



Phare

Progress and strategy paper
Small and
Medium-sized
Enterprises

Series: PHARE -)

Progress and strategy paper

Small and Medium-sized Enterprises

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Foreword

This paper is part of a series which will cover each of the main areas of Phare activity. It describes the nature of the problems faced in Phare's partner countries during their transition from planned to market economies. It goes on to examine actions undertaken to date, and to assess their impact on the transformation process.

There is clearly a need to ensure that the approach being taken in any given sector is relevant to the longer-term goals of economic transformation. For this reason, these papers also contain the thinking of those responsible for operating Phare on actions for the future and how Phare should contribute to the next phase of the transition.

The papers do not reflect any official position of the European Commission. They have been written by the Phare Operational Units and are intended as a stimulus to discussion for all those involved in the debate on economic transformation in central and eastern Europe.

Alan Mayhew

Relations with central and east European countries

The Phare Programme

The Phare Programme is a European Union initiative which supports the development of a larger democratic family of nations within a prosperous and stable Europe. Its aim is to help the countries of central and eastern Europe rejoin the mainstream of European development and build closer political and economic ties with the European Union.

Phare does this by providing grant finance to support the process of economic transformation and to strengthen newly created democratic societies. Phare also provides grant finance to help countries with Europe Agreements integrate with the European Union.

In its first five years of operation to 1994, Phare has made available ECU 4,283 million to 11 partner countries, making Phare the largest assistance programme of its kind.

Phare works in close cooperation with its partner countries to decide how funds are to be spent, within a framework agreed with the European Union. This ensures that Phare funding is relevant to each government's own reform policies and priorities. Each country takes the responsibility for running its own programmes.

Phare provides know-how from a wide range of non-commercial, public and private organisations to its partner countries. It acts as a multiplier by stimulating investment and responding to needs that cannot be met by others. Phare acts as a powerful catalyst by unlocking funds for important projects from other donors through studies, capital grants, guarantee schemes and credit lines. It also invests directly in infrastructure, which will account for more Phare funds as the restructuring process progresses.

The main priorities for Phare funding are common to all countries, although each one is at a different stage of transformation. The key areas include restructuring of state enterprises including agriculture, private sector development, reform of institutions and public administration, reform of social services, employment, education and health, development of energy, transport and telecommunications infrastructure, and environment and nuclear safety. Under the Europe Agreements, Phare funding is being used to make laws compatible with European Union norms and standards, and to align practices.

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Executive summary

The development of a strong and dynamic private sector, and in particular small and medium-sized enterprises, will form the backbone of a market economy. SMEs are a key element in the reform process. In view of this importance, Phare has made available ECU 320 million to support SME development in the central and eastern European countries between 1990 and 1993.

This paper provides an overview of Phare activity in this sector. It begins by assessing the deficiencies and identifying the main assistance needs of the small entrepreneurs. It then goes on to explain and assess the Phare SME programme responses through the setting up of 120 new SME support institutions with transfer of know-how training, regional initiatives, and the creation of financial instruments, small loan schemes, grant schemes and investment funds in particular.

It underlines the key conditions for success, namely a strong policy and commitments from national sources, good donor programme coordination and co-financing and the importance of training.

The paper concludes with strategic orientations for future action, drawn from operational experience. These include the need for:

- a coherent and effective SME policy in each country, taking account of regional policy and priorities, this being reinforced by the Europe Agreements
- continued assistance to SME support institutions, the emphasis being placed on co-financing, twinning and on a greater involvement of professional organisations
- independent SME agencies capable of ensuring coherence and coordination in policy implementation and in tackling in particular the continued lack of an enterprise culture
- a continuation of financial support, through small loan schemes, guarantees and equity financing - where the market is failing to address the needs of start-ups and small entrepreneurs - alongside substantial training and know-how transfer to strengthen financial intermediaries
- increased co-financing with the international financial intermediaries, with which Phare financing is fully complementary.

Introduction

Before the recent political changes and economic reform SMEs hardly existed in central and eastern European countries. Since then, the private sector has emerged at an impressive speed in all the countries.

The development of a strong and dynamic private sector capable of meeting the challenge of the market economy, and taking over and operating the productive capacity of the central and eastern European countries, is a key element in the reform process. SMEs, both those which have been established since the changes and those which are the result of the privatisation process, will be a major part of the private sector in the future, as they are in market economies throughout the world. In the European Union, in 1992, more than 99 per cent of the 15.7 million enterprises in the non-primary sectors were SMEs of up to 500 employees, accounting for 70 per cent of total employment.

The Phare Programme has therefore considered SME development as a priority from the beginning of the reform process.

Assistance to small business development is indeed an integral and essential part of overall economic reform, alongside enterprise privatisation and restructuring, financial sector reform and investment promotion. It also constitutes an essential element within an integrated approach to regional economic development.

Section 1 - Background

Role and importance of SMEs in the reform process

The liberalisation of the economy has led to many new entrepreneurs establishing their own firms, while those already in business now have better prospects for expansion.

Sustaining this growth of the private sector is important for a number of reasons:

- the private sector, and in particular SMEs, will form the backbone of a market economy and in the future will, as in other countries, provide most of the employment
- support for small enterprises will help in the demopolisation and restructuring of large companies as part of the process of transformation
- the shift from few large state-owned enterprises to more, privately owned SMEs will increase the number of people with a direct stake, as owners, in the economy and therefore with a vested interest in social stability, which is one of the longer-term goals of Phare as a whole
- an increase in the number of SMEs would also bring flexibility in the economy and facilitate technological research and development
- new business development, including SMEs, is a key factor for the success of regional reconversion where traditional and heavy industries will have to be restructured.

As in western countries, some of these different objectives can be in conflict and the establishment of a coherent policy towards SMEs can be very difficult. The attitude of national governments can have a major effect on the development of the sector and, in particular, on the ability of SMEs to grow in size as well as number. The initial mushrooming of entrepreneurial activities seen in several countries, although excessively oriented towards commerce rather than industry, must be helped to develop into a broad-based, stable medium-sized enterprise sector.

The absence of a strong representational base for SMEs and entrepreneurs hampers the development of these sectors, as does suspicion by, and of, entrepreneurs. Information on the sector is more anecdotal than factual and those statistics which exist are unreliable and frequently out-of-date. Finally, although most countries would agree that SMEs are important, most ministries saw their initial priority as dealing with problems such as privatisation or restructuring state industry and, in many cases, have been slow to develop a coherent policy toward SME development.

Support needs in the SME sector

Much has been achieved in this transitional process. The private sector is growing steadily and strongly. Most governments are striving to create the favourable framework required to bring this process to full fruition.

The underdevelopment of this sector in the past, however, means that there are few institutional structures dealing with SMEs and little experience in those institutions which do exist. Such problems exist not only in relation to general advice and support but also to financial institutions, in particular the banks. Entrepreneurs starting new enterprises find themselves facing problems they do not understand, in an economic environment which is less supportive of entrepreneurship than that in the west, with less regulation and lacking services and support from financial institutions which western SMEs take for granted.

The bulk of the work, therefore, is still to come. The needs of SMEs can be generally classified as follows:

Non-financial needs

Need of know-how for individual enterprises

Most SMEs lack any source of business advice, information, management and training. In many cases this is apparent at the most basic level, including advice on how to set up a business and to plan its activity, understanding of basic business concepts (particularly marketing) and information on other enterprises, both in the local economy and abroad. In addition, there is some need for practically oriented training, again at a basic level.

Lack of institutional assistance

At the outset of the reform process, there were few organisations which directly supported SMEs. New organisations need both help in organising themselves and also training and assistance in order to support the new SME sector. This applies equally to public and private organisations and there is a need both for general assistance organisations and for specific self-organising institutions, such as chambers of commerce. Lack of support for SMEs by the public sector can mean, for example, that it is difficult to identify exact owners of property which could be used for SMEs or to negotiate reasonable terms for its usage.

Lack of SME policy and SME policy making

Government policy can have a very real effect on the position of SMEs. For instance, government may have preferences for different sectors or geographical regions. However, the framework is often unclear with:

- a lack of any clear policy towards the private sector, in particular as regards tax policy, collateral registration and, in certain countries, lack of civil law, and of a proper registration system for businesses
- a need for clarity on regional and sectoral priorities. It is clear, for example, that certain geographical regions are relatively disadvantaged, or that manufacturing needs to be supported more than trading activities.

Lack of a framework for action at regional level

The issue of SME development has an important regional dimension, in particular where a specific geographical region is dominated by a single declining industry or large enterprise. Expansion of the regional SME sector is often the most effective way of creating alternative employment to counteract the job losses which may ensue.

National policy for private sector development should therefore provide a flexible framework allowing the varying local needs of individual regions to be addressed. The impact of such action can also be increased if it is coordinated through a regional body which best understands local problems and is best placed to focus resources. This type of regional approach is a relatively new concept in the central and eastern European countries, with the result that the legal framework and the local bodies needed to follow it were lacking at the outset of the reform process.

Financial needs

Problems within the financial and banking sector

Financial intermediaries and investors are either unable or unwilling to respond sufficiently to the financing needs of small private enterprises. There are a variety of reasons for this:

- lack of experience, particularly in business appraisal and monitoring, means that finance for SMEs is seen as too risky. Often the only way in which this perceived risk is reduced is by, for example, demanding high levels of collateral on loans, which means that a priori viable projects go unfunded

- lack of monitoring systems in the bank means that only very secured short-term lending is made. It also means that the normal western banking idea of securing working capital on current assets, which requires relatively sophisticated information and monitoring systems, is rarely used even when banking laws are in place
- lack of a secondary market means that valuation of collateral is difficult to perform, and that collateral is difficult to realise when loans are in default. In any case, central collateral registers may be lacking and even when they exist the length of time taken to realise collateral can be prohibitive
- the fact that the banks are undercapitalised means that they may be unable to give long-term credit from their own resources. Even when they are able, they may be unwilling to invest in areas where the pay-back is not short-term. This problem is compounded by the ready availability of better investment opportunities, in particular government bonds
- lack of track records for entrepreneurs and enterprise coupled with the fact that the environment is changing very quickly means that the inherent risk of projects is much higher than in a comparable western situation. In many cases, a rational bank would not finance the sector
- lack of many financial institutions which would be normal in the west, such as venture capital institutions. This is due not merely to the environment but also to the lack of appropriate laws and precedents as well as resources
- lack of pressure or incentives by governments to encourage the banks to take greater interest in lending to SMEs.
- the fast-changing environment, including inflation, means that normal "commercial" interest rates are very high and make long-term investment risky
- there is frequently a lack of personal equity, and high inflation has often wiped out people's savings. Property ownership and valuation are often uncertain. Finally, lack of track records for lending to individuals means that banks are unlikely to make any unsecured lending at a low level. Together, these facts mean that there is a real lack of small amounts of start-up capital
- despite rapid changes, the ownership situation is still unclear, particularly for land, notably when SMEs result from small-scale privatisation
- in the fast-changing environment, only trading companies are in a position to deal with foreign currency and exchange risk. This inhibits, for example, manufacturing companies who wish to use western equipment to serve the local market
- lack of regulatory framework and facilities for leasing.

Financial situation of entrepreneurs

Entrepreneurs themselves have problems, in particular:

- lack of personal security for loans, particularly noting that banks use high levels of collateral as a way of mitigating risk
- lack of any track record or information in a turbulent market makes it difficult to put together a reasonable business plan. Also, the lack of management capabilities has led to failure of many SMEs, in particular those resulting from small-scale privatisation, and has therefore reinforced the banks' apprehension regarding SMEs

Section 2 - Phare support programmes

Against this background and in response to demands from the beneficiary countries, Phare has made available ECU 320 million between 1990 and 1993 to support SME development. This money is additional to Phare's broader support to private sector development through the financial sector, privatisation, restructuring, and investment and export promotion programmes. Most programmes are designed for a duration of three years, and the majority are therefore still ongoing.

Phare commitments in the SME sector

On the basis of the priorities from the beneficiary countries, Phare has made the following sums available for the SME sector, including through regional development projects.

Estonia	MECU	3
Latvia	MECU	3
Lithuania	MECU	6
Poland	MECU	91
Czech Republic	MECU	35.5
Slovak Republic	MECU	22
Hungary	MECU	59
Romania	MECU	10
Bulgaria	MECU	25
Slovenia	MECU	1
Albania	MECU	6.5
Total funds made available through National programmes	MECU	262

In addition, ECU 5 million has been made available to provide support to SMEs and SME support institutions in central and eastern European countries through certain European Union professional organisations. A further ECU 5.5 million has been used for programme preparation, monitoring and evaluation.

Finally, ECU 47.5 million has been made available in 1991 and 1993 to promote the creation of joint ventures between SMEs in central and eastern European countries and in the European Union through the Joint Venture Phare Programme (JOPP).

Non-financial areas of activity

To address the needs identified above, Phare has concentrated on three areas:

- SME support institutions
- policy advice
- regional development

SME support institutions

In order to coordinate assistance to SMEs in terms of advice, information, and training, Phare has sponsored the establishment of locally based business support services. The scope varies from country to country, depending on the perceived local needs, but can cover access to property, and creation of local development strategies, such as promotion of particular industrial sectors.

The services may be provided through new institutions built on independent partnerships between the private and public sectors, drawing on the resources of both sides, or through self-organised institutions such as entrepreneurs' associations and chambers of commerce.

The concept behind public-private partnership is new in the central and eastern European countries and these institutions have indeed been built up from scratch by Phare, often with co-financing from other donors. They will eventually become independent of Phare assistance, but experience from the west would suggest that they will require ongoing public subsidy if they are to be effective and cover as wide a population as possible. The self-organised bodies have received Phare support for institution building, mainly in the form of transfer of know-how, in particular in Poland, Hungary and the Czech and Slovak Republics.

SME associations and management training

To achieve the objective of building up the in-country capacity to provide such services, as well as to encourage direct relationships and twinning between such organisations in the central and eastern European countries and in the European Union, Phare has sponsored transfer of know-how and training programmes carried out also by:

- Eurochambers, for Chambers of Commerce and Industry
- EBN, the European Business and Innovation Centre Network, for Business Innovation Centres
- EFER, the European Foundation for Entrepreneurship Research
- UAPME, the European Union of Craftsmen and SMEs, and
- European Senior Service Consortium (of Retired Executives Association), to provide direct support to SMEs through their assistance institutions

Management training programmes for SMEs have also been developed in some countries, in particular in Poland, as has training of local consultants to help promote local consulting skills.

Policy advice to governments

SMEs cannot develop and grow within an unfavourable legal, fiscal and financial environment. A clear and proactive government policy on SMEs is therefore of the utmost importance in central and eastern European countries. This is also the only way to guarantee the effectiveness of know-how transfer and financial schemes in assistance of the SME sector. Although Phare can assist in the elaboration of such a policy framework by providing funding and expertise, the single most important ingredient is political commitment to such a policy from the partner government. Where this is lacking, Phare can do very little.

Phare is providing advisers and support to relevant ministries and will continue to argue for a favourable SME policy, together with other donors and international institutions concerned.

Regional development

Experience is showing that while national-level policy and action is essential for private sector development, the situation region by region and city by city is not uniform. A flexible framework to allow for regional variations is therefore essential. The need for such a framework is increasingly being recognised by governments not only as a means of tackling particularly disadvantaged regions and towns but also because of the significant advantages of approaches based on using local knowledge, priorities, strengths and tackling local weaknesses.

In many central and eastern European countries, Phare has therefore put emphasis on encouraging SME development by supporting initiatives at regional level. This includes initiatives to assist with the identification of priorities and with the targeting of limited resources by way of regional planning. Projects involving small-scale infrastructure, training and retraining and cooperation between regions and districts have helped create an environment which promotes the development of an alternative SME sector to act as an alternative source of employment and economic activity.

These actions are nearly always carried out or coordinated by regional development agencies which bring together local experience, powers and skills with national assistance from the public and private sectors, as well as involving central governments and representatives of the banking sector. In many cases, Phare has assisted with the creation of new agencies of this kind. The creation of a business support centre network could be the beginning of such an approach. The lack, in most countries, of a specifically designed legal framework for the creation of regional development agencies has meant that Phare has drawn upon wide western European experience to support the creation of legal organisations that can meet the demands of the communities in which they are based.

Phare is also encouraging the linking of SME and regional development activity to the restructuring of communities where economic activity has been dominated by a single large enterprise.

Financial areas of activity

The difficulties encountered by SMEs in securing the finance they need to grow is a form of market failure, which Phare is addressing through a variety of financing instruments. These have been developed over time since Phare's inception, and increase the access of SMEs to the loans they need, by encouraging banks to lend to them on commercial terms. Such actions have a multiplier effect, by demonstrating to banks the commercial viability of such projects, and building up their skills in risk appraisal, etc. but also by reducing risk and thus acting as leverage on other financial resources, mainly from international financial institutions. Practically all the countries have received, or are about to receive, some support of this type. The total volume of operations approved, or about to be approved, is more than ECU 150 million with, in addition, transfer of the necessary know-how to individual banks at the point of delivery.

Phare has three specific objectives in this area of activity:

- mobilisation of finance for SMEs, either as a short-term measure to address market failure in the transitional environment, or as a longer-term lever of resources either from national or foreign sources, in particular in the form of micro-loan schemes, loan schemes and credit guarantee funds
- institution building, to create institutions which can serve the SME sector, such as small equity and seed-capital funds, or to improve those that exist but do not function properly at present (banks, in particular), where transfer of know-how alongside financial instruments helps them develop specific services for SMEs
- support to SME financing at regional level, to assist in the regional reconversion and regeneration process, in particular through regional investment funds.

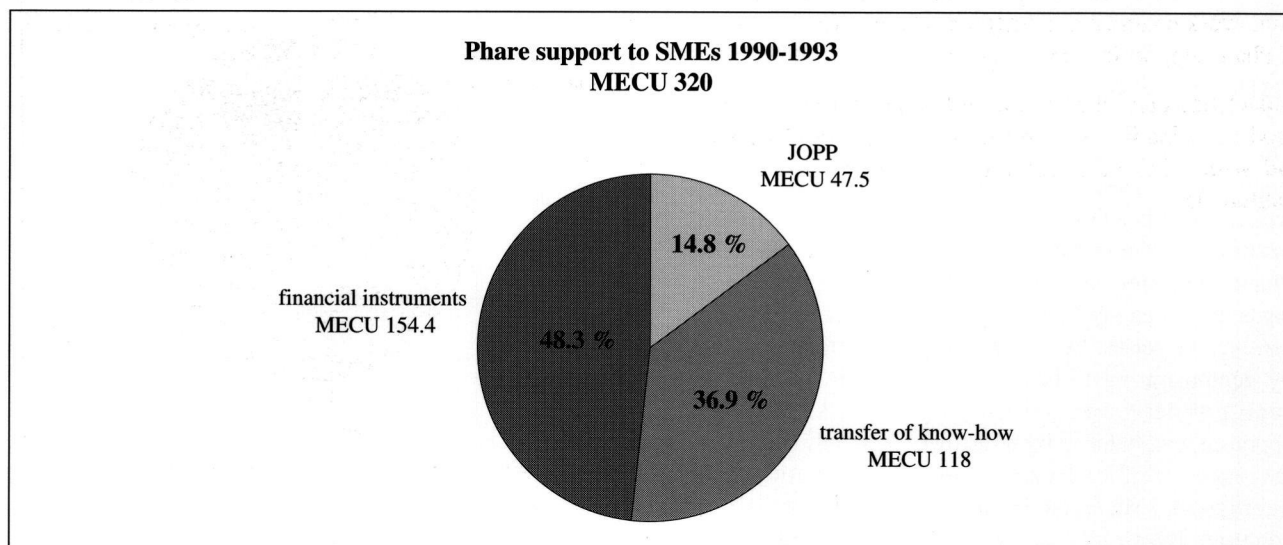
Commitments per country - areas of activity

Financial support must be supplied in combination with the relevant know-how in order to be of the greatest value to SMEs. Know-how must be transferred both to the local financial intermediaries charged with delivering finances to the SMEs, to allow them to perform in an appropriate manner, and to the SMEs themselves, through their assistance institutions in the form of counselling and training. Phare SME programmes therefore offer comprehensive packages of assistance, both technical and financial, to answer the needs outlined above.

The table on the following page summarises the amount of money allocated to each national SME programme and the areas of activity.

Country	Total MECU	Know-how ¹ MECU	Financial instruments MECU	Programme started
Estonia	3	2	1	January 1993
Latvia	3	2	1	January 1993
Lithuania	6	3	3	January 1993
Poland	91	33.7	57.3	January 1991
Czech Republic	35.5	13.5	22	January 1992
Slovak Republic	22	8.7	13.3	January 1992
Hungary	59	27.6	31.4	December 1990
Romania	10	7.6	2.4	February 1993
Bulgaria	25	6	19	September 1991
Slovenia	1	1	-	January 1993
Albania	6.5	2.4	4.1	January 1992
Total	262	107.5	154.5	
Programme preparation, monitoring and evaluation	5.5	5.5	-	-
EU organisations	5	5	-	
JOPP	47.5 ²	-	-	December 1991
Total	320	118	154.5	

48.3 per cent of Phare support to SME development between 1990 and 1993 has been committed to financial instruments, 36.9 per cent for transfer of know-how and 14.8 per cent for JOPP.



1 including training and policy support

2 JOPP is both a facility which finances feasibility studies and post-investment activities and also a financial instrument through equity participation in joint ventures.

Section 3 - Assessment

General assessment

The majority of actions undertaken have objectives which can only be fully delivered over the long-term, and their success cannot be properly assessed at so early a stage. It is, however, possible to measure concrete achievements of Phare in this sector, particularly in terms of specific inputs provided. The section below gives details of the measures taken by country and by area of activity.

A few remarks of a general nature are, however, pertinent. Impact has been greatest where Phare support has been able to respond to clear government policies as regards technical and financial support to SMEs and with a certain matching of Phare funds with local funds. Implementation of SME programmes has been further facilitated where a single and dedicated autonomous institution within the partner country has been made responsible for them in a transparent way and with the full assistance of the national authorities.

This is demonstrated most clearly in Hungary, the Czech and Slovak Republics, Estonia, Latvia, Lithuania and Albania. In these countries the authorities have adopted an integrated approach to the problems of both technical and financial needs of the SMEs. The new integrated approach in Poland with the STRUDER programme, for both regional and SME development, with both know-how transfer and financial support, promises to deliver similar benefits.

However, the failure to put in place an overall policy framework conducive to SMEs has hampered the impact of Phare support in some respects.

Impact has also been increased where there has been good coordination and co-financing, with local sources and with other bilateral and multilateral donors and institutions.

Achievements in non-financial areas of activity

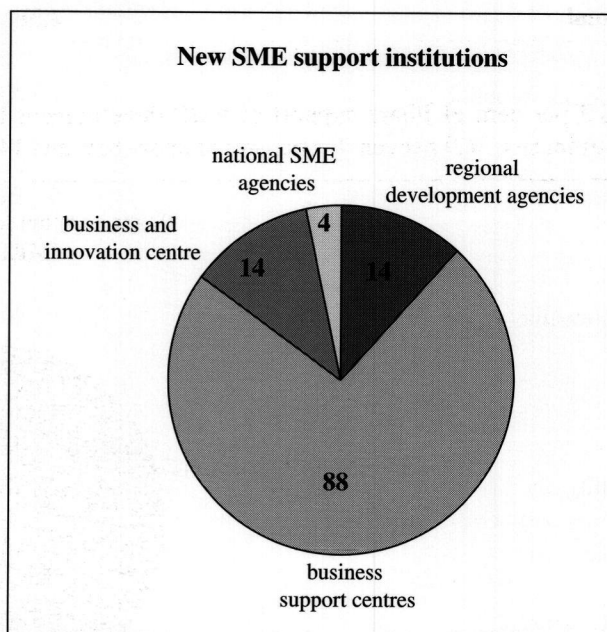
New SME support institutions

In total, 120 new SME support institutions have been set up with Phare support in the 11 Phare partner countries. A further 10 are planned in Estonia, Latvia, Lithuania, Bulgaria and Poland.

Of these institutions, 88 have taken the form of Business Support Centres, mainly to provide information, counselling and training, on business planning, marketing and accounting in particular. Fourteen have been set up as Business and Innovation Centres, including an incubator unit providing a work-space for new and innovative companies and aiming at helping innovative enterprises in the first place.

Six new multi-country Development Agencies have been set up and a further eight assisted with Phare support.

Finally, four national SME Agencies have been established in Hungary, the Slovak Republic, Albania and Romania.



The following table indicates the type and number of institutions set up in each Phare country.

Country	SME support institutions set-up
Latvia	3 Business Advisory Centres (BACs)
Lithuania	3 Business Advisory Centres (BACs)
Estonia	3 Business Advisory Centres (BACs)
Poland	16 Business Support Centres (BSCs) 7 Agencies for local initiatives 8 Regional Development Agencies (supported)
Hungary	1 National SME Agency (the HFEP-MVA) 16 Local Enterprise Agencies (LEAs) 2 Regional Development Agencies (being set-up) 1 Business and Innovation Centre (being set-up)
Czech Republic	19 Regional Advice and Information Centres (RAICs) 3 Business and Innovation Centres (BICs) 1 Regional Development Agency (RDA)
Slovak Republic	1 National SME Agency 9 Regional Advice and Information Centres (RAICs) 4 Business and Innovation Centres (BICs) 1 Regional Development Agency (RDA)
Romania	1 National SME Agency (CRIMM) 5 SME Development Centres (SMEDCs) 5 Business and Innovation Centres (BICs being set-up)
Bulgaria	2 Regional Development Agencies (RDAs)
Slovenia	1 Business and Innovation Centre (BIC)
Albania	1 National SME Agency 7 Regional Business Advisory Centres (RBAs)

The most structured approach has been applied in Hungary where 16 Local Enterprise Agencies have been established on a county basis. Hungary has 19 counties which have an average population of 500,000 inhabitants. The Local Enterprise Agencies have been given a very wide-reaching brief which includes coordination of other agencies acting at a local level. The individual LEAs operate differently according to the needs of their particular location, but all of them are now dealing with at least 300 enquiries per month, as well as dealing with the production of business plans, training new entrepreneurs and regional development issues. In addition, one BIC is being set up.

In the Czech and Slovak Republics a similar approach has been taken on a smaller scale, with 28 Regional Advice and Information Centres being established at a more local level, one per district of around 200,000 people. Since few other agencies exist, the RAICs have to operate on a self-sufficient basis. Each centre is now typically receiving 150 enquiries per month. To complement the basic advice being given by the RAICs, seven Business and Innovation Centres have been established. These BICs have been set up on the model developed in the framework of European Union regional policy and give intensive help to innovative businesses as well as running "incubator units" for a number of small businesses located together.

In Poland, organisations and infrastructure are less well identified with the administrative boundaries and there is a wide variety of different institutions supporting small enterprise. As a result, the 16 Business Support Centres which have been established are of varying sizes and functions. They are in general located in existing institutions, mainly Chambers of Commerce.

In Albania, seven Regional Business Agencies have been established, covering the whole country. These agencies give a full range of services but are particularly oriented towards the production of business plans for the SME credit line which is also Phare-funded. Applicants for credit must first undertake a training course organised through the relevant RBA.

The programmes now being implemented in Estonia, Latvia and Lithuania have produced similar independent Business Advisory Centres which give basic advice and information to new entrepreneurs. These centres are particularly geared towards answering the training needs of enterprises.

In Romania the programme is promoting SME development through SME Development Centres at the Judet (district) level. These have been constituted in a

similar way to equivalent agencies established in other countries. In addition, five BICs are being set up.

Finally, in Slovenia, a network of different agencies supporting the SME sector was already in existence. Phare's main task will therefore be to help to coordinate and develop this network and to provide training for the people giving advice. One BIC is, however, being set up.

Multi-national development institutions

Fourteen Regional Development Agencies have been supported by Phare. Six have been set up with Phare support in Hungary, the Czech and Slovak Republics and Bulgaria, whereas eight existing RDAs in Poland are assisted under the STRUDER programme.

Such bodies will play an important role within the new integrated approach which aims to achieve SME development through comprehensive and coherent multi-national policies. This approach will be followed both in the less developed regions and in those where traditional industries will have to be restructured and reconverted.

National SME agencies

Drawing on the positive experience of the Hungarian Foundation for Enterprise Promotion, which acts as an independent foundation initiating, coordinating and implementing SME support projects, Phare has encouraged the use of this model elsewhere. To date, such agencies have been established with Phare support in the Slovak Republic, Romania and Albania. It is also planned to set them up in Poland and in the Czech Republic.

Experience has shown that agencies of this kind greatly facilitate programme implementation, not because they are centrally based organisations (indeed, the more decentralised the projects, the more successful they are) but because they channel the funds and coordinate the programme implementation with a high degree of autonomy, in a coherent and transparent way, and with a board representing both public and private interests.

Linkage of Phare countries with European networks

Phare has also assisted in establishing Euro-Info Correspondence Centres. These link up the central and eastern European countries to the European Union network of information centres for SMEs. Such centres have been or are being set up already in Poland, the Czech and Slovak Republics, Hungary, Bulgaria and Slovenia. A national network of EICs is now being

developed in these countries from the Correspondence Centres. Further centres are planned in the other countries. Similarly, partner countries will be connected to the Business Cooperation Network.

SME policy framework

The European Commission, in its role as coordinator for the aid provided by the 24 most industrialised countries (G 24), was instrumental in forming the SME Task Force in Poland. This created a forum for discussing SME policy issues, and eventually produced the first comprehensive survey on the SME sector with concrete recommendations for an SME policy framework.

Otherwise, however, a coherent and effective SME policy is still lacking in most central and eastern European countries. Phare has not yet achieved its objectives in this respect and the bulk of the work is still ahead.

Support to existing institutions

In some of the partner countries, support has been provided to existing SME institutions, such as chambers of commerce and associations of employers. Phare has assisted in the reorganisation which was often required to enable them to respond to the needs of their members in the new environment.

One of the core components of the SME programme in Poland, in particular, is to give support to the local chambers of commerce and industry to better serve their members. Support is also being given to chambers of commerce in Hungary and the Czech and Slovak Republics. In addition, specific export promotion programmes, aimed primarily at facilitating SME development, are being set up in Poland and Romania, using the chambers of commerce network.

Moreover, training has been provided for staff from chambers of commerce in the central and eastern European countries within the European Union Chambers of Commerce. This programme (MERCURE EAST) is delivered through Eurochambers but is funded by Phare. Eurochambers has also organised workshops in the partner countries to assist the national chambers of commerce in their reorganisation process. Similar projects are being implemented by UAPME for associations of SMEs and the craft industries in the central and eastern European countries.

Other achievements

Self-sustainability

For some of these new SME support institutions this has still to be proved, since the revenues from their services still represent, at this stage, a minor part of their initial and running costs.

Hungary and the Czech Republic are more advanced in this respect. Their best-performing LEAs and RAICs raise more than 30 per cent of their funding from sources outside Phare, notably from the selling of their services.

Development of independent institutions

In countries where all institutions were previously controlled by the state, the development of new genuinely independent foundations which coordinate public and private interest, at the national or local level, is an achievement in itself. This is one of the main objectives of the Phare SME programme, and ties in with wider objectives of the Phare programme as a whole.

Development of a market-oriented way of thinking

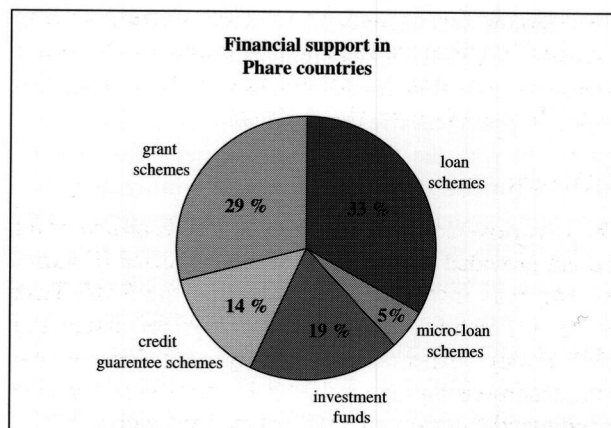
It is difficult to measure progress in this direction, but the way the SME programmes have been implemented has helped develop a market-oriented philosophy. For example, when setting-up LEAs in Hungary or Euro-Info Centres, Phare has followed European Union commercial practice by inviting expressions of interest or tenders locally. Know-how has thus not just been granted, but rather auctioned to stimulate competition, good business planning and fund matching among the potential partners.

This approach has led to criticisms from those institutions which had simply expected Phare to provide money with which they could acquire computers or improve their image. Wherever it has been used, mainly in Hungary, Poland, the Czech and Slovak Republics, it has however proved to be the best way of assuring strong commitment and transparency.

Achievements in financial areas of activity

In total, Phare has provided ECU 154.5 million of financial support to SMEs in the central and eastern European countries between 1990 and 1993, excluding the ECU 47.5 million JOPP facility, of which

- 33 per cent was made available for loan schemes
- 29 per cent for grant schemes
- 19 per cent for investment funds
- 14 per cent for credit guarantee schemes
- 5 per cent for micro-loan schemes.



The following table gives the types of financial instruments set up with Phare funding in the different beneficiary countries. The date indicates when the scheme became operational.

Country	Micro-loan and loan schemes	Credit guarantee Schemes	Grant schemes	Investment funds
Latvia	MECU 1 loan scheme September 1993 50 per cent disbursed 13 loans			
Lithuania	MECU 3 loan scheme July 1993 50 per cent disbursed 32 loans			
Estonia	MECU 1 loan scheme June 1993 Fully disbursed 15 loans			
Poland	MECU 2.3 loan scheme Disbursed 43 loans	MECU 7 Operational Autumn 1994	MECU 43 STRUDER grant scheme May 1994	MECU 2 equity with EIB, no progress made MECU 3 fund, to be set up
Czech Republic	MECU 8.5 small loan scheme February 1993 MECU 3 disbursed 333 loans made	MECU 4.5 scheme October 1992 76 guarantees of MECU 3.34		MECU 8 regional fund (Ostrava) March 1994 MECU 1 seed fund being set up
Slovak Republic	MECU 4.35 small loan scheme October 1993 No progress	MECU 3 scheme October 1992 26 guarantees of MECU 1.6		MECU 4 regional fund (Zillina) April 1994 MECU 1.9 seed fund being set up
Hungary	MECU 17.1 loan scheme September 1992 - 458 loans MECU 5.9 disbursed MECU 1.3 interest repayment scheme to be set up MECU 7 micro-loan scheme September 1992 - 1,285 loan MECU 2.7 disbursed	MECU 4 discontinued after setting up of national scheme		MECU 2 equity scheme being set up
Romania			MECU 2.4 micro-grant scheme December 1993 50 grants approved	
Bulgaria	MECU 9 loan scheme set up March 1994	MECU 3 scheme to be set up		MECU 5 for two funds, to be set up MECU 2 equity fund to be set up
Albania	MECU 1.1 micro-loan scheme June 1992 - 150 loans Fully disbursed MECU 3 loan scheme being set up			

Phare funds financial schemes as two-stage operations in that funds are provided as grants to the partner country, which in turn then provides the funds to selected financial intermediaries to be disbursed to SMEs. An agreement with the financial intermediary specifies the target groups, the disbursement conditions, the monitoring system, etc. as well as whether repayments by the SMEs will go back to a central state fund for operations to be defined, or will be "revolved" (i.e. used by the intermediary for similar operations under the same conditions). Such schemes are accompanied by transfer of relevant know-how to the financial intermediaries which are being used to disburse financial support to the SMEs.

Obviously it takes time to select appropriate financial intermediaries, to negotiate the disbursement conditions with them and with the central financial institutions and to train the financial intermediaries' staff. All this is necessary to make the schemes fully operational and to make the SMEs aware of them.

The majority of Phare funds for financial schemes were made available at the end of 1992 and in 1993. Therefore, most of these schemes are still in the preparation phase, in particular STRUDER and the investment funds.

However, loan schemes in eight countries and guarantee schemes in two have been operational for more than one year. Given that the investment operations can only be assessed in the medium term, the majority of these instruments have not been running long enough for any real analysis of their impact to be possible. Some initial indications, including rates of disbursements, can nevertheless be given and are found below.

Micro-loan and loan schemes

Under the two micro-loan schemes operational in Hungary and Albania and the loan schemes in Estonia, Latvia and Lithuania, Poland, Hungary and the Czech Republic, 2,329 loans have been made between September 1992 and December 1993, totalling ECU 20 million.

Micro-credit schemes

These are schemes for lending small amounts of money (ECU 5,000 maximum in Hungary and ECU 10,000 in Albania) to start-up entrepreneurs, who lack capital and track records.

Although it is technically possible to disburse micro-credits through the banking system, banks generally show little interest in lending to start-ups or in

appraising some projects. As a result, the micro-credits have, in practice, to be disbursed in association with other services to entrepreneurs, including business-planning, advice and training. For example, in Hungary the micro-credit scheme is managed jointly by the Local Enterprise Agencies and the local banks with the project appraisal and decisions carried out jointly and the banks delivering the credit and monitoring the performance. In Albania, the initial scheme went outside the banking system, with the Regional Business Agencies helping entrepreneurs to prepare their business plans.

The Hungarian micro-loan scheme is very successful with 1,285 loans approved for a total of ECU 3.54 million. The Albanian micro-loan scheme has provided 150 loans, totalling ECU 1.1 million, fully disbursed already.

Credit schemes

Such credit is used to target SMEs and is typically for amounts less than ECU 100,000. These are smaller amounts than are normally dealt with by the international financial institutions. In general the funds are "revolved", in that the repayments made to the banks are lent again to SMEs.

Such credit lines have an impact far in excess of the benefit to individual enterprises who receive finance, though this too is important. They also give banks more experience in dealing with finance to the private sector on normal commercial terms, particularly with regard to longer-term finance. In general, the banks are obliged to put some proportion of their own resources alongside the funds from Phare or to share the risks. It is hoped that in due course the Phare funds will also lever money from other sources.

The terms of the loans are typically slightly different from those normally given by the banks and are worked out on an individual basis, thus using in full the know-how provided by Phare alongside the financial assistance. This may mean easier interest rates, or better repayment terms, grace periods or collateral, etc. For example, in Hungary the loans have an interest rate less than the norm, but the banks are restricted in the amount of collateral they can take and are therefore obliged to perform better appraisal on projects.

In Estonia, Latvia and Lithuania, ECU 5 million have been made available for loan schemes fully operational since June-September 1993. Sixty loans have been made already, totalling ECU 3 million. All three credit lines are foreign currency medium-term loans on normal commercial terms. They are designed to provide SME medium-term financing, and to give selected banks the

experience of this type of lending and the opportunity to develop their services to SMEs.

The initial ECU 19 million credit line in Poland experienced considerable operational problems. The extreme economic difficulties in the regions selected made it harder to find suitable disbursement channels for small operations. It also transpired that the Polish

banking system was particularly averse to SMEs. Moreover, the margin offered to the banks was relatively low. Forty-three loans were approved, totalling ECU 2.3 million, all to manufacturing projects. The scheme has now been discontinued and the balance reallocated to the STRUDER programme.

Micro-loan and loan schemes

Country	Scheme (MECU)	Maximum loan (ECU)	Term	Interest Rate	Number of loans	Average size (ECU)	Amount disbursed (MECU)	Sectors
Hungary	7 micro-loan scheme	3,000 raised to 5,000	up to 3 years	NBR	1,285	2,760	3.54	industry 18 % services 32 % agri-bus 21 % trade/tourism 24 %
	17.1 loan scheme	30,000	2-7 years	NBR + 2 %	458	13,500	6.2	industry 25 % commerce 35 % services 22 %
Czech Republic	8.5 loan scheme	30,000	up to 3 years	NBR + 2 %	333	9,000	3	engineering/ construction 23 % industry 24 % services/trading 24 %
Albania	1.1 micro-loan scheme	10,000	up to 3 years	17 %	150	7,300	1.1	industry 34 % bakeries 22 % transport 21 % services 23 %
Poland	19 loan scheme	250,000	up to 7 years	Libor ECU + 3-5 %	43	53,500	2.3	industry 100 %
Lithuania	3 loan scheme	50,000	3-7 years	12 % DEM	32	42,000	1.4	industry 56 % agro-industry 13 % services 31 %
Latvia	1 loan scheme	50,000	3-7 years	12 % DEM	13	40,000	0.5	industry 88 % services 12 %
Estonia	1 loan scheme	50-100,000 depending on the banktrade	3-7 years	12 % ECU	15	66,700	1.0	industry 50 % services 25 % trade 15 % agro-industry 10 %

In the Czech Republic, the ECU 8.5 million loan scheme has been operational since February 1993 through Banka Bohemia which shares the risk of up to 20 per cent. A second loan agreement was signed with Agrobanka in March 1994, with a 40 per cent risk-sharing by the bank. Three hundred and thirty-three loans have been approved, out of 621 applications, totalling ECU 3 million already disbursed.

The ECU 17.1 million SME loans scheme in Hungary, operational since September 1992, is also performing well in terms of disbursement, with 458 loans provided, a total of ECU 6.2 million. A key feature of the scheme is that Phare funds are matched with funds from the participating commercial banks (35 per cent), the National Bank (15 per cent) and the State budget through the Hungarian Foundation for Enterprise Promotion (25 per cent).

Credit guarantee schemes

Credit guarantee schemes are designed to address the problems of entrepreneurs who lack appropriate collateral. Of the two types - mutual guarantee funds and national schemes - only the latter has already been set up with Phare support in the Czech and Slovak Republics. More schemes are being set up in Poland and Bulgaria. The Phare Guarantee Scheme in Hungary was discontinued after the Hungarian authorities established a national guarantee fund.

Under a scheme of this kind, the entrepreneur typically pays a fee for the guarantee and still has to put up some form of collateral, which is divided between the bank and the scheme if the loan is not repaid. Such schemes are an efficient way of supporting enterprises when the banking system already assists SMEs and lack of collateral is the major constraint. Since there are other problems related to banks in Central Europe, guarantee funds have had mixed success so far.

In the Slovak Republic, the ECU 2 million Loan Guarantee Scheme operational since October 1992 is moving slowly due to bank liquidity problems. Twenty-six guarantees have been approved resulting in a total value of approvals of ECU 1 million. The scheme shares the risk (up to 70 per cent) on loans by Slovak commercial banks to SMEs. The maximum credit guaranteed is ECU 25,000 for five years. The Slovak Guarantee Bank, which manages the scheme, matches Phare funds with an equivalent amount. A similar ECU 1 million scheme for small loan guarantees has shown no progress so far.

Conversely, the ECU 4.5 million Guarantee Scheme in the Czech Republic has shown considerable activity with 76 guarantees provided, with a value of approvals of ECU 3.34 million.

The scheme shares 75 per cent of the risk on loans by Czech commercial banks, with a maximum credit guarantee of ECU 110,000 for seven years. It is managed by the Czech Moravian Guarantee Bank, which matches Phare funds with an equivalent contribution. The sectors benefiting from the guarantees have been manufacturing (35 per cent), wholesale and retail activities (39 per cent) and food processing (11 per cent).

Grant schemes

Grant schemes have been an accepted way in western Europe for government to target aid to small enterprises or to particular regions and sectors. Any such grant scheme should have very clear eligibility criteria and carefully established administrative procedures to avoid corruption.

While particularly useful when linked to initiatives to promote efficiency, growth or to remedy environmental issues, grant schemes are potentially very important instruments to increase the amount of equity in unincorporated SMEs where it would be impossible to take equity directly. Since SMEs in the central and eastern European countries are normally extremely small in comparison with western Europe, such schemes may have proportionally more effect in the current transitional environment.

By far the biggest grant scheme, ECU 43 million, is part of the STRUDER programme in Poland, where grants are given against loans from accredited banks in a semi-automatic way. Eligible enterprises from the selected regions which obtain a loan from a bank will be given a grant of up to 25 per cent of the investment project with a maximum grant of ECU 100,000, provided the entrepreneur contributes with at least 20 per cent of his own resources and the bank provides the balance (up to 55 per cent) through this loan. The STRUDER Grant Scheme is expected to be operational in Autumn 1994 in five regions through eight accredited banks.

In Romania, a ECU 2.4 million micro-grant scheme has been operational since December 1993, with a maximum grant of ECU 50,000. Beneficiaries must be registered private enterprises with up to 100 employees, maximum capital of ECU 2 million and turnover of ECU 5 million. Project appraisal is performed and the grant decision taken by a committee

of the SME Agency (CRIMM), including a bank representative. Grants are paid against invoices to the equipment supplier. Fifty grants have already been approved.

Investment funds

Lack of equity is identified as a major constraint in many surveys. As in western Europe, an important reason for failure of SMEs is over-reliance on debt-financing. In addition, a number of new SMEs in central and eastern European countries, which result from small-scale privatisation through management buy-outs in particular, have extreme difficulties in obtaining bank loans due to their under-capitalisation.

To address this problem, small investment funds are used, mainly to provide equity to SMEs. Again, Phare does not invest directly, but provides the funds under a two-stage procedure via the partner country to national financial institutions. Provision has to be made under the scheme for disposal of any investments by the institution using Phare funds, after an agreed period, and for repayment to the government.

A key difference between such a scheme and credit facilities is that finding a suitable organisational structure and a clear direction has not proved so simple. The non-performance of a ECU 2 million equity scheme in Poland, designed to provide complementary support to EIB loans by a Polish bank, reveals that banks are not very interested in equity lending. The experience of other donors tends to indicate that the setting-up of specific investment funds is the best way to solve this problem.

Two Regional Investment Funds have now been set up in Ostrava (the Czech Republic) and in Zilina (Slovak Republic) with ECU 8 million and ECU 4 million. Two Regional Investment Companies have been established, with daily management carried out by a Foreign Venture Capital manager for two years, who puts forward investment proposals to a Board of Directors composed of local bodies' representatives.

Enterprises to be assisted are start-ups, existing SMEs planning to expand, management buy-outs and joint ventures with foreign partners. The RIC will provide equity or subordinated loans wherever possible as a minority shareholder and will divest after five to seven years. These two funds, set up in collaboration with the EBRD, are expected to be fully operational from May 1994.

Similar funds are being set up in Poland and Bulgaria. Two seed-capital funds, to provide early financing to start-ups, are also being set up in the Czech and Slovak Republics and the possibility is being considered in other countries.

Key conditions for success

Policy and commitments from national sources

As outlined above, a key condition for the success of any SME programme is the adoption by the country concerned of a clear and coherent policy for SME assistance, so that both technical and financial support can be provided in a comprehensive and complementary way, thus avoiding one-off projects with a more limited impact.

Most countries have now realised how important this is and, as a result, have adopted a more integrated approach for helping SMEs. Phare has played an essential role, by providing technical and financial support in a flexible manner, through large medium-term commitments.

Commitments from national sources, alongside Phare funding, are clearly another key condition for success. These can be made by the state budget, the local authorities or the financial institutions which participate in financial instruments. This co-financing with national sources is essential, not just to bring greater sustainability of projects, but also to ensure a stronger commitment from the parties involved, also reducing the risks of programmes being "foreign-driven" ones.

Much has been achieved in this respect, after a somewhat difficult start in certain countries due to a shortage of local funding and in the absence of any concrete examples to demonstrate what could be achieved. This can be seen in Hungary where extensions were made to the initial Local Enterprise Agencies funded by local councils and LEA foundations set up in other countries without any external financing. In addition, the state budget is also contributing to the know-how programme component, through the Hungarian Foundation for Enterprise Promotion.

Similarly, state and local funding is now provided alongside Phare funding in the Slovak Republic, the Czech Republic, Poland and Romania. In the Slovak Republic and Romania, in particular, the state budget contributes substantially to the activities of the national SME agencies.

Co-financing and risk-sharing of financial instruments by the participating financial intermediaries in the country is even more important than transfer of know-how, since it is ultimately the only way to ensure that the financial intermediaries are not just channels for Phare funds and that they will do their utmost to develop SME services.

Hungary is the most advanced in this respect for both the

loan and micro-loan schemes. In the loan scheme, the principal of the loan is made up of contributions from the commercial banks (35 per cent), National Bank of Hungary (15 per cent), HFEP (25 per cent) and from Phare (25 per cent). It should be underlined that the initial Phare contribution in 1992 was 50 per cent. Under the micro-loan scheme, Phare funds are also matched by a state contribution.

In the Czech and Slovak Republics, the state budget also contributes to the Phare-financed credit guarantee schemes with an equivalent amount. In addition, the Phare small loan scheme in the Czech Republic, where the participating banks share the risks, is complementary to the national interest subsidy scheme which tends to help medium to large-sized companies. In Albania, the Savings Bank will now share the risks in the new small loan scheme that is being established. In Poland, the complementarity between Phare grants and bank loans is clearly one of the key features of the STRUDER programme.

Donor programme coordination and co-financing

Programme coordination by different donors is important to increase synergy between their various programmes, improve utilisation of resources and avoid duplication and overlapping. Often donors also offer different abilities and areas of comparative advantage and it is axiomatic that the benefit which can be derived from the overall international aid effort will be maximised if they each focus on what they do best.

This is of particular interest in the field of SME support institutions, where a number of initiatives under bilateral support programmes have been "opened up" by Phare. In Hungary, the LEA programme has received considerable assistance from bilateral donors, with 13 of the G 24 members (five of them non-European Union members) providing support to agencies. This has led ultimately to twinning between LEAs and similar institutions within European Union Member States, which has helped foster direct partnership and cooperation.

The same has been achieved with some Business Support Centres in Poland, in particular between Lodz and Lyon, and between BICs and RDAs in the Czech and Slovak Republics and in the European Union. Training is another area where operations have been co-financed, for instance USAID's Peace Corps assistance. Also, in Poland Phare has taken the lead in a G 24 Task Force to prepare a major survey on SMEs including concrete recommendations for promoting this sector. A similar structured approach has been followed with the World Bank, notably in Poland and Bulgaria.

Projects are being co-financed with UNIDO in Slovak Republic and the UNDP in Albania and Romania.

As regards financial support, it is clear that there is a strong complementarity between financial schemes established by the EIB, the EBRD and Phare. Phare instruments primarily target start-ups and small enterprises, whereas the international financial institutions tend to lend more to medium and large-sized companies.

A structured approach is also being followed with the EBRD, which provides know-how to Phare for setting up investment funds, as in Ostrava and Zillina. It is possible that the EBRD will also contribute to the capital in the future.

Training

Training has been a key component in all the activities described above and a prerequisite for their success. Training packages have been provided at all levels for staff and trainers of agencies and SME support institutions, for SME managers through training projects developed by the agencies and support institutions, as well as for local consultants so as to promote the skills base in the central and eastern European countries.

In addition, specific training is being provided through professional organisations from the European Union for SME managers in the central and eastern European countries. This comprises the Industrial Training Attachment Programme, organised by Eurochambers, and direct assistance from retired executives via the European Senior Service Consortium.

As regards financial support, it is clear that no financial scheme can become operational and be successful unless accompanied by support for strengthening the institution, notably with substantial training. This is particularly relevant for the new institutions being set up, such as investment and guarantee funds. It is, however, also essential in the case of credit schemes, because the banking sector in the central and eastern European countries sees SME lending as very high-risk. This perception means that, without training, banks would be unlikely to build up such experience except in the medium to long-term.

Extensive training on loan appraisal and credit and portfolio management has therefore been provided for the staff of the local branches of the participating banks. In addition, training programmes on SME credit are now being developed on a much broader scale in the Czech Republic (ECU 1.5 million) and in the Slovak Republic (ECU 1 million), under Phare's banking sector

programmes in those countries. Training is thus not just a means to facilitate implementation of financial schemes, but rather an integral part of such schemes. By providing the banks with first-hand experience of lending to SMEs, it helps to change attitudes and ultimately to increase lending to such enterprises.

Section 4 - Current constraints and orientations for future support

Government commitment and policy

The need for an SME policy

As indicated above, the lack of a conducive and comprehensive SME policy in most countries is hampering the long-term growth of the small-business sector.

SME policy-making has proved almost impossible to set up at the institutional level. Since SME policy is a novel concept and there may be no logical place for it in the existing governmental structures, it may well be appropriate to develop further activities of a similar kind to the SME Task Force in Poland. This could stimulate a more public debate, leading in particular to the recognition of the role of SMEs in economic reform and growth.

All the governments are coming to realise that it is an important issue and that the private sector will not necessarily take care of itself, as can be seen by the continued lack of an enterprise culture in many areas of life. Support for small and medium-sized private enterprises, which currently exist to a relatively limited degree, but will probably develop very much as privatisation moves ahead, needs to be kept on the political agenda.

Phare and the Europe Agreements

SME policy is therefore an essential area for future transfer of know-how by Phare, even if insufficient progress has been made so far. It is even more important in the context of the Europe Agreements signed by the European Union with Poland, Hungary, the Czech and Slovak Republics, Romania and Bulgaria. These agreements stipulate that:

- the parties shall aim to develop and strengthen SMEs and cooperation between SMEs
- they shall encourage the exchange of information and know-how in improving, where appropriate, the legal, administrative, technical, tax and financial conditions necessary for the development and expansion of SMEs.

Multi-national policy and priorities

While a national policy is a key condition for the development of this sector, it must also incorporate regional priorities if the problems faced by disadvantaged regions are to be adequately tackled and their economic reconversion facilitated. SME promotion and development is an important element in regional economic development but is only one of several. An integrated multi-national development strategy must also tackle, or at least take notice of, zonal and community issues arising from changes in employment patterns as well as infrastructure development. The governments should therefore adopt more pro-active regional policies and target particular regions where future Phare support could concentrate its efforts and funding.

In so doing, it must be recognised that other Phare programmes at national level such as trade and investment promotion, tourism, agriculture and telecommunications frequently have regional variations and implications. As regional development institutions are created and grow, and as a means of strengthening such agencies, ways of integrating aspects of these national programmes into multi-national initiatives should be considered.

SME support institutions

Funding

Almost all the programmes have identified a need for local delivery of SME support services and developed a model whereby such services are provided by a foundation with both public and private membership and funding. This model should be developed further in the remaining countries and expanded in the others, in line also with the Europe Agreements which stipulate that the parties shall encourage the exchange of information and know-how in the provision of the specialised services required by SMEs (management training, accounting, marketing, quality control, etc.). Agencies providing such services should therefore be strengthened.

There is a great variety of approaches to support services between the different countries and each country has had to develop a detailed model applicable to its own problems. Clearly, it is important to adapt models developed within the European Union and not merely to copy them.

The funding of such organisations needs to be considered carefully. Although there are some moves towards self-sustainability in Hungary and the Czech and Slovak Republics, these are still not sufficient, whilst in other countries until there is significant public administration and budget reform there may not be enough public finance to keep the institutions going. There are obviously significant problems on the horizon arising from pressures for financial self-sustainability in the medium-term in an environment where there are few sources of public finance. These pressures are compounded where the government has failed to define an adequate SME policy framework.

Phare may therefore need to consider longer-term commitments to help SME support organisations if initial progress is not to be wasted, at least in certain countries and regions. Increasing commitments from national and local sources will be needed alongside. This is yet another argument for strong national and regional SME policies.

Coordination, co-financing and twinning

One of the ways in which this situation can be eased to a degree is through closer coordination with other programmes, in particular with labour market and regional development, as well as with other donors. Twinning with similar institutions in the European

Union would also be beneficial and this is in line with the Europe Agreements which encourage the establishment of appropriate links with EU operators with the aim of improving the flow of information to SMEs and promoting cross-border cooperation.

In this respect, European Union professional organisations should be encouraged to play a more important role in the future, as should the chambers of commerce and industry, at least in those partner countries where they are being reorganised and where specific action has been taken or is being considered to that end.

Continued lack of an enterprise culture

The readily apparent mushrooming of small traders should not mask the fact that there is a continuing lack of a real enterprise culture in most of Phare's partner countries. This relates to:

- the image that all enterprise is somehow speculation and therefore "dirty"
- the lack of adequately functioning and credible representative organisations for the sector. Those organisations which do exist are often carry-overs from the old regime (where membership was compulsory) and therefore have the wrong image, while the new organisations lack focus and are therefore unclear about whom they represent. Although support for such organisations has been written by Phare into a number of its programmes, the recipients are often unsure how best to use foreign aid. Progress in agreeing useful programmes has therefore been difficult
- the fact that the state-owned sector still dominates industry
- the notable reluctance of the financial institutions to respond to the real funding needs of SMEs.

This lack of enterprise culture reflects itself in a lack, in some areas, of sufficient local commitment to SME support institutions, which consequently have no real prospect of becoming self-sufficient outside Phare in the short-term, and in the difficulty of organising work with entrepreneurs' associations. Various types of centres to provide advice and support to entrepreneurs are found within chambers of commerce and elsewhere. This variety of models is no bad thing, but the problem of being under-resourced is common to almost all of them. Whether located in a chamber of commerce, in a regional development agency, a local enterprise agency or elsewhere, Phare programmes, national as well as

regional, could be used to encourage growth sufficient to reach a "critical mass". This would not only offer a wider range of stronger assistance than at present but would also offer greater opportunity for long-term sustainability.

As a consequence, it is clearly necessary to support more strongly entrepreneurship promotion, management training and institutional development of appropriate private sector organisations.

Institutional issues

Nonetheless, the work of such institutions should be integrated into the general approach of any programme, which can be best designed and implemented by an independent SME agency with both public and private sector membership which recognises the importance of local and regional delivery of sources and its implications for regional development. Indeed, the experience shows how important it is to have some clear SME-oriented institution not just to host any Programme Management Unit but also to ensure coherence and coordination.

This is also the best way, so far, to recruit, train and retain suitable counterparts to take over from external advisers after a period of time. In practice, this has been less successful and taken longer than expected when PMUs are located in governmental institutions. It may therefore be appropriate to make the establishment of such an agency a condition for future funding.

The banking system and financial instruments

Banks are a critical bottleneck

The main constraint in getting financial schemes mounted is finding appropriate institutions not just able to deliver them but also willing and committed to serve SMEs. Since the banks have no real experience of dealing with this sector and recognising the difficulty that banks everywhere in Europe have of seeing commercial advantages in positive assistance for the SME sector (other than normal banking services), Phare has an important role to play in institution building by providing know-how at the point of delivery, once motivated banks are identified.

The main lessons from Phare's experience so far are indeed that financial schemes are rarely successful unless there is a package of accompanying know-how. Banks must also share the risks, in particular by matching Phare funds with their own resources. Phare should therefore continue to endeavour to stimulate national resources, including banks' own resources, as much as possible.

Also, the different activities of Phare in the SME sector, including financial schemes, support to the banks and the various forms of business assistance centres, should continue to be packaged together for maximum effect.

However, preconditions for effective work in the financial support of SMEs include appropriate government policies, both to the SME sector and as regards general banking and economic issues. Phare obviously has a part to play in this respect, especially through an increased coordination between the SME programmes and the banking/financial sector reform programmes. Such support should in particular tackle the issues of appropriate collateral laws and central collateral registers, as well as leasing regulations.

Types of financial instruments

In most countries the overwhelming demand is for medium and long-term credit, in particular for start-ups and small enterprises. All indications are that there is still an abundance of good projects which the financial sector is unable or unwilling to support. Phare should therefore continue assisting micro and small-loan schemes wherever the market does not answer the needs of the small entrepreneurs. Phare financial support should also continue to be provided alongside institutional development of the local financial institutions in an integrated manner.

There is clearly a great need also for credit guarantee schemes. Although the problem of entrepreneurs having too little collateral is identified as a constraint on the growth of SMEs, the simplistic approach of having a national credit guarantee scheme is not necessarily the best one in an environment where the banks do not already give services to the sector. The model of mutual guarantee schemes can be a very effective alternative, but requires an infrastructure of associations and a time scale which is often lacking. Nonetheless, as part of its objective of promoting pilot schemes, Phare has a role to play in promoting different guarantee schemes.

Capitalisation is another important problem, and thus there is a real need for equity schemes, but as yet there is little experience in this field. Phare's objective here can be seen in particular in terms of institution building, as in the Czech and Slovak republics with the setting up of two regional investment funds. Another method of overcoming the capitalisation problem is by providing grant supplements to commercial bank loans, as in the case of the STRUDER programme in Poland.

There is a need for clear analysis before such schemes are developed so that they can have the maximum impact. It should be noted however that the impact of any of these schemes is not immediate. Indeed, given that in many cases one of the key objectives of the financial instruments is institutional development, the design phase takes a great deal of time and so does disbursement. Another constraint comes from the public aid nature of Phare, which implies that its funds are subject to greater supervision, control and reporting. This is sometimes difficult to reconcile with the private sector approach. It also complicates co-financing operations with other institutions.

As the economy develops, there may well be less need for general interventions by Phare in the field of financial instruments, but such a stage is unlikely to be reached for several years in most countries. Even when the market distortions caused by the transitional environment have been removed, it should be noted that the European Union finances instruments within the Union related to multi-national policy and it may be possible that these models should be followed in the Phare countries at a later stage.

Complementarity and co-financing

Phare is in a unique position to absorb risk caused by the unusual conditions of the transitional environment in the recipient countries. This means that Phare can afford to produce financial instruments which would be too risky for the usual conditions of international financial institutions or would be operations too small for them.

The experience so far clearly indicates that Phare financial instruments have been fully complementary to those developed by the international financial institutions, in particular the EIB and the EBRD. These two institutions have targeted essentially medium to large-sized enterprises through global credit lines and large investment funds, while Phare has concentrated its operations on the small firms. Phare should obviously continue to work more and more closely with the international financial institutions in several ways: firstly, by ensuring their respective operations are complementary, in different target groups; secondly, by joint appraisal and assessment of institutions and combining Phare know-how transfer with the international financial institutions' financing operations; and thirdly, by joint financing operations, to answer on a larger scale the increasing needs of SMEs in central and eastern European countries.



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