive Development Framework (CDF) of the World Bank and the latest UNDP Country's Cooperation Framework (CCF) until 2004.

The World Bank re-activated its SME project (at the Goskominvest) end of 1999; it provides consulting activities related to the World Bank credit line, as well as Internet training for business. The recent World Bank credit tranche (US\$5 million) foresees a technical assistance component devoted to technical assistance to SME.

A major TACIS SME project, now in the final preparation stage, is about to be launched in December this year and will include a broad spectrum of issues, from enabling environment for SME to matchmaking and cross-boarder trade.

Additional activities, especially in the area of SME training and small business micro financing, are foreseen in the major Asian Development Bank (ADB) project focusing on the development and modernization of vocational education and its entrepreneurial component.

The UNIDO/UNDP SME Project (KYR/97/001) has undertaken an initiative to integrate technical assistance and financial support for SME within a national network of Integrated Business Centres.

The formula of Integrated Business Centres (see figure 4) assumes that a United Nations Small Business Development Centre (SBDC), as foreseen in the original Project Document, becomes one of the leading components of a bigger unit, the Integrated Centre, which can provide under one roof a full range of services for entrepreneurs: consulting, training, information and financing of SME projects. The Integrated Centres have been developed together with the State Fund for SME Support and the Kyrgyz Chamber of Commerce and Industry. Therefore, the Integrated Centre consists of three main components:

- ❑ The United Nations SBDC component, which takes care of SME related consulting and training services. Business Counsellors of the SBDC provide entrepreneurs with information on possible ways and sources of financing of a SME projects and help prepare business plans according to the requirements of particular SME credit lines;
- ❑ The financial component of the State Fund for SME Support, which takes care of project financing, offers credits (from micro-credits to up to 500,000 som) and leasing services for local entrepreneurs from the domestic credit line; the services include estimation and carrying out of the necessary paperwork related to required collateral;
- ❑ The Chamber of Commerce component, which provides entrepreneurs with legal advice and business information (including foreign market related information), issues certificates of origin, as well as generally represents interests of the local business community.

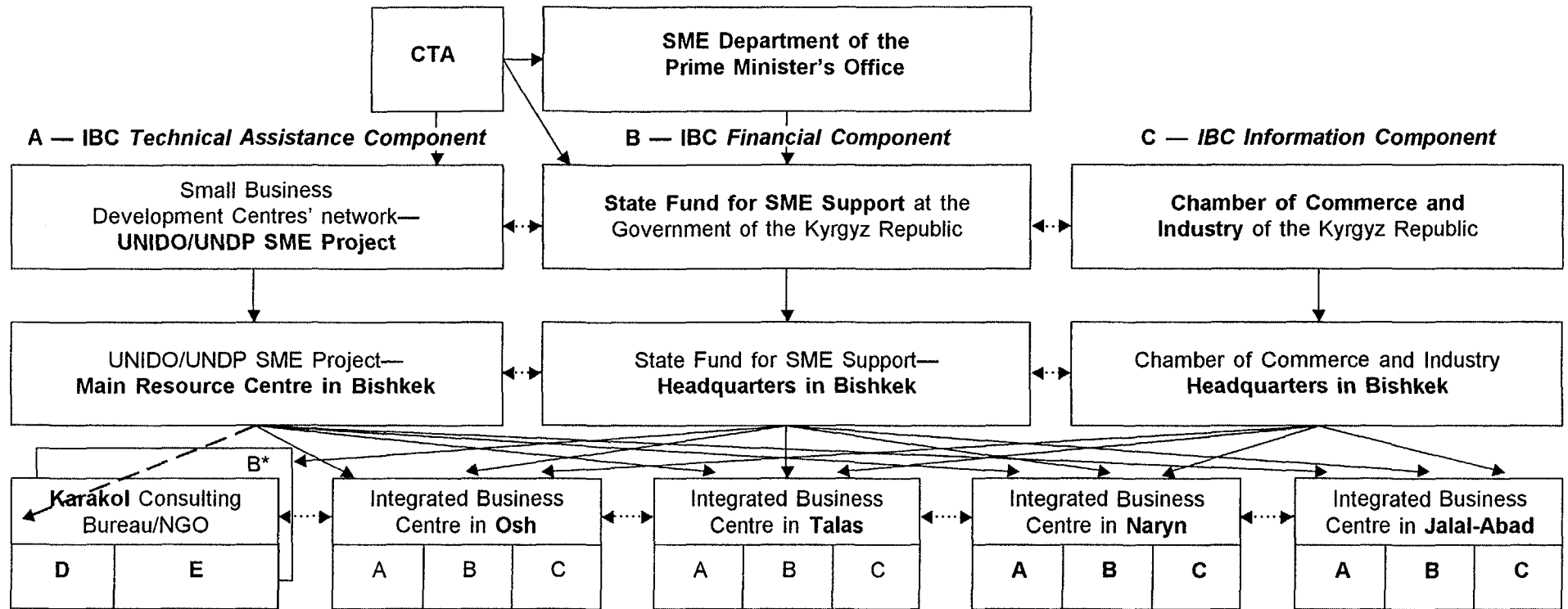
The Integrated Business Centres have been established in five major regions of Kyrgyzstan, the opening of the sixth Centre (the SBDC component already exists) in Karakol is under way. Therefore, at present, we may speak of establishing of a national network of Business Centres which are providing effective, complex technical assistance to the SME sector in a decentralized way and are capable of combining and coordinating support activities under one roof.

Before the project was launched, this type of consulting services in Kyrgyzstan was offered to entrepreneurs mainly on a commercial basis and the State Fund for SME Support had only one small regional office in Jalal-abad; almost all credits from the domestic credit line were processed only at the headquarters in the capital city of Bishkek. Both the relatively high price of consulting services, as well as the logistics of the credit application process created a serious barrier for potential entrepreneurs, especially from the poorer layers of the population.

Initiatives by the SME Project in the area of expanding its network and reaching out to the poorest regions of the country gave a considerable stimulus for the Government to decentralize its credit activity. Now, the Integrated Centres are capable of providing an SME entrepreneur with all information and advice necessary to open a new business, or expand an already existing one and to apply for credits which eventually can be disbursed locally. It is planned that in future, in this one-stop-shop type of facility, an entrepreneur would be able to fill out all documents required to start own business and register it.

The SBDC in Bishkek plays the role of the core resource and methodological centre for the whole national network. The Business Counsellors of this Centre are the most experienced ones; they have been providing important inputs to the regional Centres, including on-the-job training and other forms of internal training, preparation of teaching materials, etc. They share the SBDC management experience with their oblast colleagues.

Figure 4. SME policy advice and the National Network of *Integrated Business Centres* (IBCs) in Kyrgyzstan



- A - Component of the Small Business Development Centres' network (UNIDO/UNDP Project)
- B - Component of the network of the State Fund for SME Support at the Government of the Kyrgyz Republic (Regional Office)
- C - Component of the network of the Chamber of Commerce and Industry of the Kyrgyz Republic (Regional Department)
- D - SME Consulting Bureau at the local NGO, trained and supported by the SBDC network (new model)
- E - NGO.

Multi-way information flows within the Integrated Business Centres' network and their parent organizations:

\* B: Regional Office of the State Fund for SME Support in Karakol (the process of setting up of a fully-fledged Integrated Business Centre in Karakol has not been completed).

### 7.3 Uzbekistan

SME development has become now one of the highest priorities in the development strategy of Uzbekistan. It is progressing upon a background of macro policies, which strongly underline social aspects of development and avoid rapid and radical change. These policies—adhering to the basic principles of economic transition and development by President I. Karimov—have often been criticized and generally considered controversial by most of western experts. The country however has been developing recently at the rate of 4-5 per cent (according to the Center For Economic Research, Tashkent) faster than many of its neighbours. The next stage of important regulatory reforms (including introduction of pro-export policies, progress in the mechanisms of convertibility and changes in the banking system) has been launched. Most of the steps undertaken aim at unfettering of the flexibility of the system and at promotion of entrepreneurial behaviour.

The institutional framework in Uzbekistan is created by the following main institutions:

- ❑ The State Property Fund (Fond Goskomimuschestva),
- ❑ The Chamber of Entrepreneurs and Producers,
- ❑ The Association of Farmers,
- ❑ The Republican Coordination Council for Promotion of SME Development,
- ❑ “Non-budget” Funds, such as the Republican Business Funds, the Employment Fund and the Farmers Support Fund,
- ❑ Republican Network of Business Incubators.

The Presidential Decree of 11 April 1998 is characteristic of recent tendencies in the strengthening of support for SME in Uzbekistan. The Decree gives detailed definitions of SME organizations and specifies special custom duty and tax privileges for them. SMEs are exempted from custom duties with respect to the technical equipment used for their production. SME entities in small towns and villages may be subject to income tax reductions, provided they deal with specific types of production and construction.

The Decree refers to the institutional framework and strengthens the role of the Chamber of Entrepreneurs and Producers. Membership in the Chamber is basically mandatory for all SME entrepreneurs and only the members of the Chamber could be eligible for tax and custom duty privileges.

The Chamber (and the Association of Farmers with respect to the agricultural sector) has a major say in approval of SME investment projects and allocation of soft, to some extent government-subsidized, credits for their financing. The role of the Chamber was strengthened in the mid-1990s, when other important institutions of the national SME development system (such as the Business Fund, the Insurance Company “Madad” and the Tadbirkorbank) were connected more closely to its network.

## 7.4 Technical assistance and financial support to the sector

The pattern of technical assistance is basically similar to that of Kazakhstan and Kyrgyzstan, however with a different pattern of donors' participation in the process (most notably—much less of USAID involvement) and with the main thrust on the developing of a national network of Business Incubators under a UNDP/UNIDO Project. At present, there are 23 Business Incubators of various types in the whole of Uzbekistan (including six in Tashkent) and one Technology Park. The network has helped incubate about 200 SME firms (Policy Guidelines, 1999, p. 51).

The incubator network is at present in the process of major organizational, management and legal changes. Recently, a new non-governmental organization has been created to replace the old structure of the incubator network and take it over from United Nations and government ownership. It has been decided that the United Nations will grant all already operating equipment to the newly created NGO, thus enabling the network to continue its operation under a different legal formula.

Activities of the Business Incubator network have been recently more oriented towards dissemination of business information in the country's remote subregions. A movable exhibition of SME (domestic and foreign) production equipment ("Mini-tech 2000") has been presented in many important country's subregional centres—including Samarkand, Bukhara, Nukus and Fergana.

Foreign financial institutions involved in SME support are similar to that of Kyrgyzstan and Kazakhstan. They include EBRD, World Bank/International Finance Corporation, Asian Development Bank, Japanese Ex-Im Bank and German Kreditanstalt fuer Wiederaufbau. Along with the progress in the area of convertibility, requirements on loans' collateral and the repayment have changed recently, giving clear priority to export-oriented projects. Loan collaterals have to be liquid in terms of foreign currency and the repayment is required as a rule in a convertible currency, contrary to the previous more flexible approach, and acceptance of sum payments.

At the same time, the most popular domestic sources of financing (the "non-budgetary" funds) have become more friendly for local entrepreneurs—the interest rates have been fixed at constant levels between 12 and 16 per cent (varying with respect to the type of a project). Also, the domestic banks have become more active in the area of micro financing.

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# 8

## The need for a regional SME programme

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Eventually, one has to look at SME issues, and the technical assistance to the sector's development—from a regional, not only from an isolated, national perspective. The regional dimension of SME development has been emerging for quite some time and will be more and more important in the future.

From the regional perspective, some new aspects of SME development are coming into the picture. The SME development has to be carried out parallel to the progress in regional integration. Therefore, a new logic of international assistance to SME becomes valid and new policies could be formulated. Their bottom line would be to try to solve most common problems together—for a group of countries, rather than deal with them in isolation of particular national economies.

Regional integration has many dimensions, which cannot be dealt with separately. The three leading ones are: the political, economic and social dimension. The SME development has exactly the same characteristics. Always and everywhere the integration processes have had numerous challenges, from the very moment, when the integration concept was shaping up and when a long-term vision was necessary to abandon traditional thinking and build a new future. Development of a regionally interactive SME sector may stimulate regional integration, the integration processes in turn may help build sound SME sectors in particular economies.

The countries of Central Asia have been facing the challenge of not only building individual, sound market economies, but also the challenge of using market mechanism for the purpose of the development of the whole region. Their integration has to be perceived in the context of a common transition of the region to a fully-fledged market economy, of building together a regional investment potential and international competitiveness.

It is not that particular countries in the region are in need of poverty alleviation through modern active methods, including development of a self-generating mechanism and creating opportunities within the SME sector. It is not that individual countries need to abolish barriers hindering SME development and require technical assistance to the sector's development. It is the whole region as such that needs SME development. Already at this stage, it is possible to think about common solutions e.g. simplifying the tax and licensing systems, unifying basic regulations for SMEs (e.g. common definitions and basic principles) and abolishing barriers (including custom duties for goods and services, as well as factors of production—capital and labour) without waiting for the creation of a monetary or economic union in future.

Yet, effective abolishing of simple custom duties, as well as access to business and economic information about other countries, is still rather difficult in the three countries of Central Asia, despite important political declarations at the highest level. So is the moving of people among countries, though the standards change in the rhythm of political events.

True economic and political integration has never been easy in other regions and always required a lot of time and efforts. However, the stakes are high; the SME sector, under market conditions, could become one of the decisive factors as far as the economic future of the whole region is concerned: from the amount of new jobs created, to development of cross-border trade and technology transfer, to developing important economic multiplier effects. Development of this sector, through creation of the middle class and its prosperity, could become one of the most efficient tools to provide social and political stability within and beyond national boundaries.

There is ample room for a better exchange of knowledge and experience in SME development in the narrow (Central Asia) and broader (CIS) region and for intensifying of the collection and sharing of business information from around the world.

The integration processes could be further strengthened by new regional technical assistance programmes and projects that reach beyond national borders, just as the integration processes do. An example of good practices in this area was the UNDP/ UNIDO Regional SME programme (RER/97/005) with the centre in Bratislava, unfortunately interrupted at present. Such an idea could be further developed and fine-tuned to the needs of the CIS countries, whose SME Coordination Committee has recently (at the semi-annual meeting in Kiev, June 2000) expressed officially an interest in such a programme.

United Nations technical assistance is another dimension in the build-up of the necessary infrastructure for both SME development and regional integration.

Regional technical assistance to the SME sector may become the area of technical assistance, where the United Nations system could have a comparative long-term, if not absolute, advantage in providing support and expertise to transition economies.

The advantages stem from the national and regional experience gathered, from the United Nations projects' and programmes' position vis-à-vis governments of transition economies, and from the ability to undertake innovative activities and fulfil complex tasks.

Examples of good practices on a national scale include:

- Ability to provide long-term sustainability of quality Business Development Centres and ability to develop local capacities and human resources, which could be used for regional training of national consultants (Romanian UNIDO/UNDP SME Project);
- Ability to introduce an integrated pattern (under one roof, one-stop-shop type of facility by the United Nations, Government, Chamber of Commerce) of SME financial and technical assistance and decentralize the existing development support system in order to reach out to underdeveloped provinces with comprehensive SME support (Kyrgyzstan—project KYR/97/001);
- Ability to prepare quality training materials and basic, original SME handbooks (including the Romanian, Kazakh (KAZ/95/003), Albanian and Kyrgyz SME projects), or an SME newsletter Alliance published successfully in Belarus;



- ❑ Ability to offer a comprehensive, diversified package of services tuned to the needs of a complex national environment (Belarus—projects BYE/97/001 and BYE/97/003);
- ❑ Introduction of new forms of cooperation with leading private sector companies (the Atyrau projects in Kazakhstan—Micro-credits, KAZ/98/10 and Business Development Centre KAZ/98/09) such as the Citibank and Chevron, or the Kyrgyz (in the final preparation stage) project on establishing wireless communication systems for remote areas with LM Ericsson and Telenor;
- ❑ Ability to play a leading role in SME technical assistance among local donors (e.g. the Romanian and the Kyrgyz SME projects),
- ❑ Ability to introduce innovative forms of project objectives' implementation, including: devising the pattern of cooperation within the network of Integrated Business Centres, micro-macro (policy level) feedback, efficiency and quality of cooperation with government institution under the modality of National Execution of projects, setting up of a SME Business Club (UNIDO /UNDP SME Project in Kyrgyzstan ); application of expertise and training capacities from more advanced SME projects to start-up projects (Romanian SME Project –SME Project in Kyrgyzstan –SME Project in Tajikistan).

The issue of special importance seems to be the collection of all existing experience from national projects belonging to the same family. The usage of this experience for the benefit of other projects may lead ultimately to the creation of national and regional models of technical assistance, which could become the major reference points for future United Nations activity in this area. Since the United Nations has invested considerable resources in SME technical assistance in the region, this issue is important from the point of view of both: a long-term success of particular national SME projects and programmes; as well as from the point of view of the shaping of a future United Nations strategy in this area.

The need for regional information exchange and regional consolidating initiatives has been indicated by the success of the regional FEED Forum (Forum on Entrepreneurship and Enterprise Development) organized jointly by UNIDO and OECD Centre for Cooperation with Non-Members since 1998. The main idea of the FEED Forum was to create a series of seminars, which would facilitate experience and information exchange, and to put in writing (Policy Guidelines, 1999) a set of international standards for creating a modern SME development system in transition economies.

There is a stronger than ever need to revive, or newly develop, a regional level SME programme. It could complement the national projects, which are based primarily on efficient use of local human resources and target development of national capacities and institutions. Regional programmes should help integrate the whole regional SME-oriented technical assistance into one system. The regional programme could bring important results without involving a lot of new funds and it may not require complicated extra arrangements. Its coordination and administrative centre, located in one selected country, should remain lean and flexible in order to play to a greater extent a conceptual role as a think-tank. The main regional network could be created by chosen team members of existing national SME projects, which would achieve new or additional tasks to represent the regional programme directly in their countries.

The regional programme could:

- ❑ Help support and amplify national achievements and/or select stronger components of particular SME projects, in order to create real life models and experimental labs for other projects and countries to follow;
- ❑ Facilitate information and experience exchange among particular national SME projects;
- ❑ Work on permanent improvement of the whole SME technical assistance system;
- ❑ Help expand the traditional pattern of SME assistance by introduction of ambitious, innovative topics (such as e.g. assistance in introduction of venture capital financing for SME, now being developed in Uzbekistan) parallel in a group of countries.

Within the regional system, basic, regular information exchange should be secured, including exchange of progress reports prepared according to the same pattern and allowing for a comparative assessment of progress, exchange of drafts of new SME-related legal acts, information on new initiatives and forthcoming events. Dissemination of information and exchange of ideas aiming at permanent improvement of the system should be supported by regular meetings of national projects' representatives.

New United Nations programmes should strengthen integration processes and reach beyond national borders, just as integration processes do. United Nations technical assistance could become another dimension in the build-up of the necessary infrastructure for both SME development and regional integration.

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