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17751-E

Distr.
LIMITED
ID/WG.492/4
18 August 1989
ORIGINAL: ENGLISH

United Nations Industrial Development Organization

First Consultation on Small- and Medium-Scale
Enterprises including Co-operatives

Bari, Italy, 9-13 October 1989

ISSUE 1: ENVIRONMENT CONDUCIVE TO SUSTAINED GROWTH OF
SMALL- AND MEDIUM-SCALE ENTERPRISES*

Discussion paper

Prepared by
the UNIDO Secretariat

3a/37

* This document has not been edited.

Integration of small- and medium-scale policies and strategies in overall development plans

1. There is renewed and widespread recognition of the importance of the small- and medium-scale enterprise sector as an agent of balanced economic growth and welfare. The economic crises of the 1980s slowed down growth in the developing countries as they were forced to reduce or abandon new investments to cope with mounting debt burdens, depressed commodity prices and a growing trend in restrictive trade practices. The focus of policies has consequently shifted to small- and medium-scale production to meet internal demand for industrial products and to exploit market niches in exports.

2. The potential for industrialization through small- and medium-scale enterprises is subsumed in the critical role that they play in employment generation, redistribution of income, eradication of poverty, reduction of regional imbalances, promotion of vertical integration and in saving and/or earnings of foreign exchange. Moreover, small- and medium-scale enterprises provide the breeding ground for the development of entrepreneurship which is recognized to be a vital factor for the industrialization of the developing countries. One of the most important factors influencing this process is the promotion of an economic environment that is responsive to market signals. Since the sector's economic contribution is generated by thousands of enterprising men and women, the right environment would unleash their private initiative and latent entrepreneurial spirit and talents.

3. Developing countries in general lack an appropriate policy framework for an effective growth of small- and medium-scale enterprises. Policies tailored to the specific requirements of the sector are a necessary condition to produce the desired impact. Often the macro-economic policy framework and its measures have a built-in bias towards large-scale industries and the use of capital-intensive technologies. Subsequently, these measures are often detrimental to the needs of small- and medium-scale enterprises and signal the need for deregulation and structural reforms at the macro-policy level. Economic measures should be of a long-term nature and should consider the overall linkage between large-, medium- and small-scale industries and enterprises. Small- and medium-scale enterprise policies should be integrated in overall economic development plans, since small- and medium-scale enterprises are an integral part of the overall economy.

Harmonization of macro-economic, fiscal, financial and other policies with incentive measures for small- and medium-scale enterprises

4. The recognition of small- and medium-scale enterprises as an integral part of the economy presupposes that they should be treated on an equal basis with their large-scale partners. However, in many countries, the economic development policy and practice had been dominated by the large-scale sector. Subsequently, all existing macro-economic policies as well as fiscal and financial measures focus on the needs of the sector. Little or no attention has been given to the specific needs and requirements of small enterprises. If small- and medium-scale enterprise development is to be given the emphasis it deserves, the incentives necessary for sustained growth of the sector need to be established and should be integrated within overall development plans, programmes and policies of industrialization. In the first instance, the adverse effects of existing economic policy measures on the development of small- and medium-scale industries should be reviewed in order to establish the most appropriate policy mix. Secondly, incentive measures and mechanisms should be so designed and administered so as to induce a substantial flow of investments to small- and medium-scale enterprises. These imply a thorough

review and analysis not only of fiscal and financial policies, imports and exports, marketing etc., but also cover other sectors such as agriculture, trade, transport, infrastructure as well as training and education, with the aim of promoting a harmonious development of small- and medium-scale enterprises alongside the large-scale sector.

Creation of an appropriate environment and long-term government commitment as a priority in the development of small- and medium-scale enterprises

5. The environment is the most important factor among the elements and policy instruments applied to stimulate growth of small- and medium-scale enterprises. It is not the industrial or economic environment alone but the general socio-economic and political environment which stimulates or hampers potential entrepreneurs to risk their own funds and invest in their own enterprise. In cases of economic instability and uncertainty, or if the rate of return on investment is higher or equally high in other sectors, entrepreneurs would not invest in small- or medium-scale enterprises even if there were a network of promotional measures available. Instead, they would invest their savings in housing, real estate, agriculture or other sectors perceived as more profitable.

6. There are a number of measures to improve the environment of the small- and medium-scale enterprise sector. The first one is the inclusion of small- and medium-scale enterprises into the economic policy and planning framework as an important element having, however, some characteristics which require specific measures. Furthermore, small entrepreneurs are hampered by the numerous regulations governing economic and industrial development. Deregulation and reduction of bureaucratic requirements would help small- and medium-scale enterprises; the more so as many of the rules are meant for large-scale enterprises and are not always fully applicable to the small-scale sector.

7. Any policy framework for effective growth of small- and medium-scale enterprises should be of a long-term nature. Strategies and policy measures need to be tailored to the specific needs of the sector, analyzing in detail the requirements and developing well-defined measures for practical implementation. The measures should be consistent with the target groups for which they are intended to serve as well as with the responsibilities and functions of public, semi-public or private institutions providing these services.

8. There are some definitional problems in determining the target groups. Whilst there is a flexible line between the medium- and small-scale sector, a new group - the informal or micro-enterprises - has attracted the attention of policy-makers. The need to define the micro-, small- and medium-scale enterprises at the national level is not a subject of discussion. A definition is needed to determine the types of enterprise for which a number of incentives are valid. Some countries are using as criteria capital invested in machinery and equipment, others the number of employees, or a combination of both. A few countries use additional factors such as electricity consumption or even qualitative criteria to determine the respective target groups. An internationally valid definition is not meaningful, since the groups of beneficiaries and the purpose for which small- and medium-scale enterprises are meant differ greatly from country to country.

9. Few countries have as yet a well-defined policy framework for effective growth of small- and medium-scale enterprises and where such policies do exist, these have been found ineffective due to insufficiently defined target

groups, lack of co-ordinated provision of inputs as well as legal and procedural barriers.

10. The appropriate environment for the smooth growth of small- and medium-scale enterprises requires a set of well-defined strategies and policies. If such a system does not yet exist, it should be established as an integral part of the economic policy. Existing institutional support mechanisms for small- and medium-scale enterprises need to be analyzed so as to determine their suitability for the objectives for which they were originally intended.

11. The guiding principle of the entire range of measures for accelerated growth of small- and medium-scale enterprises should be based on feasible, viable, competitive and self-reliant enterprises. The market and profitability of the individual enterprise should be the dominating factor. Policy measures to support development should not only be of a fixed time-frame for individual units but also lead to an institutional framework available to the small- and medium-scale enterprise sector on a long-term basis to enable growth to be sustained and substantial.

Establishment of institutions at the national level for entrepreneurship development programmes

12. National institutions for the development and support of small- and medium-scale enterprises are required to act as intermediaries between the government and the entrepreneurs. The institutions are expected to analyze the requirements of the sector and synthesize them for submission to the policy-making organs, and represent the small- and medium-scale enterprise sector's interests vis-à-vis the government and other public bodies.

13. National institutes should reach as many small- and medium-scale enterprise units as possible. Since the individual clients will be scattered all over the country, one central institute would suffice at the initial stage only and a decentralized system of service institutes should be offered at a higher development level. The number, type and location of the institutes should be determined according to the demand and distribution of small- and medium-scale enterprises.

14. The choice of location of the service institutes should be based on the availability of services to individual clients bearing in mind operation costs. Moreover, care should be taken to offer sector-specific assistance at certain locations. The most effective way to offer services is provision in the form of a comprehensive package of measures. Compartmentalized measures will not produce the expected results; on the contrary, they might defeat the basic objectives. The goal should be an integrated approach with regional and sectoral coverage.

15. The degree of development of the small- and medium-scale enterprise sector is a determining factor in choosing a single window approach (one institute providing all services required) or a multi-window approach (several institutes providing a number of specialized services). At an early stage, the single window solution should be given preference. Increased development requires specialization in these services and would favour multi-window solutions which in turn demand well-functioning co-ordination among the specialized institutes.

16. Small- and medium-scale enterprises should be managed effectively; they must react quickly to the demand of the market, the trends in tastes, styles

and behaviours of customers. They need to be flexible in order to be efficient. The development and support institutions should react in the same way. If the appraisal for obtaining a loan takes many months before the funds are made available, the opportunity on the market may have been taken by somebody else. Service institutions working for the benefit of small- and medium-scale enterprises should be able to react quickly to demand and should be managed in an enterprise-like manner. A slow bureaucratic administration will certainly defeat the objective. The staff of the institutions are in daily contact with the enterprises. If their salary scales and their total remuneration are much below the level of the industrial sector, there will be a continuous exodus of experience from the institute towards better paid employment opportunities in the industrial sector. Under these circumstances it will be difficult for the institutes to maintain their skills, experience and knowledge in giving advice to small- and medium-scale enterprises.

17. In the 1960s and 1970s many such institutions were set up in developing countries under bilateral or multilateral technical co-operation schemes. However, these bureaux became weighed down with administrative detail and in many cases lost contact with their potential clients. Analysis of the situation is urgently required. If need be, the existing institutes should be transformed into real service stations providing advice and guidance to their clients, the entrepreneurs of small- and medium-scale units. This restructuring should focus on increased participation of semi-governmental or private initiative.

Role of industrial co-operatives

18. It has been recognized that industrial co-operatives have an important role to play within the socio-economic environment of small- and medium-scale enterprise development. Particularly in centrally-planned economy countries, industrial co-operatives are the preferred form of ownership in the small- and medium-scale enterprise sector. While certain fundamental management problems have limited their growth in market economy countries, there is considerable scope for their development in specific sectors such as agro-based industries and micro-enterprises (informal sector). In addition, their role in marketing and the supply of raw materials, mobilizing financial reserves and savings among members as well as their function in channelling mini-loans, especially in rural areas and in the informal sector, underscore the importance of measures aimed at the development of industrial co-operatives.

Need for a single window agency for ensuring co-ordinated provision of inputs for small- and medium-scale enterprises

19. Requests for support from the small- and medium-scale enterprise sector are manifold covering a variety of activities such as information and advice on economic and managerial matters, project appraisal for loans, and selection of technologies appropriate to the situation; they also include physical infrastructure measures such as the provision of water and sewerage lines, road connections, electricity or gas supply, and can even include the provision of functional workshops within or outside an industrial estate. Whilst the provision of "normal development incentives" does not create undue co-ordination problems, difficulties increase when infrastructural services are requested. In such cases it has been advantageous to entrust a development institute with full responsibility of all co-ordination activities in order to ensure co-ordinated and timely provision of all necessary inputs for the small- and medium-scale entrepreneurs.

Role of associations of small- and medium-scale enterprises

20. The government policy framework and institutional infrastructure set up form the background for creating feasible, viable and profitable small- and medium-scale enterprises.

21. At the initial stage of development, these two elements - governments and institutions - play the major role. In reaching a higher degree of development, the entrepreneurs themselves as the beneficiaries of these environmental measures should be directly involved in the development process of their own sector. Through the creation of groups they could speak for themselves and should present their interest vis-à-vis the government as well as the institutions. In addition, entrepreneurs should have the possibility to provide part of their services to their fellow entrepreneurs and to some extent take over the initial service function of governments and/or institutions. In a number of countries, associations of entrepreneurs have become important factors for negotiation with institutes and policy-making organs. The creation and development of entrepreneurial associations should be supported as an important mechanism in the promotion of small- and medium-scale enterprises.

Final consideration

22. Based on the above-mentioned problems confronting small- and medium-scale enterprises in their development, the Meeting may wish to examine the following key considerations with a view to elaborate conclusions and recommendations for accelerated growth of the sector.

(a) Integration of small- and medium-scale policies and strategies in overall development plans

Prerequisites for the optimum contribution of the small- and medium-scale enterprise sector to the overall economy:

- Institutional bodies such as National Council for Small- and Medium-Scale Enterprises to set overall national objectives, define sectoral strategies, and establish suitable mechanisms for co-ordination and mobilization of resources;
- Strategic planning focussed on integrating small- and medium-scale enterprises in overall national plans covering methodologies, policy instruments, regional and rural development objectives and sectoral target setting;
- Participation of the key agents of change, namely enterprises, urban and rural communities, manufacturing associations, universities and research institutions in the formulation of plans, policies and strategies;
- Establishment of a coherent national programme of action for the development of entrepreneurship facilitating growth from micro-enterprises through small to medium enterprises;
- Long-term public commitment to small- and medium-scale enterprises and to the development of an entrepreneurial culture enshrined in policy pronouncements and allocation of resources for research and development, training and promotional activities.

(b) Harmonization of macro-economic, fiscal, financial and other policies with incentive measures for small- and medium-scale enterprises

Development of national capabilities and capacities for formulating and administering strategic policy measures and mechanisms to create an economic environment conducive to the growth of small- and medium-scale enterprises covering inter alia:

- Analysis of existing macro-economic policy measures with a view to their impact on the small- and medium-scale enterprise sector;
- Deregulation possibilities at the macro-economic level;
- Harmonization of macro-economic measures with an integrated incentive scheme for small- and medium-scale enterprises;
- Restructuring and reorienting existing mechanisms and legislations of incentive measures;
- Efficient administration of support policies and measures.

(c) Establishment of institutions at the national level for entrepreneurship development programmes

- Network of institutes to provide integrated and comprehensive packages of support measures either through a single window and/or multi-window approach;
- Private sector role in the operation of service institutes on business lines;
- The changing roles of Small Industry Development Organizations (SIDOs) and industrial co-operatives and their needs of technical co-operation in regard to marketing, supply of raw materials and as lending channels for financial assistance.