Business Development Services
for SMEs:

Preliminary Guideline for
Donor-Funded Interventions

A report to the Donor Committee on Small Enterprise Development

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1. **Introduction**

1.1. **Background and objectives**

The development of small and medium-sized enterprises (SMEs) has long been regarded as crucial for the achievement of broader development objectives, including poverty alleviation, economic development and the promotion of more democratic and pluralist societies. Donor support for SME development interventions has increased substantially over recent decades and donor agencies have accumulated considerable experience in this field. However, recent years have seen major shifts in the approaches adopted.

Donors have supported SME development in a variety of ways. Since the early 1980s, support for financial services has received particular attention, reflecting the widespread agreement that real progress has been made in the design and delivery of financial services for SMEs. Support for the provision of business development services (BDS) to SMEs has also been popular with donors since the mid 1970s. However, during the 1970s and early 1980s, BDS interventions tended to be confined to training and technology and often involved donor and implementing agencies working directly with SMEs. The sustainability of interventions was not given priority, since subsidies were regarded as investments in the future, and little consideration was given to the questions of impact, effectiveness and efficiency.

During the 1980s, the range of services that were supported, in addition to credit, widened substantially to include counselling, the facilitation of market access, the development of networks and clustering, the provision of information in a variety of areas, such as equipment, technology and markets, as well as physical facilities and shared services. In particular, as methodologies for the delivery of financial services (savings and micro-credit facilities) to small enterprises have developed they have shown that services to the sector can be delivered in a sustainable manner. Donors, recipient countries and intermediary organizations have become increasingly concerned about the impact and cost-effectiveness of interventions and sustainability has become a major objective in terms of both cost recovery and institutional capacity at the country level. Beneficiaries have become clients willing to pay for the cost of the services provided.

In the early 1990s, big strides were made in turning experience from credit programmes for small businesses into a well-defined set of best practice principles that could be widely replicated, leading to improved levels of impact, sustainability and cost-effectiveness. In 1995, the Committee of Donor Agencies for Small Business Development published a good practice guideline on key principles in finance-based interventions.

Recent years have seen a similar effort to identify best practices in the area of non-financial services. However, these services are much broader in their range and more complex in terms of their contents and delivery. Guidelines for BDS interventions comparable to those for financial services have not yet been developed.

The field of BDS delivery continues to change rapidly as methodologies for defining and delivering services become more sophisticated and more rooted in the commercial, day-to-day realities of small businesses. This guideline is designed to contribute to the development of principles for best practice in BDS delivery by providing a ‘snapshot’ of the current state of the art and identifying the most important gaps in current knowledge.
1.2. Definitions
In this guideline, the term business development services (BDS) refers to a range of donor-supported non-financial services provided to SMEs at various stages of development (including before start-up). These services may include, for example, training, counselling and advice, information provision, technology development and transfer and business linkages. BDS are aimed at assisting SMEs to overcome internal and external constraints on their development and thus improve their performance. The guideline does not contain any analysis of BDS interventions concerned with physical infrastructure development.

There is no definition of SMEs which commands universal agreement and it is certainly not the intention of this guideline to add another definition to an already considerable list. The following is the Donor Committee’s own broad definition:

‘The term small (enterprise) has never been explicitly defined. The Committee considers this term to include formal and informal non-agricultural enterprises ranging from micro to medium size’.

1.3. The importance of SME development
Donors support the development of SMEs for five main sets of reasons:
1. Their importance for the promotion of national and regional economic development. SMEs provide a means of mobilizing the resources of a country and strengthening its capacity strengthened to generate employment and wealth for the general benefit of regional and national economies.

2. Their role in alleviating poverty and assisting those who are disadvantaged. For many donors, poverty alleviation and a more equitable distribution of income (and opportunities) are key objectives. SME development programmes can focus on empowering specific groups of people, such as women or those on the margins of society.

3. Their importance in the transition to a market economy. SME development can perform an important role in the overall development of the private sector, including the promotion of privatization.

4. Their role in promoting democracy and a civil society. SME development can assist in the development of the private sector and of institutions which promote participation by entrepreneurs in the economic, political and social systems of a country.

5. Their role in promoting a more flexible, innovative and competitive economic structure. SMEs, in some sectors, have considerable comparative advantages over larger enterprises which enable them to respond more quickly and effectively to changing and increasingly global trends.

The perceived importance of SME development in supporting the above development objectives is manifested in increased donor commitments. While there is no comprehensive collation of statistics on donor resources devoted to SME development, a few examples illustrate a clear overall trend.
• Annual IDB disbursements to the microenterprise sector averaged annually $8.2m in the period 1978-89, $63m in 1990-96 and are planned to be $100m in 1997-2001.
• ODA support for SME development in Africa rose from £0.3m in 1992-93 to £10.1m in 1996-97.
• SDC figures show that the proportion of total SDC disbursements for crafts and industry promotion has increased slightly from 8.2% in 1982-85 to 9.5% in 1992-95.
• GTZ's small enterprise portfolio increased from 26.9 DM to 58.2 DM between 1990 and 1993.

The conclusion from all of the above is clear: the importance of SME development to donors is growing.

1.4. Guideline structure
As in any SME development intervention, the starting point for this guideline is the needs and perceptions of SMEs themselves. Section 2 examines the different types of constraint commonly faced by SMEs in different situations. It also develops some basic principles on how needs assessments should be carried out and offers a brief summary of some approaches to SME analysis which are gaining currency.

Section 3 address the issue of what is meant by good practice in SME development and how this can be measured. Good practice refers to how BDS interventions are undertaken, but what ultimately matters is the outcome of these interventions. Particular criteria of performance and specific indicators associated with these are examined and some key principles of evaluation are presented.

Section 4 breaks down the broad heading of BDS into specific instruments of intervention. The term ‘instruments’ means the specific ‘activities’ undertaken or, following the business language increasingly favoured by BDS providers, their ‘products’. Instruments are assessed at three levels:
• the micro level (i.e. at the level of SMEs);
• the meso level (i.e. the level of intermediary BDS institutions); and
• at the macro level (i.e. the level of policy and regulation).

For each level, the guideline seeks to provide a detailed picture of current knowledge of good practice and specifies key lessons which emerge from donor experience to date.

Section 5 withdraws from the specific analysis of individual instruments and summarizes briefly the general principles of good practice in BDS. A matrix of instruments against principles is provided which offers a simplified summary view of where we are currently in BDS.

Section 6 presents a brief review of some of the key areas where there are significant gaps in understanding of good practice and where more work is required to advance current knowledge. This list may form the basis of a future action-research agenda.

A selected annotated bibliography is included at the end of the report. This is intended to act as a signpost for those interested in finding out more about different aspects of BDS. References are contained in the text to these documents, but there is no attempt to exhaustively list other references to support every assertion, as might be expected, for example, in an academic journal. The purpose here is to allow interested readers to pursue any of the many strands of analysis which pertain to good practice in BDS.
Throughout the document, examples (in boxes) of different BDS approaches or issues are given to illustrate particular points. Some of the cases highlighted have been made anonymous but all are real. **It should be emphasized that the boxed examples do not necessarily represent good practice.**

1.5. **Explanatory points**

From the outset, three points need to be borne in mind about the nature of this guideline.

First, BDS are inherently very diversified. SMEs are differentiated by numerous factors such as size, location, type of product or service, the education of owner-managers’, skill levels, wealth and networks, sector, customer base, investment levels and access to services. Their needs are inevitably varied and the range of BDS which have emerged to meet these are similarly broad. Moreover, donors may emphasize different objectives in their SME interventions, some giving greater weight to poverty alleviation than, for example, the development of a more pluralist society. This considerable differentiation in BDS means that it is unrealistic to expect a conveniently tight, standardized approach to their design and delivery. The analysis of best practice which follows here must be seen in the light of the intrinsic diversity of BDS.

Second, in comparison to financial services, which have been at the forefront of SME development in recent years, the donor community’s experience of BDS has been less exposed to systematic and detailed analysis. It is not therefore realistic to expect conclusive answers commanding broad consensus to the many challenges faced in BDS. On the contrary, we - the donor community - are following a clear learning curve.

Third, the guideline is largely the result of donors’ self-assessment of their experience, as revealed in discussions, questionnaires, project documents and policy statements. Although facilitated by external consultants, it is primarily a statement of the donor community’s own reflections on its experience.

1.6. **How to use this guideline**

The structure of the guideline - beginning with needs assessment and moving to the future agenda - aims to provide a complete view of all the main aspects of BDS good practice. However, each individual section is relatively self-contained and can be referred to without consultation with other sections.

The focus of the report is on how donors should intervene, rather than on the specifics of what they should do. In every section, there are principles of good practice to support donor programme officers in identifying, developing and managing BDS interventions. References provide guidance for those wishing to find out more on any of the key subject areas covered in brief throughout the report.
2. SME Needs

2.1. A logical starting place
The starting point in considering the design of any intervention to promote SME development is the assessment of the needs and perceptions of entrepreneurs. This is the right place to begin for two core reasons:

- **First**, at the heart of any intervention rationale is the need for a detailed understanding of SMEs and their situation. Donor-support for intervention in SME development is centred on a belief that the existing mixture of factors influencing SMEs can be changed positively to encourage improved performance. SMEs exist in a broad market environment in which demand for their products is influenced by numerous factors related to geography, consumer tastes, purchasing power, trade, the weather, politics and governance. These can be classified generally as *demand-side* factors.

- **SMEs**’ performance within their market is also affected by factors such as skills, networks, access to resources, physical infrastructure, information availability and government regulations and policies. These may be classified as *supply-side* factors.

- **Most interventions** are focused on improving the supply-side. Some; however, such as international trade agreements and alternative trade organizations, focus on changing the demand-side. Whatever the intervention, a prerequisite is a clear understanding of the situation of SMEs*.

- **Second**, there is now considerable agreement among agencies of the importance of operating in a *business-like* way (Gibb, Manu, 1990). The comparison of BDS providers and businesses is a theme explored in more detail in Sections 4 and 5. For now, it need only be acknowledged that, just as successful businesses must have a keen understanding of the needs of their customers so that they can respond to them appropriately, BDS organizations need to have the same understanding of the situation of their customers or clients, the SMEs with whom they are seeking to work, before they can develop their *offer* to them. This means that both SMEs and BDS organizations, analysing the needs of those with whom they are working is the best starting place for any intervention/product.

* In practice, of course, other donor interventions will also impact on this picture. For example, health, education and vocational training interventions will all also clearly influence the environment for SMEs. These are not the focus of this document.

2.2. What do we mean by ‘SME needs’?
SME needs have been subject to many different analyses. For example, Figure 2.1 categorizes needs into different supply and demand-side factors influencing the SME environment. The term ‘SME needs’ therefore refers to the specific problems/issues they face in seeking to develop their business. Needs change depending on the particular circumstances of a business. Typically, the pattern of needs varies according to factors such as sector, sex, location, size and stage of development. Needs are not static; they change throughout a business development cycle. The range of different possibilities here is vast and it is dangerous to try and over-generalize about the nature of these business’s needs. Indeed, good
practice in needs assessment encourages BDS organizations to be as precise as possible in their analysis of needs.

**Box 1: Two approaches to examining needs**

1. **The CARE Framework**
   This is based on a continuum of constraints (to development) covering internal (capacity), access (to services) and external (such as damaging policies or poor infrastructure) constraints. Along this continuum are placed more specific categories: poor management and technical skills, inadequate technology, disadvantageous market structures, inadequate infrastructure and government policies and regulations. By charting these constraints (or needs) against instruments of intervention it is possible to create a rough matrix showing what donor-supported interventions are doing and what problems they are trying to address.

2. **The MAIR Model**
   This approach (developed by Durham University Business School) views the process of business start-up and development as being iterative and having several stages: acquiring motivation, finding an idea, validating an idea and identifying resources. The key factors influencing an individual’s progress through this path are categorized under four headings:

   **Motivation:** reasons for going into business, degree of family support and evidence of serious preparation
   **Abilities:** previous working life, especially in small business, skills (technical, business, people) and character
   **Ideas:** the basic business idea, needs being met, potential customers, competitors, viability
   **Resources:** equipment, premises and finance

   BDS interventions to support business development can also be grouped under these headings.

Regrettably, there is no neat and precise universal model relating needs to particular stages or types of business, although there are some useful frameworks, such as those developed by CARE (McVay, 1996) and Durham University Business School (Gibb, 1988) (Box 1) which can be used in needs classification. Furthermore, there have been many specific studies on particular situations which illustrate the kind of priority given by SME owner-managers themselves to different felt needs (Box 2).

Discussions about SME needs are increasingly characterized by the use of different terms which sometimes serve to confuse more than to clarify. For example, *needs, problems, constraints* and *barriers* all essentially refer to the same factors which influence the performance of business. However, there is one specific set of jargon which does need to be clarified; this is the use of the terms *felt or perceived need objective, logical or real needs and demand.*

- **Felt/perceived needs:** these are what SMEs perceive and state to be their problems. It therefore reflects their own immediate analysis of their situation.
• **Objective/real/logical needs**: these are what BDS organizations believe to be the needs of SMEs. It reflects their analysis of SMEs’ situation.

• **Demand**: this implies a willingness to pay for a particular service offered by a BDS organization. It reflects not only SMEs’ analysis of their (felt) needs but also their willingness to pay for a service which will address this need (felt needs plus a willingness to pay).

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**Box 2 Prioritizing their own needs: examples of SME felt needs**

Increasingly, BDS organizations are seeking to base their intervention strategies, in the first instance, on a detailed analysis of SMEs’ felt needs. A number of examples show the kind of information which this type of analysis may generate. A 1995 study in Kenya found that entrepreneurs highlighted two main problems: finance and markets (K-Rep Research Paper No.26, *Employment and income in micro and small enterprises in Kenya*; Daniels, L., D. Mead and M. Musinga). In Zimbabwe, a similar survey found that the same issues - finance and market - were the main problems faced by SMEs (M. McPherson, *Micro and small-scale enterprises in Zimbabwe: Results of a country-wide survey*). In the Dominican Republic, in contrast, market saturation and other market-related issues were given as their most pressing problem by over 30% of entrepreneurs compared with 14% which cited finance (Pons, F.M. and Martina Ortiz, *Microempresas y Microempresarios*, 1993-94). A GEMINI study in Malawi found that credit was the key barrier facing SMEs, but also listed lack of access to raw materials as an important constraint (Silcox, S et al. *Strategic options paper for Malawi small enterprise support institutions*, USAID, 1994).

These studies offer a useful starting point in developing BDS for particular groups. However, in themselves, they are unlikely to provide sufficient in-depth analysis for the development of relevant tailored BDS.

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In many cases, these terms are used interchangeably without proper definition. Clearly, they are different. For donor agencies this poses a question: if it is accepted that interventions should be based around SME needs, to which needs should they be responding? Two points need to be made here:

In the main, BDS organizations should be developing services for which there is a demand from SMEs; i.e. that SMEs feel they need it and for which they are prepared to pay. There are an increasing number of examples of SMEs paying for services which they perceive will address a problem area and will bring recognizable benefits.

This priority towards being demand-led should not be regarded as a signal that SMEs’ objective needs cannot be the basis for interventions. It is clearly not the case that SMEs always know what it is in their interest. They do not have perfect knowledge of all the factors pertaining to their business, for example, marketing opportunities, business management practices or technology trends. However, interventions which are based on an external analysis of SMEs’ situation may well have to educate SMEs on the potential benefits of an intervention. Innovative interventions such as subsector analysis may be based on an idea emerging from outside SMEs’ own sphere of knowledge.
It is important that SME development interventions are clear about what is meant by SME needs. Most projects now at least claim to be based on needs; this is sometimes part of a virtual ritual of project designs. However, unless a specific definition is given for these ‘needs’, such a claim remains largely meaningless. There are many examples of project interventions which are supposedly based on the real needs of SMEs, but which are actually rather half-hearted attempts at justifying the intervention a BDS organization had in mind all along. Generalized needs assessments are seldom useful in developing project designs.

Box 3: Focusing on felt needs in Kenya

ApproTEC and SITE (Strengthening Informal Sector Training and Enterprise) are two Kenyan NGOs offering BDS to the informal sector. ApproTEC’s main intervention thrust is related to technology development and marketing through SMEs; SITE focused on training programmes for informal sector SMEs. The experience of both is that SMEs respond positively to training opportunities which meet an immediate, felt need. ApproTEC has found that SMEs will pay up to around $18-20 per day for training specifically related to technologies in which they have invested, covering all ApproTEC’s direct costs. In programmes which are more generic, cost recovery is lower. In a first wave of training programmes, SITE covered around one-third of direct costs from participants; having broken down initial resistance to the idea of paying for training, they aim to charge over 50% for programmes thereafter.

2.3. The process of needs assessment

In practice, the issues of what needs are identified is related closely to how needs are assessed and to the interventions that are developed thereafter, i.e. the process through which needs assessment takes place is linked directly to what needs are assessed. A number of specific needs assessment approaches have emerged in recent years. Underpinning these approaches appear to be five key ideas:

1. Being close to SMEs

Who undertakes needs assessments can be a crucial influence on the needs that are assessed. ‘Classic’ approaches by BDS organizations to identifying SME needs usually involve surveys and questionnaires, perhaps undertaken by young researchers or under the supervision of an academic institution. While these may have value in generating basic data on SMEs - size, location, nature of business, overall trends, etc. - they may be much less useful in gaining a real understanding of a business. This requires needs assessments to be undertaken by people with experience of SMEs and SME interventions, a ‘feel’ for business matters and who are comfortable in discussions with SME owner-managers. Ideally, these should be the same people who will be working in the intervention. In most situations, there will be a need to interpret actively the results of a needs assessment exercise.

Similarly, in many areas, the results of needs assessments have to be seen against a background of other aid activity. ‘Aid-swamped’ areas will have established precedents for intervention which may well influence the responses of potential SME clients, for example, by encouraging them to exaggerate a particular weakness in the hope that an intervention will be aimed at its solution. However, this problem is less acute for BDS than it is for finance-related interventions.
Box 4: A pointless SME needs assessment in Eastern Europe

A project in Eastern Europe decided to carry out a needs assessment before designing a programme to assist SMEs and contracted an academic institution to undertake a survey. This planned to cover most SMEs in the area, visiting them with a questionnaire. The type of information to be collected included questions on business type and size, current performance, future plans and what steps had been taken to realize them. The institution had never undertaken this kind of work before and took two months to do the work, twice the time originally envisaged. The data collected were of reasonable quality but, because the institution had been working through the local authorities, many SMEs had refused to cooperate, particularly unregistered enterprises which feared that they would be drawn into the tax net. This meant that the sample of SMEs covered was not representative and the needs assessment process had actually created considerable suspicion in the SME community.

The analysis served to confirm what project staff had already concluded following visits to commercial areas and informal discussions with business owners: there was little diversification, competition was high, markets were limited, yet most SME owner-managers said that they wanted credit to expand their present activity. The survey added nothing to what was already known; indeed it might have made things worse by alienating potential project clients. It was decided that in other areas, rather than a survey, needs would be assessed through focused discussions with groups of entrepreneurs. This would take one day and help to start the process of building client relationships.

2. Being participative

Participation is now accepted as a key principle of good practice in development interventions generally. Involving potential clients and other related parties in the process both of identifying needs and of designing interventions leads to better project design and a stronger sense of ownership over the whole development process. This is particularly important when considering the sustainability of interventions. Indeed, the most common donor approaches to project design - variations of the logical framework - now put as much emphasis on the process of intervention design as on the final design structure itself.

3. On-going learning and planning

Interventions which are seeking to operate in a genuinely demand-led manner do not see needs assessment as a one-off activity undertaken at the beginning of an intervention which is never to be repeated. On the contrary, just as SMEs themselves need to review their customers’ situation regularly and learn on a step-by-step basis, BDS organizations should review SME needs frequently and ‘learn-by-doing’. In practice, this means that the difference between needs assessments and programme evaluations will close significantly. Regular reviews of performance will double as an opportunity to assess future customer needs.

4. Developing a tight focus

A common problem with needs assessments is that they result in generalized statements of need. SMEs, for example, are said to need ‘management skills’, ‘access to markets’ or ‘technology assistance’. These kinds of conclusions are so vague as to be largely meaningless. Needs assessments should generate very specific information on the problems which SMEs face:
- what SMEs cannot do now that they should be able to do; and
- what prevents them acting as they want;
so that the design of interventions can be suitably precise.

5. Not just what they need, but how they need it

Needs assessments should not only identify SMEs’ situations but also provide an insight into
the way in which SMEs might need a suitable intervention to be delivered. For example,
many training programmes aimed at small-scale businesses are still offered during week-days
because that timing suits the BDS provider. However, it may be very inconvenient for the
SME owner-manager! Assessing issues such as how, when, where and in what format SMEs
want BDS organizations to deliver services is also part of a needs assessment exercise.
Many different techniques are used in needs assessment for SME development interventions.
Indeed, it is noticeable that many ‘standard’ development planning techniques, such as ZOPP
and logical framework analysis, used not just in SME development but in other sectors, lay
greater emphasis but on needs assessment than previously. Three techniques which in practice
may overlap which have become more popular in recent years are summarized below.

A. Subsector analysis

Subsector analysis has become more widely-used in recent years and is advocated by many
BDS organizations as an excellent starting analysis for any intervention. A subsector is a
vertically integrated group of enterprises (both large and small) which are concerned with the
same product group. This approach is built on the view that SMEs in the same subsector or
trade face constraints and issues which are common to them and distinctive from other
sectors. Interventions which are focused on overcoming these specific constraints are more
likely to have a significant effect than those which are more generic. Key manuals on the
subsector approach list a number of key steps (Lusby, 1995; Chen, 1996):
• Choice of subsector: is this a subsector in which large numbers of the intended target
group are concentrated? What is important, interesting or promising about the subsector?
• Introduction to subsector: what does your target group have to say about the operations,
technologies, participants and linkages within the sector?
• Subsector ‘map’: what are the main operations or functions, participants, technologies,
distribution or marketing systems, product flows, production relationships or other
important characteristics of the subsector?
• Working environment: how does the regulatory and institutional environment affect
enterprises in the subsector?
• Dynamics within the subsector: what are the driving forces within the subsector and how
do these interact? What are the constraints and opportunities with regard to market
demand, technological change, profitability of different niches, barriers to entry, input
supply, etc.? What are the common perceptions of constraints and do these reflect actual
constraints?
• Subsector strategies and points of leverage: what are the main interventions planned? What
interventions can influence large numbers of people? What types of institutional
infrastructure, services and skills are proposed?
• Subsector analysis can also be undertaken in a participatory manner which stresses a target
group’s own analysis and development of ideas for interventions rather than that of an
external catalyst.

B. Action Research
This is a flexible approach based around an action-reflection-action cycle which encourages learning by experiment in developing approaches for SME development, i.e. which encourages a rapid circular process of needs assessment, implementation and evaluation. There are a number of notable features of action research (Gagel, 1995):

- facilitated by an external person, it seeks to put user learning at the forefront of the intervention. As facilitators, external people should not impose their ideas on their partners in the action-research process.
- users have an opportunity to develop objectives, methods and implementation measures as ‘trial runs’ for cooperation between a group of SMEs and a BDS agency.
- since SME owner-managers themselves are more likely to be able to take account of the complexity of their situation, the solutions that they generate may be more sustainable.
- a number of donors are now using action research as a preliminary phase in interventions to test ideas and potential partners and, if found positive, to invest in a larger collaboration.
- action research seems to have been used particularly in working with associations of entrepreneurs.

In practice, the term action research is now used to cover any intervention which has an experimental component and which is seeking explicitly both to learn and to ‘do’.

**Box 5: Subsector analysis in the retaso industry, Philippines**

The key objectives of Save the Children Fund’s (SCF’s) initiative on microenterprise networks in the Philippines are to reach large numbers of low-income women, increase their profits (earnings) and exert influence on the policy environment. It also seeks to develop a self-sustaining programme. Subsector analysis has been a central feature of SCF’s pursuit of these objectives. SCF sought to identify industries which employed low-income women, exhibited growing demand and displayed potential for coalition building’ (i.e. linkages with government, other NGOs etc.). The retaso industry - fabric remnants of by-products from the garment industry - met all three criteria; it employs around 50,000 people in Metro Manila with average earnings well below the poverty line; demand is growing, especially from industries; and a network of NGOs already served the women. Subsector analysis revealed one key feature of the industry: the women usually had only one source of inputs and few institutional buyers. In particular, women were often ignorant of the product specifications of different industries. This constraint on development represented an opportunity for the project and became the key factor in shaping the design of the initiative: to allow women to buy in bulk (with appropriate scale economies) and to sell in volume to larger buyers. The project is still on-going but significant progress has been made in improving materials supply to entrepreneurs and access to institutional customers.

**C. Participatory Rural Appraisal (PRA)**

This term is used to describe a family of techniques used primarily by rural development organizations in working with rural communities. Its key features are allowing rural people to describe their own situation in their own way; i.e. to see people’s own analysis of their situation as the starting point for an intervention. PRA exercises can take a considerable period of time (the pace is set by the people themselves) and involve people using a variety of tools - often using material around them - to analyse various aspects of their environment including, for example, productive resources, environmental trends and wealth ranking. PRA
has proved a very effective tool for gaining an accurate insight into people’s real situation, for giving people ownership over subsequent interventions and in providing baseline information. Its use in urban situations has been much less successful (Chambers, 1997).
3. Good practice: Meaning and measurement

3.1. Defining good practice

Donor support for BDS is aimed at providing an appropriate response to SME needs (identified in Section 2) so that the performance of SMEs can be improved. As mentioned earlier, although this objective may have its roots in economic and/or social factors, it is ultimately concerned with enhancing the business development process; i.e. more businesses (higher start-up and survival) which perform better (longer duration, faster growing). ‘Good practice’, therefore, has to be seen in relation to this overall objective.

This report seeks to offer a set of principles and approaches which underpin the design and implementation of effective BDS. However, as stated at the outset, BDS is a relatively undeveloped field, one in which donors and practitioners should be as conscious of how much they do not know as how much they do. In this sense, use of terms such as ‘good’ or even ‘best’ practice needs to be qualified with a suitable amount of caution. There is much that is not known.

This section has two themes. First, the issue of what is meant by good practice in BDS is examined. What criteria can be used in defining good practice? Are there any benchmarks which can be used in specifying broad ranges of acceptable performance? Second, the question of how good practice should be assessed is considered. What are the key points to bear in mind in evaluating BDS? What are the most successful approaches to evaluation?

‘Good practice’ in BDS refers to approaches which deliver the most beneficial outcomes. Sections 4 and 5 present emerging principles of good practice in BDS. However, ultimately, good practice has to manifest itself in success in achieving final objectives, i.e. it is results which matter. Only practices which result in ‘good’ performance against an intervention’s objectives can be said to be good.

Good practice in BDS interventions is defined here with respect to four key levels of impact and four broad performance criteria (Figure 3.1).

Impact levels

1. The enterprise level: changes in the activities and behaviour (i.e. capacity) of an enterprise and its owner-manager and in the performance of the enterprise which may have resulted from these changes in practice.

2. The meso level: changes in the capacity and performance of meso-level institutions.

3. The ‘beyond enterprise’ level: wider changes in society, especially at the household level

4. The macro level: changes to the policy and regulatory environment.
**Performance criteria**

a) Outreach: the quantitative scale of a programme’s influence - numbers of people, enterprises, organizations etc., reached by an intervention.

b) Efficiency: which is concerned chiefly with the delivery of an intervention and the rate and cost at which inputs are turned into outputs. In itself, efficiency is not directly related to the impact of an intervention.

c) Effectiveness: this measures the extent to which an intervention’s objectives have been met (including a comparison of impacts with costs). Assuming that these objectives are related to general development goals, effectiveness is also a measure of development relevance. Since BDS interventions have different objectives, obviously the indicators of their effectiveness vary according to these objectives.

d) Sustainability: this can be seen at two levels: (1) the extent to which the service offered by the BDS organization can be financed through client fees, and (2) the extent to which changes in SMEs (and beyond) are durable.

All of these criteria represent aspects of BDS performance. Together they offer a balance of different concerns relating to qualitative impact, quantitative scale and efficiency. However, there are two difficulties with a definition of good performance which is based on these indicators.

Very few interventions are able to measure performance in relation to all of these criteria. In this sense, they represent an ideal which very few BDS organizations are yet able to achieve.

There are potential conflicts between some of these criteria. For example, strong outreach performance may be at the expense of both business and development impact. High levels of financial sustainability may well be at the expense of outreach, particularly among more disadvantaged groups. Looking at performance in relation to one or two criteria only can easily distort the true picture of performance.

### 3.2. Indicators of good practice

In practical terms, in order to measure BDS performance, we need to ask how each of the above criteria can be made tangible? How do we recognize good practice; what indicators are required? For each of the main criteria listed above, it is possible to identify a number of common indicators, which are included in Figure 3.1. While these may be useful in assessing performance, some caution is necessary:

(Figure 3.1, Figures 5.1 and 5.2 are not part of this document)

- lists of indicators can never be comprehensive and those given in Figure 3.1 should be supplemented by more appropriate local indicators where necessary.
- invariably, there are strong qualitative aspects to good practice which are not readily captured in quantitative indicators. It is not possible to reduce BDS evaluation purely to a ‘box ticking’ exercise.
there are often indicators of the process of delivering BDS which are significant in assessing performance. Efficiency and outreach are internal measures of performance and not, in themselves, concerned with impact. However, there are many other valuable operational indicators in BDS which are not addressed here, but would be expected to be covered in a monitoring system.

- the indicators chosen in Figure 3.1, as much as possible, are generic and not specific to a particular type of intervention. Obviously, one would expect to see more specific indicators for particular interventions. For example, in a marketing training programme, specific changes to SME marketing strategies would be one anticipated result.

- the different criteria are linked together and sometimes overlap. Most important, generating a high proportion of cost repayment through client fees can be seen as a useful indicator of impact, as well as sustainability, since it tests clients’ own willingness to pay for a service (i.e. the value which they place upon it).

- developing indicators at a meso-level is particularly difficult. The criteria listed in Figure 3.1 (Edgcomb, Cawley, 1993) - vision, capacity, resources and linkages - aim to provide a rounded framework for institutional development assessment.

### 3.3. The benchmark issue

The preceding analysis attempts to develop relatively standardized criteria and indicators of performance. The corollary of this analysis is to try and develop values for each of these criteria to allow more detailed benchmarking of performance. This could be used by donors and BDS organizations to compare performance with peers/competitors, provide a solid base for appraisal and evaluation and lay the basis for future improved intervention design. Benchmarking has been one of the features of the development of the microfinance sector and is an established practice in business.

While it is clear that, in theory at least, benchmarking could be a useful tool in the development of BDS, its application currently is limited by a number of constraints.

1. **No standardized approach:** unlike microfinance, where there are considerable similarities between most programmes and great scope for comparison using a large number of operational criteria, BDS refers to a broad collection of approaches which are generally not standardized. Indeed, good practice requires BDS to be focused and specific for particular client groups. There are relatively few generic BDS products. For example, on the basis of a criterion such as cost per business worked with, technology-based interventions would always be many times more expensive than training interventions.

2. **Cost-based indicators can be misleading:** different costs of living between countries make cost-based comparisons potentially misleading.

3. **Definition of tight indicators:** there appears to be more scope for benchmarking at a national level, where costs are broadly comparable. However, even here, care needs to be taken to define indicators precisely. For example, cost per trainee shows one aspect of delivery efficiency but cost per trainee per training day would be a more accurate unit for comparison. This is seldom measured.

4. **Problems with impact measurement:** there are formidable problems associated with the measurement of BDS impacts (see 3.5 and Box 7 below) which make it a rather fragile basis for comparison between different BDS organizations. Benchmarking for microfinance programmes is usually not on the basis of impact measures. In BDS, some
efforts have been made at comparison on the basis of costs and benefits, but there remain
major questions over the accuracy and usefulness of these measures (Box 6).

Inadequate data: there are not sufficient quality data available (from existing project
documents) to provide a sound basis for comparison. To attempt to make an estimate on
the basis of a small number of cases (even with appropriate caveats) would risk presenting
a highly distorted picture.

Given these constraints, on the basis of figures from a number of project documents*, there
are only three indicators for which preliminary value ranges for current good practice can be
suggested, and one of these, the survival rate, is of limited value unless compared with
average survival rate figures. All three are related to training/consultancy (data were only
available for these instruments):

- **Percentage of direct cost recovery in training programmes**: on average 50%; for
growth orientated SMEs, 100% or over; for smaller SMEs nearer the start-up phase, less
than 50%.
- **Start-up rate** (the proportion of participants on a start-up programme actually starting a
business afterwards): 30-60%
- **Survival rate** (the proportion of businesses surviving one-year after a training
programme): 80%

* These figures are derived from project documents from GTZ, SDC, ODA, IDB, UNDP
and UNIDO.

<table>
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<th>Box 6: Benchmarking using effectiveness ratios</th>
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| Benchmarking has been used successfully for comparison and performance improvement in
| microfinance programmes but, in general, it is confined to efficiency or outreach measures.
| Comparison on the basis of effectiveness - the impact of a programme on the real world - is
| much more unusual and is fraught with difficulties. A recent study (Harper, 1995) makes an
| attempt at comparing the effectiveness of a variety of programmes using several different
| cost-benefit ratios, the most prominent being cost per job created. For training programmes,
| figures from India show cost per job figures of $60-$150; in Indonesia, $42-$125; and in
| Nepal, $470. For technology development programmes, the ratio ranges from $1,800 to
| $23,000, depending on country and technology; World Bank figures for 1980-90 estimate the
| cost per job created to be $4,675. Aside from concerns over the accuracy of these figures -
| and the subsequent importance which should be attached to them - their sheer diversity
| complicates attempts at interpretation. Although they are ‘interesting’, the weight which
| should be given to such benchmarking figures is a largely unanswered question. |

3.4. **Assessing good practice**

Given the above relatively broad definition of *what* good practice is, the next issue to
consider is *how* this good practice can be assessed. Evaluation of SME development
programmes has emerged as a major and complex area of study in its own right in recent
years (SEEP Network, 1987; Gibson, 1997). From this experience, there are clearly many key
points which should be considered in any evaluation of a BDS organization’s work; ten of
these are highlighted here.

**Good evaluation:**
1. is based on a sound monitoring system
Monitoring should capture the on-going day-to-day, week-to-week information related to the delivery of services. This includes data on all appropriate costs, numbers and the identity of clients for particular interventions, feedback from clients on service delivery and usefulness, and analysis of clients’ fee payments.

2. requires comparison
Ideally, comparison should be made between the situation of clients before and after (or during) an intervention. This requires the collection of some form of baseline information on all or some clients. In the absence of baseline information, evaluations have to strive for another point of comparison: this may come from national statistics, other BDS organizations or other non-clients in the same area. More commonly, evaluators will ask clients themselves to make a ‘before and after’ comparison in their own minds.

3. is increasingly converging with needs assessment and forward planning techniques as an integral part of a BDS organization’s development process.
‘Classic’ evaluation is a one-off event taking place on an occasional basis (usually at the end of a project cycle) and focusing only on impact assessment. A more business-like approach to evaluation (pioneered by organizations pursuing a financial systems approach (Otero, Rhyne 1994)) views it as part of an ongoing process of market and customer research aimed at understanding BDS product strengths and weaknesses and identifying opportunities for new products. It also recognizes that the real evaluation being undertaken continuously is that done by BDS organization clients in paying for their services rather than buying a different BDS or other product.

Box 7: Problems of impact measurement: what is a job?
One of the most common indicators of impact in BDS interventions is number of jobs created or, moving on from this, the cost per job created. The reasons for this are clear. Unemployment is seen to be a major cause and symptom of poverty and social imbalance. Moreover, unlike other indicators, jobs are highly visible; bodies can easily be counted. In the uncertain world of evaluation, there seems to be a satisfying certainty about jobs.

But are jobs such a neat and wholesome indicator offering indisputable proof of impact? The answer is that it is usually very useful, but there are a string of questions which show that it's apparent simplicity is sometimes an illusion; 'a job' created may be very different from one project to another.

- Is it a full-time or part-time job? What does full-time mean? Can part-time be expressed as a fraction of full-time equivalent?
- Is it permanent or seasonal?
- What is the likely duration of the job? (dependent on the soundness of the business)
- What are the average earnings associated with the job?
- Has the job been created by the project intervention or would it have been created in any case? Would the small enterprise have expanded or would the person have set up in business without the training programme, loan or advice from the project?
- What was the person currently in the job doing before the project? Was she/he working or were they unemployed?
- Who is the person in the job? What is her/his gender? Level of education? Age? Social class? Ethnic background?
- Is the creation of the job at the expense of another job in the immediate area? Or the wider province?
- How will the expansion of the business or the start-up of the business affect other businesses? Does the business have any direct links - as a buyer or supplier - with other businesses in the area?
For every job, these questions will produce different answers reflecting a different impact on the local economy and community. It may be unreasonable to expect NGOs to ask all these questions, but similarly it is also unreasonable to suggest that a ‘job’ created always means the same thing.

4. is well prepared, especially when using external evaluators
Choice of evaluator is clearly very important, but another aspect of evaluation preparation which is often neglected is the drawing up of terms of reference (ToRs). The ToRs shape the task of the evaluation exercise. ToRs which are designed without considerable consultation with different stakeholders - for example between donor and BDS implementing organization - are often likely to be, in some way, unrealistic or wrongly focused. The value of the ensuing evaluation (for everyone) is then diminished.

5. adopts a realistic approach to information collection.
A continuing problem in BDS evaluation is that evaluators may have unrealistic expectations of what information can be collected from clients. In attempting to gather too much ‘textbook’ information, evaluators often encounter problems of clients (especially at a micro level) either genuinely not knowing or being reluctant to divulge the ‘correct’ answers. Evaluators may need to adopt a variety of strategies to overcome this problem.

6. can be undertaken by either external people or internal staff.
Internal evaluations may offer advantages such as familiarity, reduced threat, lower cost, more empathy with clients and possibly more practicality in final conclusions and recommendations. External evaluations may offer advantages such as objectivity and freshness, drawing in lessons from elsewhere and the use of ‘sophisticated’ techniques should they be necessary. In practice, a combination of external and internal people can sometimes provide a useful balance of strengths.

7. is done with rather than on people.
Whoever undertakes an evaluation should seek to do it with BDS staff (and clients) so that the picture of their organization which emerges and the path forward is one in which they believe and to which they are committed.

8. is aware of costs as well as benefits.
One of the most serious criticisms of BDS in the past has been a reluctance to include costs in the analysis of BDS organizations’ performance. Good practice in BDS, however, does require inclusion of costs in performance analysis.

9. uses methodologies which offer a combination of rigour and practicality
Evaluations should be based on solid research ideas but acknowledge the requirement of evaluation findings to be grounded in the real world of BDS. Effective and appropriate methodologies include a range of different approaches, such as surveys, case studies, rapid assessment techniques, key informants, critical incident analysis and focus group discussions.

10. is not overly expensive
The primary purpose of any intervention is to take action and have a positive impact. Evaluation exists simply to provide guidance to these activities and therefore has to be seen as a subsidiary function. As a general rule of thumb, evaluation should cost not more than 10% of a total budget and usually considerably less than this in major interventions. Only in
smaller action-research type interventions, where there is a specific learning priority, could more than 10% be justified.

### 3.5. Assessment difficulties and delusions

While there are clear general lessons on how to evaluate BDS, it is not the case that evaluation is a precise science which has accepted answers to all the questions related to BDS performance assessment. On the contrary, there are a number of fundamental methodological issues which pose great difficulties in BDS evaluation.

1. The additionality problem
As Figure 2.1 shows, there are many influences on SME performance. One of these is the effect of BDS. The implicit assumption made in many evaluations is that change - especially positive change - in SME performance in terms of profits or sales or employment can be attributed solely to BDS and that the influence of other factors is negligible, i.e. that there is a clear line of causality running from service delivery to wider societal impacts. This is a brave and usually naïve assumption. Of course, the performance of businesses will be affected by a range of other factors in the environment, most notably the general level of demand in the economy.

How can the impact of BDS be isolated from other influences on SMEs? To what extent can apparent changes be said to be really additional and caused by a BDS intervention. The classic ‘scientific’ response to this problem is to use control groups and some BDS organizations are trying this approach. In practice, however, there are often serious cost, practical (finding similar groups and gaining their cooperation) and ethical (controlling people in poverty) issues which make control groups difficult to initiate and manage.

2. The displacement problem
SMEs exist in competitive markets. Their performance affects not just their customers and staff but also competitors. If an SME is successful, its success may be at the expense of a competitor. This is the displacement effect, the negative impact on other enterprises (and people) resulting directly from the positive success of enterprises supported by BDS. Sometimes this can be a positive influence through linkages with other businesses. Furthermore, in growing economies and economies in transition, actual negative displacement may be minimal. It can also be argued that displacement is an inevitable element in a vibrant, dynamic economy. Nonetheless, ultimately it is often the case that if one SME wins, another loses. In practice, this means that the net impact of a BDS intervention is usually less than the apparent impact. In assessing the scale of the displacement effect, evaluators need to take into account the geographic area in question, the identity of the target group of SMEs, the location of their main competitors and overall trends in market demand.

3. Defining costs
Although more BDS organizations now accept that cost control, management and allocation to specific BDS products is important in assessing overall performance, there is still no widespread consensus on what costs should be included/excluded from measurements of performance. Clearly, there is considerable scope for distortions between different BDS interventions. As in microfinance, there is a need for greater clarity and transparency of what
is meant by costs. Cost analysis is generally easier than examination of benefits; there are relatively standard financial management techniques which are applicable in BDS organizations. Often the most immediate challenge for BDS organizations is to view costs not simply from the perspective of (external) financial accountability but in terms of organization resource management; the difference between a ‘project’ and a ‘business’ approach. Beyond this, there are some common problems to be faced in looking at costs, such as:

- **Hidden client costs**: organizations’ own expenditures are not the only cost incurred in delivering BDS; clients also incur costs, especially the opportunity cost of their time. ‘Transaction costs’ are usually not costed formally by SME owner-managers, but are nonetheless very real.

- **Other agency inputs**: in some situations, SMEs may be clients of more than one BDS agency and the beneficiaries of more than one external subsidy. Failure to acknowledge this multiple assistance will lead to aggregate costs being underestimated.

- **Initial investment costs**: although BDS organizations may choose not to pass on the development costs of an intervention - programmes developed, people trained, technologies improved etc. - to their clients, these costs still need to be transparent. Even if they are not included in a comparison of direct costs and outcomes, it is important that they are not forgotten.

- **Apportioning fixed costs**: while BDS organizations can allocate direct (or variable) costs to outputs relatively easily, indirect costs (usually associated with central administration and support) are more difficult to apportion accurately and, because of their scale, often completely alter cost recovery figures. Nonetheless, control of fixed costs is a key management task which, in the first place, requires the identification of such fixed costs.

4. **Defining benefits**

The critical question in considering benefits is: how do changes to SMEs resulting from BDS manifest themselves? Answering this question requires responses to significant methodological problems, not least those associated with additionality and displacement. However, there are at least three other core issues which need to be addressed in considering benefits:

- **Defining intermediary measures**: the line of causality running from a BDS to business performance improvement involves intermediary stages, such as knowledge/skill enhancement and changes in business practices. If these intermediary impacts are not assessed and only bottom-line measures (profit, sales etc.) are measured, there is a danger that wider factors (economic growth, government policy, drought, etc.) are being measured and not the impact of a BDS.

- **Defining indirect benefits**: ripple effects from BDS interventions are especially difficult to capture in evaluations. For example, the natural process of learning in SMEs is based around copying from peers/competitors. The overall impact of, for example, a technological intervention may be far in excess of those directly benefiting.

- **Defining longer-term benefits**: again, while immediate changes from a BDS may be relatively easy to identify, it is more difficult to assess longer-term changes. For
example, advocacy and institutional capacity-building may not appear to have any discernible impact in the short term. However, it may be unreasonable to believe that real change can brought about except in the medium to long term.
4. BDS instruments

4.1. Introduction
Having considered the broad criteria which may be used in assessing BDS practice, it is now appropriate to consider in more depth the instruments employed by BDS organizations; i.e. what the organizations actually do.

In this section, instruments are examined at the three levels commonly understood by donors: micro, meso and macro. For each, no attempt is made to give a comprehensive guide on ‘how to’. Considerable material is available on each instrument. Rather, for each instrument, the following is presented:

a) a definition of the instrument  
b) a brief description of how it has been applied  
c) the lessons emerging on good practice  
d) major unresolved issues on good practice  
e) current interesting innovations and ideas

In so doing, especially in examining lessons emerging on good practice, we draw upon the criteria of outreach, efficiency, effectiveness and sustainability established in Section 3. While it is not always possible (or desirable) to try and isolate assessment by each individual criterion, collectively, these underpin the following analysis.

4.2. The micro level
BDS instruments used at the micro level are delivered directly by BDS organizations to SMEs. Donors, of course, are rarely in the position of being actual deliverers of services themselves, but they must be able to recognize good practice in assessing potential and existing BDS programmes. Many different approaches are used by BDS organizations at the micro level and these frequently involve a natural overlap of more than one instrument. For example, training and counselling often are combined, as is training with a networking or linkage initiative. To some extent therefore, the analysis which follows presents instruments in an artificial state of separation. However, analysis becomes hopelessly complicated if every potential combination of instrument is assessed.

4.2.1. Training

a) Definition
Training covers a broad swathe of interventions based around teaching-style inputs, usually not on a one-to-one basis, involving facilitators/trainers and groups of trainees. Training is aimed at enhancing SME learning. It covers both business management/entrepreneurship subjects and vocational subjects. It seeks to develop knowledge and skills covering:

- what SMEs do: subject-based training on marketing, book-keeping, production techniques, product development, etc.
• **how to** deal with problems: how to find new customers, get higher prices, reduce material costs, develop new product ideas, etc.

• **who with**: introducing or pointing SME owner-managers to useful resource people, potential customers, suppliers or collaborators, and how to deal with them.

### b) Application
Training is the most common form of BDS intervention (CEDEFOP, Durham University Business School, 1993; Grierson, McKenzie, 1996). Indeed, prior to the microfinance revolution, it was probably the most prominent instrument used in SME development. There is broad acceptance that earlier training interventions suffered by being:

• too **generalized** relying on relatively standardized material

• too **supply-driven**, with impractical subject matter far removed from SME realities

• delivered in an **inappropriate top-down teaching style** which failed to understand how SME owner-managers learn

• delivered by people who were **ill-qualified** for the task

• insufficiently aware of **cost-control**

• insufficiently aware of the need to encourage **trainee commitment** to learning

• insufficiently concerned with **follow-up** in situ

The view that training has been a ‘black hole’ consuming resources and offering little evidence of impact was held quite widely. However, there have been detailed studies which have provided evidence that improvements to learning mechanisms in SMEs have a substantial impact on productivity and added value (Biggs, Shah, Srivastava, 1995). At least some of the criticism of training can be attributed to the difficulty of making a transparent connection between instrument and impact.

A number of well-known semi-generic training products have emerged over the last 10-20 years which now enjoy widespread use:

**Entrepreneurship development programmes (EDPs):** originally started in India and focused on start-ups, and adapted to local conditions in many countries

**Competency based Economies Formation of Enterprise (CEFE):** this programme, developed by GTZ, has been influenced strongly by the EDP approach. Again, significant local adaptation has taken place.

**Improve Your Business (IYB):** developed by the ILO and aimed at existing businesses.

**Growth Programmes:** the youngest of these programmes, developed originally in the UK and aimed at SMEs with the potential for high growth.
At least partly spurred by the example of microfinance, recent years have witnessed a significant re-focusing of training efforts, in particular towards a demand-led, market oriented perspective.

c) Lessons

1. Treating training in a business-like way
Training is not simply an extension of a national education system, but a service for discerning clients. In practice, this means that the process of developing training interventions requires BDS providers to ask the following kinds of questions (as any business would do):

* What is our market position? With whom do we want to work? In which market segment (sector, business size, socio-economic group) are we most interested?
* What are the needs of our potential target group?
* What should be the design of a training programme for them?
* What capability is required to deliver this programme?
* How can we reach the market with this programme?
* How will we monitor and evaluate our work?

2. Splitting from financial services
The experience of mixing training with financial services has generally not been successful. Where the same organization wishes to provide both, it is important to keep each operationally separate. Mixing the two often involves SMEs who are only really interested in accessing a loan coming to training under duress and with little commitment to learning. Mixing financial and SME training messages often appears to result in the latter’s learning objective being diminished.

3. Designing on the basis of client needs
All SME training needs to be grounded in a comprehensive knowledge of SMEs’ reality. Training should be shaped by the learning requirements of SMEs, driven by their need to know (see Section 2). Inevitably, other than perhaps for some generic needs at start-up or growth phases, this will mean that simple replication to scale is difficult. Training which seeks to encourage owner-managers to ‘learn to learn’ from their environment and which is provided through associations may help to create a sustainable capacity for learning and therefore, to some degree, overcome these problems. There is also considerable scope to customize generic models for different client groups.

4. Designing and delivering on the basis of SMEs’ practical learning styles
Research suggests that the least effective learning methods are traditional approaches, such as classroom lectures; the most effective are based on learning by doing. SME owner-managers are accustomed to incremental learning from experience; this type of learning is the essence of business development. Training must therefore be based on real SME situations, should allow interchange between participants and should encourage participants to try and apply training to their own business situations. Among clients’ key expectations of a training
programme are that it should be practical, problem-oriented, of immediate relevance and not be laced with a ‘classroom’ atmosphere. The design of programmes also needs to consider which venues and what times are most suitable for SMEs. Often this will mean evenings or weekends.

**Box 8: CEFE: impact of a semi-generic training product**

The Competency-based Economies, Formation of Enterprise (CEFE) approach to SME development was first developed in Nepal in the 1980s by GTZ and has since been adapted and implemented in many other countries. The general CEFE ‘model’ focuses on developing the capabilities, motivation and resources of people either already in business or aspiring to start in business (there are different programmes for each). CEFE emphasizes the importance of the local adaptation of its approach, depending on local needs and environment. However, the broad framework of the programme is common. A recent evaluation of CEFE’s pilot activities world-wide, focusing on its start-up programme (not including follow-up activities) found that an average of 45% of trainees had started in business. In long-term projects (including post-training services), the corresponding figure is more than 50%. Contributions from trainees typically average around 30-50% of direct costs.

5. **Delivery: the right institutions and people**

The most effective BDS organizations and people are those which are closest to SME owner-managers. In addition to core competencies in training and knowledge of SMEs, trainers should ideally be close in terms of their values, language and general manner. Institutions which convey an image of superiority or detachment are unlikely to be successful.

6. **Reaching the market**

There are a variety of ways in which training can be marketed. These include using trade associations as channels, packaging the training offer (price, location, potential benefits, etc.) in an appropriate manner and, particularly for new programmes, meeting with and discussing the programme with potential clients.

7. **Monitoring and evaluating**

While most programmes have a feedback form for clients, they only offer some clue as to clients’ immediate feelings (they are often called ‘happy sheets’). This is of little value in assessing how much impact training is having on clients’ businesses. Follow-up visits of some sort are required for this purpose and these also offer an opportunity to assess future needs (see Section 3).

8. **Ensuring client commitment; getting the right relationship**

One of the biggest changes in training approaches over the last few years has been in attitudes towards charging for training. All BDS providers agree that strong trainee commitment is vital for training success; most would now agree that charging helps to strengthen trainee resolve. Owner-managers are accustomed to transactional, exchange-based relationships in their daily business lives; they will pay for things which they value. The arguments made against charging are most common in environments in which there is a strong precedent of free training and are based as much on the weight of tradition as on training effectiveness.

**Box 9: Empowering SME clients: the training voucher scheme in Paraguay**
The starting point for this scheme (supported by the IDB) is the view that creating a successful system requires it to be demand-led and market-oriented. Although external subsidies are required for microenterprise training, they should be offered in such a way as to strengthen the market relationship between training customers and suppliers. In this system, microenterprises can purchase vouchers from government offices at a subsidized rate and use these to pay for training programmes at institutions which have been approved by the government. Institutions can exchange vouchers only after programmes are completed and only if participants have attended more than 75% of classes.

In the first 20 months of operation, 11,324 microentrepreneurs participated in 696 training programmes with an external cost of only $220,000 (a relatively modest subsidy). Empowered by the purchasing power of vouchers, entrepreneurs are exercising their choice and already there are signs that institutions are having to become more responsive to their needs. Furthermore, there are signs that entrepreneurs are re-evaluating their own attitudes to training and to what this may result in a further reduction in the external subsidy in future.

d) Unresolved issues
1. To what extent can training be expected to recover costs through fees charged to clients?
   While there is a growing practice which acknowledges the importance of the payment principle, there is no consensus on what an appropriate amount should be (Section 3.2 provided some idea of current benchmarks). Two views at opposite ends of the spectrum are put forward:

   a) Like any education intervention, the benefits from training are broad, often intangible, sometimes only discernible in the longer-term and usually hard to measure (in economist’s jargon, there are significant long-term positive externalities). Nonetheless, these benefits are real. Nowhere in industrialized nations do SMEs pay the full cost of training and should not be expected to do so in developing nations. Continued support for training is a wise investment.

   b) If owner-managers are not prepared to pay the full costs of training, they do not really want it. Training is essentially no different from any other commercial product which SMEs buy for their business. Interventions may be required to introduce the idea of training as a worthwhile product and develop appropriate instruments, but on-going subsidies are not justifiable. The practice in better-endowed industrialized nations is not necessarily relevant.

Arguments float between these extremes, with current practice generally occupying the middle ground. In recent years, however, perceptions of best practice have unquestionably moved towards the latter position.

2. Can the poor and disadvantaged be reached?
   For those donor agencies which have a mandate to ensure that interventions benefit particularly disadvantaged groups, the issue of how to reach them is problematic. Again, there are several competing points of view:
a) The principles of good practice outlined above have not really been applied to disadvantaged groups as yet. There has not been a systematic attempt to find out more about their needs and develop training approaches based on these. Most training has actually been based on a ‘we know best’ attitude. It is too early to say that training is not relevant to the poor.

b) The poor have to be viewed within commercial and production sectors. If the sector’s development is enhanced, all participants in it will benefit.

c) Businesses operated by the poor are usually relatively straightforward enterprises. With little scope to add value in saturated markets, the only external support of value is finance to realize economies of scale in buying inputs and therefore raising margins. In reality, there is little scope for enhancing knowledge or skills to make a meaningful difference to business performance. Only in SMEs which are bigger and more sophisticated is there a real opportunity to make a difference.

3. How can growth orientated ‘winners’ be identified?
Donors whose primary goals relate to economic development rather than poverty alleviation are often concerned with identifying SMEs with real growth potential. Unfortunately, ‘picking winners’ is an exercise in which external agencies have often proved unsuccessful. There are some tools used by agencies in analysing SMEs, but again there are questions over their effectiveness. A demand-led approach suggests that SME identification should be through a self-selection process on the basis of willingness to pay, but this implies that growth potential equates to SME self-awareness of potential and resources. This may not always be the case. To some extent, subsector analysis offers one way of focusing resources and therefore of at least alleviating the difficulty of ‘picking winners’.

e) Current interesting innovations
a) Vouchers as a means of educating SMEs on training benefits: making supply more responsive to demand and leveraging higher contributions from SMEs (see Box 9).

b) Group organization of training: borrowing from microfinance approaches, asking small groups of SMEs with similar needs to form cells and selling the training to them as a block. Peer pressure can then be used as a means of encouraging higher participation. This idea is currently being considered by some organizations in Kenya.

c) ‘Piggybacking’ on other interventions: while there are dangers of training being used only as a means to an end (as in credit situations), one key problem is that SMEs find it difficult to envisage (and therefore value) benefits. Some agencies have found that having training as one component in a wider intervention - perhaps through a subsector strategy - can help to develop training in a ‘tighter offer’ to SMEs.

d) Expanding trainer supply: this idea is based on the evolution of training and consultancy services for larger businesses, which have grown at a fast rate in the last 20 years. SMEs, however, especially at a micro scale, are usually not regarded as having the potential to become a viable market for training products. Changing this perception, strengthening a range of trainers and equipping them with useful analytical tools may encourage them to offer the equivalent services to micro-enterprises.

e) Flexible payment schedules: in finance schemes, SMEs only have to pay for their assistance over a period of time. Training requires initial payment, even though benefits may not be realized until well after the training is completed. One idea being considered
by some agencies is a flexible arrangement which - if it can be enforced - would allow the flow of benefits and costs to be co-incidental.

f) Using technology to enhance learning: the training field in general has found many innovative ways of using technological developments - computer-based learning, distance learning, etc. - to improve training quality and outreach. Training for SMEs is beginning to pursue a similar path, but there is considerable scope for further improvement.

4.2.2. Counselling and advice

a) Definition

The above terms are frequently used more or less interchangeably and it is therefore important to define their specific features:

· *Extension* is the delivery of any form of advice or non-material assistance outside a classroom, usually to clients at their places of business. It is a generic term, and includes both consultancy and counselling.

· *Consultancy* is expert advice, on specialized technical and managerial issues, provided by a skilled and experienced consultant who appraises the situation and recommends a course of action.

· *Counselling* is a guided process of self-discovery, whereby the counsellor guides and assists the client to identify problems, opportunities and resources, define options and select a course of action. It could also be described as ‘coaching’ for entrepreneurs, with a view to strengthening their entrepreneurial capacity and competence. Counselling requires a high level of interpersonal skills, such as being able to listen, empathize, communicate and motivate.

b) Application

For a long time consultancy, both ‘on-site’ and ‘off-site’ was a classical instrument of SMEs’ promotion. Indeed, extension services, in terms of providing specialized expert advice, was one of the major instruments of multi-purpose Small Industry Development Organizations (SIDOs) and Small and Medium Enterprise Development Agencies (SMEDAs), long before Entrepreneurship Development Programmes were developed and diffused. Consultancy is also part of many pre-investment activities and is often linked to loans schemes. However, in recent years, there has been increased concern over a number of aspects of consultancy:

- consultancy requires skilled and experienced staff. However, the staff of business support agencies is generally young and lacks the practical experience and specialized expertise that are necessary for effective and credible management and technical consultancy.

- there is often a social and cultural distance between the advisor and the entrepreneur of a smaller business. Moreover, if the consultant comes from a State or parastatal BDS provider, entrepreneurs are suspicious and will not provide critical information about turnovers, assets, etc. because they are afraid of taxation and other charges.

- consultancy advice was often provided in a standardized and therefore inappropriate manner in relation to the actual situation and potential of an enterprise. Cases of recommending to invest in over-sophisticated technology were reported, reflecting the links of the consultant with an investment goods supplier or the existence of special credit lines for such investments, than the actual needs of the enterprise.
particularly, where foreign short-term consultants provide advice, they are sometimes not aware of the specific situation of an enterprise in the country and may therefore give inappropriate advice.

consultancy, particularly where it was free of charge or heavily subsidized, often lacked the acceptance of the entrepreneur.

consultancy has often been an isolated intervention with follow-up activities.

one-to-one consultancy is resource intensive and therefore expensive.

monitoring and evaluation was frequently neglected, with the result that few records of the outcome and impact of consultancy exist.

and, last but not the least, long-term consultancy was often used to obligate entrepreneurs to become clients of a more or less ineffective (parastatal or State) BDS provider (clientelism).

Counselling was developed in recognition of the deficiency of one-to-one consultancy and because of the problems experienced by BDS providers in recruiting and retaining qualified and experienced staff. Hence, problems related to counselling include:

- counselling by people on a voluntary basis (e.g. voluntary networks, NGOs) cuts costs but can be to the detriment of quality;
- people from a big business/higher education background may find it difficult to pursue a capacity-building process of counselling (encouraging people to learn for themselves) and instead tell SME owner-managers what to do, sometimes to their great disadvantage;
- it is difficult to assess the benefits of counselling, since the outcome is not tangible; and
- it is hard to obtain any significant direct payment from clients for counselling service, since the entrepreneur may not see a direct impact, e.g. in the form of a business plan or written advice.

c) Lessons
Acceptance of these criticisms and problems has resulted in adjustments, with new and additional forms of providing advice to entrepreneurs being developed, such as the strengthening of local consultancy services, group consultancy, business clinics and counselling. Extension services continue to be important for SME development, particularly if they accompany training (follow-up), but also for business expansion. Although, consultancy and counselling are different in nature, there are a number of common, but also separate lessons to be learned.

1. Strengthening of local consultancy and counselling capacity
Consultancy by foreign short-term experts should be an exception, and applied only in well-justified cases. The focus should be on strengthening national and local institutions. This can be done by classroom or on-the-job training or independent (self-employed) or employed extension staff. In addition to the classroom training, local consultants can be twinned with foreign short-term consultants for on-the-job training. Moreover, they later can take up the follow-up and thus ensure continuity of the consultancy.

The same applies to counselling. Rather than setting up artificial, externally supported counselling systems, more emphasis should be given to developing nascent local and private initia-
tives and networks. The most effective business learning support and counselling mechanisms are always private and have developed indigenously, strengthened by culture and local institutions.

2. Professionalism: The right staff for consultancy and counselling services
The issue of professionalism is closely linked with the capacity of a BDS provider to recruit and retain qualified, experienced and motivated staff. This is again closely related to the capacity of a BDS provider to develop its own personnel policy, including such matters as the ability to hire and fire, job classification, terms of employment, salary scheme, awards and sanctions, and staff development. The choice between consultancy or counselling must therefore be based on an assessment of staff capacity, and of the demand potential and economics of both options.

- Consultancy: Effective and credible management and technical consultancy can only be provided by a skilled, specialized and experienced staff.
- Counselling: Good business counsellors require a broad generalist knowledge in order to being able to understand issues across the range of functions of SME and a high level of interpersonal and networking skills.

3. Diagnosis before action
Standardized and generalized consultancy should be avoided. Since one-to-one consultancy is an expensive instrument, it should be applied only after a thorough diagnosis (business profile, needs and potential) of the enterprise. Consultancy will continue to be of particular relevance for the upper segment of SMEs and for those which are in the process of expansion.

For smaller enterprises, counselling appears to be a more cost-effective way of enhancing entrepreneurial competencies. Moreover, counselling should only be applied after an assessment of the client group, their characteristics and needs.

4. Targeted: relevance through focus
Based on this diagnosis, a plan for tailor-made consultancy, if necessary including counselling and other BDS, should be developed jointly with the entrepreneur. The involvement of the client will ensure the acceptance of consultancy. Adjustment will have to be made in the course of implementation and an appropriate monitoring and evaluation system is therefore required.

5. Providing consultancy and counselling services in a business-like way
Extension services should be marketed like any other BDS. The willingness of a client to pay for an extension service is a good indicator of whether the consultancy or counselling is appreciated by the client or not. There is evidence that charging can sharpen the attitudes of both the client and the consultant/counsellor. As with training, fees can produce a more coherent demand-supply relationship. In order to sustain local extension capacities, an appropriate monitoring and evaluation system should be established to provide information on the outcome and impact of the services.

6. Cost efficiency: Group activities versus individual consultancy/counselling
Reducing costs, particularly with a view to financial sustainability of BDS providers, the charging of fees makes it important to introduce more group activities instead of one-to-one consultancy/counselling.
It is often argued that entrepreneurs are not willing to discuss their problems in front of other potential competitors. This assumption is not correct. Case studies indicate that most entrepreneurs are willing to share experiences and problems; they are doing so already in training courses. However, they would not wish to share information that provides them with a competitive edge. Bearing this in mind, general management issues can be dealt with in seminars, business clinics and group consultancy. If a group of entrepreneurs from the same subsector can be brought together, group consultancy can also be provided on subsector specific and technical matters, such as product development, productivity, quality improvements and eco-management. To achieve an optimal outcome, a combination of group and individual consultancy could be organized.

Counselling can already commence as part of an EDP course, where the first in-course business diagnosis is carried out and continues until the completion of the business plan. Since the client is familiar with the instrument, he/she may be interested in receiving such an assistance either on group or individual basis. For example, CEFE encourages the creation of clubs or associations of trainees which meet on a more or less regular basis. These groups can be used for special follow-up seminars and business cliniques.

7. Assure quality of extension services
Quality standards for both consultancy and counselling have to be defined and monitored. It is reasonable to define a ‘code of conduct’ for consultants and counsellors who obtain an intimate knowledge of a business and may be tempted to earn extra rewards. This is of particular relevance in societies where bribery and corruption are prevalent.

8. Piggybacking with other services
Including consultancy and counselling as part of a wider SME intervention package can help to alleviate the cost burden and increase the effectiveness of overall interventions. Extension as a follow-up to training is increasingly recognized as a more effective and efficient way of enhancing the ability of SME business owners than stand alone interventions. It also takes into account the range of functions in SMEs.

9. Linking up with other BDS-providers
Taking up new functions may sometimes overburden a BDS provider. Specialization in a few services (e.g. training, counselling) which are provided to a high quality and linking up with other business service providers for additional services if needed (e.g. consultancy, marketing, feasibility studies) could be a feasible way of offering comprehensive assistance to SME.

d) Unresolved issues
1. How can local consultancy and counselling services for SMEs be sustained?
Charging fees for expert advice and counselling is difficult due to the fact that the immediate benefit for the entrepreneur is often not tangible. This is particularly true in the case of counselling, since the ‘product’ and its benefits are difficult to define and payment systems appear to be hard to implement. Since there is a long tradition in many countries of subsidizing - by donors and national governments alike - this type of service, there will have to be a major change in attitude. The challenge will be to develop good quality extension services - afforded by independent consultants or BDS providers - while at the same time introducing an appropriate fee structure for the services.
2. How can consultancy and counselling services be provided by non-State institutions
In many countries SME promotion is still in the hands of government and parastatal institutions. The State continues to see itself as the ‘motor’ for modernization and mistrusts any other organization which tries to enter their innate field of activity. In countries in transition (e.g. Laos), the legal framework sometimes does not even recognize not-for-profit organizations, NGOs, etc. Assuming, according to the principles of subsidiarity, that consultancy and counselling are best provided by non-State or private organizations, governments will have to be convinced of that approach.

3. How can counselling capacity be developed in existing voluntary organizations?
In the long-term it is clear that a vibrant SME sector requires strong private mechanisms of learning. As much as developing counselling and advisory skills, the challenge may be to develop a culture and institutions of mutual support.

e) Current interesting innovations
1. Group-based consultancy and counselling: which considerably reduces the cost of counselling per client by bringing together similar businesses in one group. The ILO’s Business Improvement Groups are one such initiative.

2. Combining consultancy and counselling: some agencies are now combining both, e.g. they are seeking to use counselling as an ‘entry’ and/or as a ‘backing-up’ for other consultancy services.

<table>
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<tr>
<th>Box 10: Strengthening learning by regular counselling: the growth programme in Kenya</th>
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<tr>
<td>The business growth programme implemented by the Kenya Management Assistance Programme (K-MAP) is aimed at high growth potential companies. It is based around twelve one-day training sessions and six-day counselling inputs over a period of a year. The programme covers all its direct costs and makes some contribution to K-MAP’s overheads. Counselling is seen as an integral part of the programme. The role of the counsellor is to help individual owner-managers develop a business profile by measuring the business’s present performance, helping them to reflect on their situation and make progress in relation to their action plan, encouraging appropriate behavioural changes and assessing future training needs. Preliminary assessments of the programme - training and counselling - show significant impact in terms of employment, sales, profits and product development. In recent years, K-MAP has placed considerable emphasis on training counsellors to further improve the quality and impact of counselling.</td>
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4.2.3. Developing commercial entities

a) Definition
These are interventions intended to create sustainable profit-making enterprises to overcome an identified key constraint or fill an identified gap in the existing market structure. Developing commercial entities is an active intervention designed to create a new market player to play the role of a ‘broker’ in the commercial activities of buying, selling and, in the process, adding value. In this sense, this kind of intervention is comparable with
developments in the microfinance sphere where a considerable number of new entities are being started to fill a gap left by formal banks and informal money lending sources.

The rationale for intervention here is rarely articulated in any depth. Implicitly, the reason for intervention is that existing market structures are in some way not providing an adequate service to SMEs/individuals. By intervening, the market will work more effectively. However, since markets are never perfect, the rationale is in practice often vague and imprecise.

Included in the analysis here are new enterprises concerned with marketing SME products or accessing inputs for SMEs. Not included here (although clearly related) are technology marketing interventions which are dealt with later.

b) Application
BDS organizations have arrived at this kind of intervention from a number of different angles.

- Subsector analysis may show a gap or constraint which can be seen as a business opportunity
- NGOs seeking to raise revenue to finance their operations have set up businesses to do so and become major market players in the process.
- Perceived exploitative trade relationships have spawned a number of alternative trade organizations which set out to offer ‘fair’ conditions (including prices) to developing country producers exporting to industrialized markets.
- Less formally, work in a particular sector or area shows that there are opportunities for creating new market players which will have a potentially wide impact. More BDS providers are pursuing a business-like approach to their work and the corollary of this direction is (sometimes) to set up a business.

Overall, the experience of BDS providers with this type of intervention is fragmented and no clear picture emerges. Some BDS organizations have arrived at this intervention without any clear strategy. However, it does appear to be the case that more BDS providers are instigating interventions to create new market entities. One good reason for this interest is the potential of such interventions to eventually cover costs and become financially self-sufficient.

**Box 11: Reducing input costs through the development of specialized raw material suppliers in Ecuador**

A key problem facing small-scale woodworkers was the cost and availability of raw materials - both lumber and other imported items. The National Association of Small Industry Woodworkers (ANPIM), together with a support organization, the Institute of Socio-Economic and Technological Research (INSOTEC), identified and examined this issue in a subsector analysis and then undertook a feasibility study on establishing a supply outlet for wood industry raw materials. On the basis of this study, a new entity - CENTRIMA - was formed with initial capital from INSOTEC and from $400 contributions from 22 ANPIM members. The bulk purchasing capability of CENTRIMA allowed it to negotiate considerable discounts on raw materials and, even taking an appropriate margin for its own operation, was able to pass most of this saving on to members. CENTRIMA operates profitably and its
members' input costs have been noticeably reduced, which should also allow them to increase their profit margins.

c) Lessons
1. **Being clear about the intervention rationale**
   Establishing commercial operations in any marketplace is a major step and raises many questions related to the fairness of competition and market distortion. BDS organizations need to be very clear about why they are taking this step. While any BDS is an intervention, developing a new actor in a competitive market is particularly interventionist. If there is a commercial opportunity available, why has the private sector not identified and acted on it previously? If there are potential losers from the intervention, who are they? Will the market as a whole be more efficient because of the intervention? Possible reasons may include filling in a supply-side constraint as a marketing 'broker' (either because there are not enough of them or their practices are monopolistic/exploitative) or as a supplier realizing economies of scale in input purchase.

2. **Acting as a business from the outset**
   In the long-run, the success or failure of this type of intervention will be entirely attributable to its performance as a business. Prior analysis, therefore, has to look at the standard elements in any business proposal: customers, the market, competitors, the offer, finances, etc.

3. **Placing ethics in a consumer context**
   Alternative trade organizations have enjoyed mixed fortunes as direct market players (as distinct from advocates for more ethical trade, where their record is better). Where success has been achieved, it is mainly because a brand identity has been achieved which includes ethical criteria and for which consumers are happy to pay a premium. This does not of course replace normal consumer criteria associated with quality, safety, etc.

4. **Think ownership and management**
   The essence of SMEs is strong personal ownership by the owner-manager; this is their most distinctive feature. Most NGOs that have tried to set up revenue generating businesses have failed and the absence of strong personal ownership of these businesses has been a key reason for this failure. In practice, this means that:

- the operations of the new market structure should be separate from the BDS organization (i.e. it should not be a department of another organization)
- considerable operational freedom should be given to the management to encourage them to take personal responsibility and ownership over performance
- conditions for staff should reflect those of the private sector and, in particular, performance-related incentives should be introduced.
- collective, cooperative or group management should be discouraged. The record of these kinds of enterprises is generally bad because ownership is lost and decision-making becomes slow and imprecise. Legal ownership can still involve many parties and this may be desirable where business associations are the initiator of the idea.
• the legal structure should be clear and encourage operational autonomy, but with some element of accountability

5. Provide financial support (if any) on a commercial basis
Equity investments by BDS organizations help to maintain accountability and provide valuable support that is not seen to be a handout.

Box 12: Social privatization as a commercial opportunity
Since 1989, the Institute for Social Development (IPES) in Lima, Peru, have been developing an approach to the development of new commercial entities which meet an environmental and health problem. In Lima, the management of municipal environmental services was seen to be inefficient because of the organizational structure of the municipalities, the high cost involved in their ‘conventional’ environmental systems and public indifference towards environmental problems. For IPES, this problem was regarded as an opportunity to develop a practical solution; social privatization. Under this approach, IPES provides technical support for 6-12 months for microenterprises which are awarded contracts or licenses by a municipality to manage specified services, related for example to solid waste collection and disposal, maintenance of parks and gardens and sweeping streets. The enterprises are, ideally, formed by local people from the localities concerned; this is considered to be vital so that there is real community accountability. Enterprises are either paid by the municipality or by the community directly.

The programme has been highly successful in Lima where 140 environmental service entrepreneurs have been formed, serving 1.2 million people, which are operating in a sustainable manner

d) Unresolved issues
1. Creating new or supporting existing businesses?
Developing a new business through a BDS organization of some kind is seldom a straightforward activity. In some cases, where the supply-side of the economy is underdeveloped, there may be no alternative but to set up a new structure. However, in other cases, there may already be potential private sector partners who are simply not aware of the opportunities. This alternative approach often remains unexplored.

2. When to let go?
BDS organizations which help to establish market enterprises will naturally feel a strong sense of ownership over their development. While this can be especially useful initially, it can also undermine the enterprise’s management and prevent them taking real responsibility for performance. ‘Letting go’ is necessary and should be planned from the outset by giving prime responsibility to the enterprise’s management.

3. When is it fair, when is it not?
The competitive nature of markets means that there is usually some negative displacement resulting from an intervention. It is not clear, however, when intervention leading to artificial distortion in markets. BDS organizations need to be aware of the market power which they can wield, especially in low-income countries, because of their access to foreign exchange.
Donors need to be aware that direct interventions of this kind are sometimes only permissible because of undeveloped regulatory systems governing business competition and that the same actions may not have been allowed in industrialized nations.

e) Current interesting innovations
The entire area of creating new market entities is fluid and changing; to some extent everything is innovative. The key issue for most interventions is how to create capacity and with whom. Options include setting up a new organization (perhaps with BDS staff); working with business associations to set up a related but separate unit; or working with existing private businesses.

4.2.4. Technology development and transfer

a) Definition
This refers to the design and development of technologies and their dissemination to or development by SMEs. The purpose is to raise the standards of the technology that is used, manufactured and sold by SMEs and therefore to improve the quality of their products for consumers. It is also concerned with increasing technology awareness and capacity in SMEs, although not necessarily design and development capacity.

There are many types of intervention which broadly share the goal of improved technology in SMEs, including technical training, physical infrastructure development and improved information services. However, the focus in this section is on two distinctive and common approaches: a corporate approach to the design, development and transfer of appropriate technologies, aimed specifically at improving the lives of poor people; and an indigenous approach to enhancing the technology development capacities of SMEs.

b) Application
Technology interventions ultimately aimed at improving the lives of the poor originate from the appropriate technology movement in the 1970s. While some notable technologies were introduced at that time, there is a widespread view that much of this effort did not achieve the level of impact once anticipated. The prime reason for this shortcoming is seen to be the technology-driven nature of the development. Technology itself was to be the answer to problems. The fact that technology is used through market mechanisms was either not accepted or not given sufficient attention.

Current approaches to technology development and transfer are polarized between two views. The first is based on externally developed technology (by ‘experts’) and emphasizes the importance of professional technical expertise in technology development, its application in a demand-driven process and the need for strong marketing skills and systems to ensure its widest possible use. This view is ‘corporate’ in the sense that it mirrors precisely the approach that a commercial organization would take to developing and delivering its product. The overall thrust is towards the delivery of relevant, useful technologies for the benefit of end consumers, with SMEs being a means to this end.
The second, alternative view is based on indigenous technology development and emphasizes the importance of SMEs themselves in developing technologies on the basis of their own capacity. Efforts by BDS organizations focus on enhancing SMEs’ ability to learn from the environment (especially customers) and on providing access to information on technology and product designs. The overall thrust is towards the incremental and sustainable development of SME capacities.

The two views offer very different visions of technology development and transfer. At this stage, it is not clear which constitutes good (or better) practice. Each offers different strengths and weaknesses (Box 13) and, at this stage, there is certainly room for both approaches in SME development.

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<thead>
<tr>
<th><strong>Box 13: Corporate against indigenous technology development: the key arguments</strong></th>
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<tr>
<td>The on-going debate between the corporate and the indigenous technology development approaches has many strands. However, using the assessment criteria set out in Section 3, a broad overview can be given.</td>
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<tr>
<th><strong>Outreach</strong></th>
<th><strong>Corporate</strong></th>
<th><strong>Indigenous</strong></th>
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<tr>
<td>Potential to reach large no. of end-users through relatively small no. of SME producers and distributors.</td>
<td>Work directly with small no. of SMEs; encourage spread through ‘natural’ process of inter-enterprise learning.</td>
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<tr>
<th><strong>Efficiency</strong></th>
<th><strong>Corporate</strong></th>
<th><strong>Indigenous</strong></th>
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<tr>
<td>High initial development costs of technology; marketing and distribution systems. Potential for economies of scale to lower per unit and per customer cost.</td>
<td>Low initial costs and low number of direct initial beneficiaries. Improved overall efficiency is dependent on ‘ripple out’ learning to other SMEs.</td>
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<tr>
<th><strong>Effectiveness</strong></th>
<th><strong>Corporate</strong></th>
<th><strong>Indigenous</strong></th>
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<tr>
<td>If initial market assessment is (and remains) correct and skills/resources are available, opportunity for widespread (narrow) benefits for consumers. SME development primarily is a means to an end</td>
<td>Aimed at enhancing SME capacity (to produce a range of different products). Less discernible benefits, more likely to be intangible. Facilitating rather than direct delivery role for BDS organization.</td>
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<th><strong>Sustainability</strong></th>
<th><strong>Corporate</strong></th>
<th><strong>Indigenous</strong></th>
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<tr>
<td>Set up costs for both technology and marketing/distribution not intended to recover costs. System operation should be sustainable. Private sector development only hope of complete sustainability.</td>
<td>Seeking to strengthen ‘natural’ processes of technological development and learning rather than create new entities and systems.</td>
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</table>
c) Lessons

THE CORPORATE APPROACH

1. Putting technology in the marketplace
The first point of principle is that any benefits to be derived from technology come from its use. Even if a wonderful design has many potential benefits, technological potential can only be realized when it is manufactured, distributed, sold and used in a market context.

2. Making technology development market-led
The overall process of technology development should follow these main stages:

- identification of market niche;
- identification and (if necessary) adaptation of technologies to meet these needs;
- detailed market research and financial analysis (using a subsector analysis to gain a full understanding);
- testing and product refinement;
- production planning;
- development of promotional and marketing approaches;
- development of sales and distribution systems.

Box 14: Marketing the treadle pump in Bangladesh
The treadle pump was designed by an NGO in the early 1980s. Although it was sold commercially, there was also significant subsidized distribution by NGOs. International Development Enterprises (IDE) became involved when the design had been finalized. They set about changing the existing approach to transferring the technology, arguing that this should not be a subsidized process and that the most effective way of reaching the largest number of people was a self-sufficient, private network of manufacturers and retailers. Eventually, after resistance from the charitable instincts of some NGOs, this view prevailed. IDE then set about a process of selecting village dealers and agreeing on terms with them (among which was a requirement that they had to set up a demonstration pump), training village well dealers and advertising through a variety of means, including village theatre and a film. The result of this effort has been that over 1 million pumps have been sold - around 4 times the initial target - and according to an external evaluation the ratio of benefits to costs is over 40:1.

3. Making the business-like message tangible
In practice, following the business-like principle has a number of implications for the way in which interventions develop:

- final users have to be regarded, first and foremost, as customers (and not the recipients of charity)
- incentives have to be understood and built into the value-added chain extending from manufacturer through distributor to sales agents
- pursuing marketing techniques which educate potential customers about the product and raise awareness of the product’s brand name
• recruiting people who have a feel for business as much as a commitment to poverty alleviation

4. Self-financing after initial development costs
On the basis of current experience, the design and development costs of the technology and the initial costs of setting up the marketing and distribution system need to be financed externally. Thereafter the systems should be entirely sustainable.

THE INDIGENOUS APPROACH
Many of the instruments used here are actually concerned with training or information rather than technology development per se. The lessons identified for these instruments are therefore applicable here.

1. Identifying ‘star’ SMEs
The whole approach is based on the technological and market leadership exercised by key growth oriented entrepreneurs and the view that, in strengthening them, a natural process of technological learning is being strengthened. The difficulty experienced by external agencies in ‘picking winners’ has already been alluded to (see 4.2.2.) and is particularly important in this context.

2. Encouraging (and not swamping) innovation
Leading growth-oriented SMEs operating successful businesses will already be involved with their own innovations. Ensuring that external support does not undermine these processes, but builds on them, is a crucial balancing act - facilitating technology development rather than delivering it directly.

d) Unresolved issues
1. Why isn’t the private sector already doing it?
Various reasons are advanced to justify external support for what is essentially the development of a commercial product. The poor are not regarded as being a credible commercial opportunity by business, investment in low cost technologies is seen as high risk activity with relatively low returns, ‘basic’ industrial research in industrialized nations often receives some form of State support, and, in any case, in many developing countries technical research and manufacturing capacity and that of the marketing, sales and maintenance network is so low that any private sector interest would have to invest significantly in building capacity.

In the long-term, however, for technology development in developing countries to gain real momentum, it is essential for SMEs to begin to assess the potential benefits of this kind of technology and to be prepared to take risks in investing in its development. The extent to which interventions actually encourage SMEs to begin this process is not yet clear.

2. How will design and development capacity be built?
The success of technology development and transfer is based on mutual benefit for all parties in the chain. However, where SMEs are buying technologies, their own capacity to develop technologies may not be being stretched. Indeed, it is very difficult to develop these skills
quickly, since they are normally the product of early technical and vocational education. While SMEs may well be innovative, in itself, this is not a substitute for the ‘hard’ design skills which underpin technological change. Without development of these skills, it is very difficult to envisage how SMEs will be able to develop or adapt the next wave of technologies for low-income customers.

3. When is sustainability reached?
In practice, it can be difficult to specify when a technology development and transfer system has reached a stage where it requires no further external support. There may be continuing involvement from the original BDS organization and an expectation from SMEs that it will always be there. However, there is a need to be specific about the criteria which define sustainability. Otherwise, external (corporate) technology development may appear to be an endless commitment.

e) Current interesting innovations
Again, this is a dynamic area where good practice is being developed as BDS organizations confront and overcome problems. For those pursuing the corporate approach, finding appropriate ways of developing effective marketing systems is the part of the process where the most interesting developments are taking place. The development of effective collaborative projects with larger private sector businesses which may have the technical capacity to develop products is currently being discussed. For those pursuing an indigenous approach, enhancing natural processes of SME technical learning so that interventions may be scaled-up is particularly interesting.

4.2.5. Information

a) Definition
Information services for SMEs are concerned with providing access to a variety of information in either written or spoken form. In this sense, there is clearly an overlap with training and counselling, which are both aimed at knowledge and information and offering an opportunity to learn.

The rationale for interventions which focus on information provision is that SME development is hampered by an ‘information poor’ environment. Market signals on business opportunities, customer trends, methods of organization etc. are not communicating themselves effectively to SMEs. SMEs perform better in information rich environments; information services seek to help create such an environment.

b) Application
There have been a wide range of donor-supported activities aimed at improving SMEs access to information. This includes:

- support to attend national or international trade fairs and business exhibitions;
- business one-stop-shops which provide a variety of information including potential business partners for joint ventures, legal and tax information, etc.;
- written technical briefing information;
- learning visits to other SMEs in different locations but engaged in the same sector; and
interventions aimed at the development of business associations are also concerned with improving information flow between SMEs.

It is very difficult to assess the wider donor experience with information provision initiatives. Until recently there has been little use of the willingness-to-pay criterion as one indicator of the value which SMEs attach to information. Moreover, standard evaluation approaches which seek to link an interventions to impacts are sometimes difficult to use because of the intangibility of some information provision. Certainly, initiatives which have assumed that SMEs will seek out rather passive BDS providers to access information have not generally succeeded. More recently, information has been the subject of more innovative developments.

c) Lessons

1. Needs-based and focused
Information which is of value to SMEs has to be focused and precise, concentrated on what they need to know (rather than what they may like to know). Subsectoral analysis can be a useful tool in developing the detailed knowledge required to develop information products which SMEs may want. If information is needs based, its potential benefits should be transparent to SMEs.

2. Not just what but how it is presented
Many SME owner-managers, especially at the micro level, are not accustomed to learning from written materials. Information has to be accessible. This means that the form of presentation needs to take into account the learning style of potential users. Similarly, exchange visits and trade fairs can only be useful if people are able to have an opportunity to meet.

3. Information suppliers with credibility (who delivers)
Effective delivery of information services for SMEs has to be based on a sound knowledge of their own mode of learning. SMEs learn incrementally, from experience, through trial and error. They also learn from their environment, particularly from their peers, competitors, suppliers and customers. As with all BDS, SME owner-managers are more likely to value and use information which comes from someone close to them who can stamp information with practical credibility.

4. SME owner-managers are willing to pay for information opportunities
There is emerging evidence that SMEs will pay for the right kind of information (i.e. information that is useful for their business relatively immediately) which appears to offer the chance of tangible gain (e.g. product development ideas).

<table>
<thead>
<tr>
<th>Box 15: Enterprise visits to promote exchange and learning in Kenya</th>
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<tr>
<td>In Kenya, partner BDS organizations of the FIT programme organize enterprise visits for SMEs (informal sector jua kali businesses) aimed at providing them with a real opportunity to learn and exchange information and to develop commercial linkages. The process had several stages. First, the BDS organizations select the subsector which will be the focus of the programme and assess its main needs and on this basis lay out an initial programme. Second, the participating entrepreneurs are selected. Care is taken to ensure that they do not include</td>
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direct competitors to facilitate the free exchange of information. A workshop then follows, during which the participants are introduced to the programme’s objectives and are assisted in setting personal goals and formulating a workplan for the visit and afterwards. Baseline data are collected on the enterprises. Visits are mostly in groups, accompanied by someone from the organization. After the visit, one-to-one advisory services on product design, development and skills upgrading are provided. Further learning is facilitated by later joint workshops with the entrepreneurs, which also help to assess impact.

Enterprise visits appear to have had some success in terms of new practices and skills acquired by the enterprises. Direct costs of the visits are covered by the SMEs. There is also some indication that entrepreneurs who do not participate but learn of them organize their own visits without support, which in itself is a useful indicator of perceived impact.

5. **Investment is required in initial client awareness**
The relative novelty of learning through materials or visits to other businesses means that SMEs are often sceptical about the value of such information. Once the benefits are apparent, they are more likely to pay for information.

6. **Information as a product to be sold**
There has been a passive approach to information provision, which is inappropriate given its relatively unusual nature and the need to educate sometimes sceptical SMEs of its benefits.

7. **Trade fairs are perceived to be valuable**
There is significant evidence pointing to international trade fairs as a major source of market information for export-oriented SMEs. Less clear is the rationale for external financial subsidy for SMEs to participate in such occasions.

d) **Unresolved issues**
1. **How can the sustainability of information interventions be assessed?**
In situations where interventions are seeking to initiate exchange between different players in the same subsector, the most direct indicator of sustainability is whether or not the practice of exchange is maintained. For written information, the extent to which other private sector operations seek to copy is also an indication of the market’s approval. However, in other cases, there may be no effective market mechanism. The information rich environment of industrialized nations has its roots in a multiplicity of different organizations and individuals; it may be unrealistic to expect SMEs in developing economies to shoulder the cost of its development.

e) **Current interesting innovations**
1. **Promoting exchange visits**
   and meetings between SMEs operating in the same sector, but in different areas. There is some evidence to suggest that SMEs will organise these visits themselves after an initial sponsored exchange.

2. **Bringing together producers and customers** for a frank exchange on how products might be improved to make them more useful and attractive has created some signs of positive impact. FIT are supporting these innovations.
3 Publication of technical booklets, including drawings, with finance coming from customers and advertisements. This is being promoted currently in Kenya.

4.2.6. Business linkages

a) Definition
This heading covers interventions aimed at improving commercial linkages between SMEs (Mead, 1994). Three main types of linkage are considered:

1. Subcontracting: this usually refers to an arrangement where a large customer contracts out a portion of its work to smaller suppliers. In reality, however, subcontracting also includes a complex variety of linkages in which small firms subcontract work to other small businesses all the way down the production chain. Interventions aim to promote and organise this kind of relationship.

2. Franchising: under this arrangement, one enterprise sells to another the right to produce or sell a commodity/product for which the franchiser holds the trademark. This means that the franchisee must follow the standards and procedures laid down by the franchiser.

3. Clusters and collaborative production networks: this refers to a broad system of production involving many different firms of different sizes and possibly other actors such as business associations, R & D networks and specialist service providers, in a complex production arrangement. It is differentiated from ‘straight’ subcontracting by the number of actors involved and the sheer scale of the collaborative agreements required, and is sometimes referred to as flexible manufacturing systems. This kind of arrangement (and subcontracting) allows SMEs acting in concert to overcome the limitations of being small-scale, with each taking a small part in the overall production chain, but without abandoning the flexibility which is a key advantage of smallness.

Business linkages also sometimes refers to brokerage functions, the analysis of which was included in the earlier section on Developing commercial entities (4.2.3).

b) Application
There has been a major move towards more subcontracting and outsourcing arrangements in industrialized nations in recent years (Tewari, 1994; Humphrey, Schmitz, 1995). Inspired by the key role of subcontracting arrangements in Japan, large businesses have sought to focus their activities in areas of core strength and subcontract more peripheral functions where other businesses have greater expertise. Subcontracting should therefore offer mutual benefit to both firms and ultimately to consumers who receive a better product, and to the economy as a whole, through higher collective efficiency. In practice, subcontracting can actually take different forms. In some cases, it can be a major source of learning for the subcontractor. In others it is a more transient relationship which involves little technical benefit to the subcontractor.

While subcontracting has become much more common in recent years, in many developing economies, particularly sub-Saharan Africa, there has been relatively little growth in subcontracting. Among the reasons cited for this situation are the historic importance of
vertically integrated companies, a missing middle of SMEs which have the potential to act as subcontractors and the different networks in which large and smaller business operate, often heightened by racial and ethnic differences.

There have been a number of attempts to promote subcontracting but with mixed results. Earlier attempts in India to establish subcontracting exchanges proved to be over-regulated and unpopular with SMEs, especially the policy of price floors to try and ensure that subcontracting arrangements were not ‘exploitative’. In practice, SMEs valued the opportunity to develop relationships and found price regulation an unwelcome intrusion.

There are now signs that subcontracting is receiving more attention from donors. UNIDO has been particularly active in promoting subcontracting for a number of years.

Franchising has also become more popular in recent years in industrialized nations. Although a circumscribed relationship and relatively static in terms of its potential for further development, franchising is a simple way to start a business. It encourages learning by requiring novice owner-managers to become familiar with a market and to meet prescribed quality standards in service/production. Franchising is advancing in developing economies, but it is not yet clear what role donor interventions may have in encouraging it further.

Business clusters have been the subject of a great deal of research interest recently (Tewari, 1994; Humphrey, Schmitz, 1995) and they have been investigated in detail in a number of developing economies, especially in South America and Asia. To some extent the growth in the use of subsector analysis mirrors interest in clusters of SMEs operating in flexible manufacturing systems. In both cases, the primary unit of analysis is not the individual SME, but the subsector group as a whole: it is the collective well-being of the subsector which is important. While there have been successful cases of interventions based on subsector analysis, it is not yet clear what role donor interventions may have in encouraging it further.

c) Lessons
Unless otherwise stated, the following general lessons apply equally to subcontracting and networking (there is insufficient experience to make any comment on franchising)

1. Do not set too many rules
In setting up subcontracting exchanges or other forums for potential subcontractors and their clients to meet, it is important that the role of facilitation - providing a means for people to come together - does not try to overly-govern what parties agree on themselves. Price floors and ceilings are not appropriate; over-zealous interference is likely to be resented. Any attempt at forcing companies into subcontracting against their will is obviously counterproductive.

2. Building on a commercial logic
Networking and subcontracting is based on sound mutual advantage (a ‘win-win’ situation). If potential subcontracting situations do not materialize, there may be sound commercial reasons to explain this. There is no point in trying to force relationships against the logic of the market.
3. Investing to overcome market distortions
Where subcontracting and networking have not developed to the extent that might have been expected, significant constraints to efficient market operation may be present such as a lack of information; a lack of business communication; a lack of awareness of customer standards, subcontractor capacities and potential benefits; and business practices, especially concerned with payment terms, which are not conducive to developing trust between potential business partners. Overcoming these identifiable market imperfections is a suitable case for limited short-term subsidy.

4. A subsectoral focus
While UNIDO’s system of subcontractor exchanges is usually not focused on one subsector, more recent initiatives are seeking to be more specialized. From a practical perspective of knowing markets, industries and the key players, it appears more likely that a narrow subsectoral approach would be successful. However, there can be useful complementarities in cross-sectoral initiatives.

| Box 16: Building subcontracting networks in Latin America |
| UNIDO’s programme to support the development of industrial subcontracting grew out of the substantial regionalization of the economy, with increasing commercial links at every level. Building on this real interest, UNIDO supported the development of a number of subcontracting and partnership exchanges. These are computerized data banks/markets through which subcontracting arrangements can be identified, promoted and concluded. Software development has allowed the development of common terminology and methods of procuring and placing contracts across countries so that the inefficiencies resulting from physical location and lack of information have been reduced. National counterparts exist in 14 countries and in all there are 30 subcontracting exchanges. 15,000 enterprises have registered with the exchanges and, of these, 40% per year actually undertake work gained through the exchanges. The overall management of this network of exchanges is now undertaken by a local non-profit organization. The success of the programme appears to have been built on (Gibb, Manuel 1990) early identifications of a market interest in subcontracting and (McVay, 1996) identifying a way through which collaboration could expand the benefits of this trend. |

5. Bringing people together and more
The basic thrust of subcontractor interventions is premised on the view that a key constraint is awareness of the potential benefits of subcontracting, of potential subcontractor capacities and of potential subcontracting opportunities. Helping to build initial relationships by offering different parties an opportunity to meet and gain confidence is a key role of an external BDS organization. However, there may be more fundamental problems inhibiting subcontracting, such as problems related to subcontractor management capacities and inexperience with legally enforceable contractual relationships. In these situations, interventions should seek to address these constraints as well. Where the gap between parties is simply too big for a meaningful working relationship to develop, a proactive role which may be considered is to encourage SMEs to come together in a network with a new entity created to represent them as ‘system articulator’.

6. Give space for ownership to develop
In network situations, following a process from the outset which puts key players, such as business associations and chambers of commerce and industry, at the heart of the planning activity encourages their enthusiasm. Linkages of any kind can only be driven by the linkage partners and real participation during planning will nurture this commitment.

**BOX 17: Restructuring and modernisation of SME clusters in India**

In this ongoing project, funded by UNDP and other donors, UNIDO aims to support the formation of SME networks by developing local capacity among geographically clustered SMEs operating in the same subsector, to identify and prioritize their own specific needs, and then, with the help of partner organizations, develop focused programmes to collectively build their competitiveness. The chief instrument for formulating cluster and sector-specific programmes is the diagnostic study. All actors who were likely to be involved in the design and implementation of the programme (associations, chambers of commerce, banks and key local government agencies) were involved from the very beginning in order to build their ownership over the programme. Based on the findings of the diagnostic studies, key actors in each cluster developed programmes that best addressed their specific needs. For example, twenty-two small and medium entrepreneurs from one successful hosiery cluster paid their own way to visit Italy to see how those clusters had addressed the problem of effluent treatment, a problem that was plaguing this cluster. In another cluster, local food processing firms prepared a detailed programme of collaboration with a local food research institution for the development of common standards. Emerging experience points to the importance of the role of facilitator in allowing SMEs the opportunity to exchange views and experiences and of focused interventions which are pertinent to the specific conditions in a particular subsector.

**d) Unresolved issues**

1. **To what extent can donors intervene to promote other forms of business linkage such as franchising?**

There is clearly considerable market SME interest in this area but, as yet, it is not clear what interventions, if any, can be taken to increase SME access.

**e) Current interesting innovations**

Linkages are also a relatively young and fluid area. Using a subsectoral approach to promote improved linkages is receiving increased attention in several countries, sometimes through local business associations. If associations are weak, however, as they are in many countries in Africa, finding the appropriate vehicle for intervention is a significant challenge.

4.3. **The meso level: Institutional capacity building**

**4.3.1. Introduction**

This section is concerned with interventions aimed at developing the capacity of institutions which can provide services (of various kinds) to SMEs. Meso level development has become the most important area of involvement for many donors. The structure follows that of Section 3. However, given the size of the topic, some further explanation is useful.

**Definition** (4.3.2): this looks at:
a) the rationale: why meso level development is considered to be important;  
b) what kinds of institution are present at the meso level;  
c) what is meant by institutional capacity; and  
d) what instruments are used in capacity building

Application (4.3.3): here some general comments are made on donors’ experiences of institutional development.

Lessons (4.3.4): this looks at lessons emerging from donors’ experience under three headings: 
a) important factors in developing a business-like organization;  
b) appropriateness of different organization types; and  
c) general principles underpinning capacity building

Unresolved issues (4.3.5): this identifies some questions where there is still considerable debate over appropriate practice.

Innovations (4.3.6): this lists (in brief) some of the most important current institutional development innovations.

4.3.2. Definition

a) Rationale
Most donors involved with SME development no longer attempt the direct delivery of services to enterprises. Their focus tends instead to be on the development of local and national BDS organizations. Such organizations are then often called *intermediaries* or *counterparts*. In reality there is a growing consensus that donors' appropriate function is to develop a capacity for *service delivery* in counterpart organizations; the role of counterpart BDS organizations is to provide services to SMEs.

Interventions at the meso level have become more popular in the field of direct activity at the micro level for two main reasons.

1. **Sustainability**: services provided directly by a donor-funded project terminate with the project. In contrast, a sustainable indigenous SME development organization should be able to deliver benefits to a client group for a period of time after donor support comes to an end. Although significant (donor) investment may be required to achieve this, a sustainable organization will eventually serve larger numbers of SMEs than a short-lived project.

2. **Effectiveness**: an indigenous organization should have a better knowledge of the needs and demands of client groups and should be able to develop more cost-effective services to meet them.

The objective of meso level interventions is the enhancement of BDS organizations’ efficiency, effectiveness and sustainability. This is realized by what is generally known as
institutional development or capacity building. More specifically, capacity building takes place to:

1. Strengthen and expand existing BDS organizations, to improve their services, add new services and expand to new target groups or geographical areas.

2. Assist in the establishment of new organizations, especially where existing organizations do not provide an adequate basis.

3. Assist in the formation of networks between organizations through, for instance, referral services or sign-posting. This recognizes that no single institution can deliver all possible services.

b) Types of organization
Donors work with a range of local and national BDS organizations. There are significant differences between these organizations, especially with regard to ownership, management, funding and the services they offer. Such differences can have important consequences for their performance and therefore for the potential for and type of donor support.

One of the most useful distinctions between membership and service delivery organizations relates directly to ownership of the organization.

Membership organizations
These are essentially self-help organizations created and owned by SME owner-managers to support or represent their interests and provide members with services. They include chambers of commerce, business associations, trade or sectoral associations and different types of cooperatives. Most have some kind of legal identity, but some are as informal as the enterprises of which they are comprised. They are non-profit. The largest may be nation-wide and include thousands of enterprises of different size, while the smallest may have just a dozen members.

Genuine membership organizations are by definition private sector organizations. They fund their activities from membership fees, fees for services and, in some cases, donor support. In a number of countries, however, chambers of commerce and industry receive government subsidies and fall under the authority of the ministry of industry or commerce. Furthermore, in many countries chambers have had a semi-government status because of quasi-state role in relation to foreign exchanges and labour rules. Liberalization is now changing this role.

An alternative and less common type of membership organization which qualifies for the meso level is associations of SME development professionals. These usually commercial providers of services for SMEs are an important feature of the institutional landscape in which SMEs operate, particularly in transition and middle income economies.

Service delivery organizations
These are institutions which have been set up and are owned by agents other than entrepreneurs, with the aim of providing specific services to SMEs and, sometimes (though less common) to represent their interests. If they have a membership basis (generally they do not), this does not consist of entrepreneurs. Entrepreneurs may in some way be involved in
the management of the organization through membership of its board or advisory committees, for instance. Most are non-profit. Some are nation-wide, others are local.

Service delivery organizations can be further differentiated on the basis of ownership, management and funding, between:

1. **Government or semi-government organizations:** these include departments of government ministries and a range of government agencies and para-statals, with a budget to which the State contributes significantly.

2. **Not-for-profit or non-governmental organizations:** these are all outside the government and provide their services on a not-for-profit basis. Funding may be through fees, income generating activities and donor contributions. Most countries have legislation which regulate this sector.

3. **Commercial private sector organizations:** which include enterprises such as consultancy firms, private training institutes and any other form of private business (including for instance wholesale suppliers, subcontracting businesses, equipment suppliers). These organizations provide services on a for-profit basis.

Membership as well as service delivery organizations show great variation with regard to the services they provide. While advocacy is the core role of membership organizations, they also offer some BDS, such as training, information and financial services (savings and credit, provident funds).

Service delivery organizations can be placed on a continuum from lower to higher levels of specialization. At one end are organizations offering one service only, such as training or technology development institutions. At the other end are organizations for which SME development is just part of their broader development mandate. These multi-sectoral development organizations may include assistance to SMEs in a more comprehensive programme, along with, for instance, community development, agriculture or health, either in an integrated package, or relatively independently. An important distinction should be made between organizations which combine financial and non-financial business development services, and those which do not.

Finally, it is important to make a distinction between institutions and organizations. While the latter refer to entities (such as membership and service delivery organizations) which have a formalized structure, the former are more comprehensive and refer both to organizations and to looser alliances or networks of individuals (see 4.3.5).

c) **The meaning of ‘capacity’**

Capacity is a term which is used frequently (if vaguely) in relation to donor interventions at the meso level. Before proceeding with any detailed analysis of capacity building, it is important to develop a more precise view of what is meant by capacity. BDS institutions of whatever variety require capacity in four main areas (Henriques, 1994):

1. **Organizational capacity:** this relates to an organization having a vision, i.e. the ability to ‘articulate and generate commitment for its mission, goals and objectives, client
population, approach and desired level of impact’ (reference), as well as a corporate culture which reflects and supports this vision. It is also related to the external and internal legitimacy that an organization needs to grow and the network of relations it establishes with other organizations.

2 **Managerial capacity:** an organization requires a legal and organizational structure which allows it to realize its vision, appropriate management systems and procedures, and staff with the necessary management capabilities. Systems and procedures include administrative and personnel policies; planning, monitoring and evaluation systems; information systems; and financial administration systems. These allow the organization to plan, control, monitor, report on and evaluate its programme.

3 **Technical capacity:** an organization should use the instruments or methods which allow it to realize its vision, and staff able to use these instruments. This should include a capacity for further development of the programme, to meet the changing needs of the clients.

4 **Financial capacity:** this refers to an organization’s ability to obtain funding for the implementation and development of its programme, through self-financing or external support and to keep costs to an acceptable level.

d) **Capacity building instruments**
While most donors emphasize the importance of capacity building, they do not tend to differentiate between individual approaches. Capacity building is generally a term used to describe a variety of inputs, most of which fall under three headings:

- ‘guidance/advice’, consultancies, technical support from ‘experts’: this can take a variety of forms and focus on a range of subjects, be provided on a one-to-one basis or with groups and be on a continuous or part-time basis
- a number of donors emphasize the important role that organizational development (OD) approaches can play in ‘holistic’ capacity building, which goes beyond technical capacity building to embrace all the four dimensions of capacity identified above
- training of staff and management (or members)
- financial support: this may take the form of funding for specific projects or, less frequently, general budgetary support.

Donor’s own analysis of their meso level, capacity-building interventions does not dwell on the detail of these approaches. Much more important is attached to ‘how’ capacity building is implemented. The focus generally throughout this Section is therefore on the principles which apply across all instruments (Duval, Waterfield 1996).

4.3.3. Application
The majority of donor supported interventions understand capacity building mainly in technical and, to a lesser extent, managerial terms. The most common instrument is ‘training of trainers and other technical staff, which often goes together with a project providing support for the design and development of services. The training of managers is a less usual though still common intervention. The development of management systems is generally
limited to monitoring and evaluation, which is of course also directly linked to donor and project objectives. Monitoring and evaluation systems may serve the (temporary) needs of donor projects, rather than the long-term needs of the counterpart organization. All other management systems required by an organization, as well as its overall organizational structure, generally lie beyond the scope of the majority of projects.

There is growing recognition of the need to embed organizations in networks. This is viewed more in terms of service delivery (if one organization cannot provide a certain service, then another in its network does), but there should be a broader purpose of establishing substantial legitimacy. In general, interventions to develop what we have called organizational capacity are scarce.

Financial capacity is a major concern of a growing number of interventions, in line with donors' increasing emphasis on the need for financial sustainability. This generally takes the form of projects introducing fees for services. These are, however, often nominal. Reducing costs attracts donor attention, but this is inadequately reflected in interventions at the level of organizational structures and management systems.

Above all, what is most striking about the majority of donor interventions is that they are not comprehensive attempts at institution building. Instead, they are piecemeal and limited to issues most directly related to an immediate improvement in services. A project adding training to an organization’s package of services, for instance, may develop the required technical capacity, train a training manager and establish a monitoring and evaluation system; but it is unlikely to look at the integration of training into the organization’s vision and its overall management and financial capacity. It may thus attempt to graft a successful unit onto a weak organization, which is not sustainable in the long run.

Inevitably, in a field dominated by small enterprise development specialists, most interventions at the meso level have been focused on developing technical capacity, with limited attention to the most obvious managerial and financial issues, and very little to broader aspects of institutional development.

4.3.4. Lessons

a) Important factors in developing a business-like organization

As mentioned in Section 2, there is widespread general agreement that the guiding paradigm for the management and operation of BDS organizations should be SMEs themselves; i.e. BDS organizations should be business-like or entrepreneurial. A business-like BDS organization:

- has a better understanding of its clients, since (like them) it is a business;
- has an inherent interest in offering services which the clients need, rather than those it can easily provide, since they are its customers without whom it cannot survive;
- is able to make use of emerging opportunities to develop services for which demand is high;
• can be self-financing at least in part (by charging for services), and may therefore be more sustainable; and
• offers a demand-driven programme of services, which allow it to exist and grow in a market place in which SMEs are the clients.

Using the above framework to define capacity - organizational, managerial, technical and financial - the factors outlined below have been found to be important in creating business-like BDS organizations.

(1) Organizational capacity
1. A business-like vision and corporate culture
The target group should be defined as clients or customers, and there should be a strong commitment to the organization and to providing appropriate services to clients. The relationship with clients should be defined as transactional, i.e. one in which a service is offered for a price, from which both parties benefit. Generally, the economic importance of SME development should be emphasized not in preference to social and welfare aspects, but rather as a fundamental prerequisite to improving welfare.

Although a business-like approach is sometimes perceived to be contrary to social objectives, in reality there need be no such contradiction. The situation of clients clearly determines their needs, the nature of services to be offered and the extent of contribution which they can make; the design and implementation of interventions has to take be based around these. However, the overall approach of how BDS organizations work is not affected; no matter how disadvantaged, people can still be valid clients. The only real alternative to a business-like approach is a (traditional) charitable relationship, which is only really appropriate for welfare/relief situations.

(2) Managerial capacity
1. A legal form which encourages business-like behaviour
This is the case with any form of organization in which performance is related to its continuing existence, the number of jobs it can offer, and the rewards employees receive. Developing organizations as actual companies in which staff members own (at least part of) their organization may be most effective. Where subsidies are provided, these should not be automatic, but performance related.

2. Decentralized Structures
Giving staff at the local level who interact with the clients and know their needs best a high degree of authority and responsibility. There should be a strong local presence to be able to reach out to clients.

3. A high degree of autonomy from government
Structures should allow the organization to be free from the (usually non-business-like) influence of politicians and bureaucrats.

4. Including client representatives in the organizational structure
For instance on a board, is useful for creating a more entrepreneurial style in the organization, as well as for greater relevance of services.
5. **Management systems to introduce or simulate market mechanisms**
Mechanisms should be introduced which provide immediate and significant feedback on the extent to which services meet demand. This should include market research and continuous monitoring and evaluation, and charging fees for services. Linking individual or team performance to financial or other incentives may strengthen the impact of such mechanisms.

6. **Participatory management systems and styles**
Management approaches allow individual initiative and promote a sense of ownership, i.e. by allowing a degree of ‘entrepreneurship’ at all levels.

7. **Flexible management**
This is necessary to allow the organization to react to changing needs and demands.

(3) **Technical capacity**
1. **Specialize in core areas of expertise**
Rather than trying to provide services for all possible client needs; organizations should focus their activities. This enables them to reach a higher degree of technical expertise, meet demand more effectively and simplify management functions.

2. **Develop the technical capacity to adapt or develop new ‘products’**
In addition to being able to deliver services to meet changing needs and demands, organizations should have their own product development capacity, or they should be able to access such a capacity in their network.

(4) **Financial capacity**
1. **Develop transactional relationships**
Focus and clarify relationships by charging fees for services which the market will bear. A degree of self-financing should thus be realized.

2. **Diversifying funding**
Where organizations find full self-financing not to be feasible, they should diversify their sources of funding in order to reduce risk.

3. **Realize economies of scale**
* Larger (but decentralized) organizations.
* Specialization.

4. **Reduce costs**
* Working with a small core of permanent staff and engaging free-lance specialists as required (keeping the fixed cost base under control).
* Providing services through groups rather than to individual enterprises, where this is technically feasible.
* Developing a professional management capacity in the organization, both in terms of human resources and systems. Computerization of management systems can reduce costs in many situations.
There is least certainty, paradoxically, about the financial aspects of the business-like BDS organization. The extent to which business development can be fully self-financing is still doubtful. Most experience seems to indicate that full self-financing of some services as they are currently being delivered is not feasible, especially if:

- micro and small, rather than medium-size enterprises, are the main clients;
- disadvantaged groups, such as the poor, or women, are among the main target groups; and
- the per capita income in the country is low and the economy is not growing rapidly.

Where their clients' purchasing power is low and growth prospects are limited, there may simply not be a sufficiently large market for the organizations to sustain themselves as a business. One way to address this, without the organizations becoming permanently dependent on government or donor subsidies, is to subsidize services with income from activities which earn a surplus income. While good practice clearly indicates that financial and non-financial services should be split, there are clear examples of SME development organizations achieving this split operationally within the same organization. Where this can be done (and experience suggests that it usually cannot) there may be some scope for cross-subsidization.

**b) Appropriateness of different organization types**
Against the business-like standards set above, how do different types of BDS organizations fare? The donor experience is summarized for each below:

**Membership organizations**
Membership organizations have demonstrated the potential to play an important role in advocating SME interests and, to a lesser extent, in providing services. Being made up of SMEs, they are closer to them than any other type of organization and have the most immediate knowledge of their needs. Membership organizations can suffer, however, from a range of weaknesses which detract significantly from their ability to be business-like in their work for SMEs (Havers, Gibson, 1994).

* Their vision is often undeveloped, and often focuses on a single issue of immediate importance, mostly to be addressed through advocacy rather than through longer-term service delivery. The membership is often not clearly defined.

* Larger organizations, in particular chambers of commerce, are often dominated by the interests of larger enterprises and develop purposes of their own, quite unrelated to the needs of their members. Smaller organizations are often closer to the membership-driven organization ideal. Many organizations, both small and large, are politicized.

* Management capacity, in terms of systems as well as human resources, is often very weak. As this may result in a low level of accountability, conflicts and lack of commitment are usual.

* Technical capacity is generally weak as well: the smaller membership organizations typically have no professional staff, while the quality of staff in the larger ones is low. The financial basis of many membership organizations is fragile, as members fail to pay their dues and the organizations show as great a reluctance to charge cost recovering fees such as those
charged by Government organizations and NGOs. It is brave to assume that organizations made up of enterprises can be expected to apply business principles to their operations.

In practice, there are clearly very different traditions associated with membership associations which impinge on their performance in donor-supported interventions. For example, both South America and the Asian subcontinent have strong association traditions embedded in their social and business institutions. In East and southern Africa this tradition is largely absent and most interventions have not been successful.

Government or semi-government organizations

Among service delivery organizations, government BDS organizations are generally least successful at being ‘business-like’. The global experience is that government is not a good BDS provider. This is not surprising. Government organizations are usually subject to administrative rules and regulations which discourage an entrepreneurial organizational culture and risk-taking behaviour. Many suffer from a general lack of vision: they have a mandate imposed from the outside rather than a sense of mission which generates internal and external commitment. Neither funding for the institution or rewards for individuals are unrelated to performance. Salaries may be too low to attract well-qualified and motivated staff. Government organizations often score low on decentralization, participation and ownership, and are frequently subject to political and bureaucratic interference.

Not-for-profit or non-governmental organizations

NGOs have demonstrated a higher level of success and have the potential to behave in a more business-like way. They often have to prove themselves in the marketplace. Even if it is a marketplace for donor funding in addition to one made up of SMEs, there is in any case a strong incentive to produce results. NGOs generally also have a stronger vision and a greater level of commitment to realizing their vision. However, this is not always a vision which generates a business-like organizational culture; indeed, many NGOs hold a charity orientation which is either suspicious or decidedly antipathetic towards business. There is generally a greater sense of ownership, more decentralization and encouragement of individual initiative and greater flexibility. On the other hand, overall management and technical capacity are often weak: good intentions and motivation often take the place of professionalism, especially when the organization relies significantly on volunteers or low-paid staff.

Commercial organizations

The logical conclusion of the search for business-like BDS organizations is, of course, the commercial private sector. Businesses are the most successful service providers to SMEs. However, there is an important caveat: the services they sell are not generally those which NGOs and governments provide, e.g. in business training and counselling. Their market is also generally different: it may not include the smallest and poorest enterprises which many non-commercial programmes target. The success of businesses in servicing SMEs does therefore not mean that they are the appropriate mechanism for realizing the objectives which donors aim at. Nonetheless, as reported in 4.1, extending the range of commercial BDS provision is an important current trend.

c) General principles underpinning capacity building

1. Comprehensive and systematic institution building interventions
Such interventions are based on assessments which analyse the institution's capacity, and consider the extent to which it allows the organization to be business-like and entrepreneurial in the ways it identifies and meets the needs of SMEs. This often requires an initial intervention to develop an institution's organizational capacity, most importantly its vision, following which its needs to realize this vision can be established. A number of donors are turning to organizational development (OD) type interventions to achieve the necessary comprehensive scope of capacity-building interventions.

2. Part of a dynamic process
Successful interventions are conceived and implemented as part of a dynamic process, rather than being designed at the start of a project as a set of activities which can be implemented mechanically. Initial interventions will often have effects which require modifications in strategy. Organizational needs assessment should therefore be a continuous activity.

3. Partnership
Interventions should be planned and implemented in a partnership between the donor agency and the SME development organization. Organizational change which is imposed by donors is unlikely to result in the desired changes. If it does, such changes cannot be expected to be sustainable. In this partnership, the receiving organization should in the final analysis have the last word on the planned interventions. The donor should, on the other hand, have the option to discontinue support for the process of institutional development if the counterpart's response does not meet with its expectations.

Box 18: Comprehensive institutional development: the Association of Cambodian Local Economic Development Agencies (ACLEDA)
This ILO executed project, funded by UNDP and other donors, ran from 1992 to 1995. It set up from scratch a national non-governmental organization which implements an integrated programme of financial as well as non-financial services for micro and small enterprises of low-income target groups. The project and ACLEDA developed and implemented a comprehensive programme of institutional development, which addressed the need for organizational, managerial, technical and financial capacity-building. This started almost immediately when the programme became operational. One of the first interventions supported the organization in the development of its strategic plan, through an innovative methodology which enabled all its members (staff) to participate. This was a key element in the development of a vision and a sense of ownership. A structured approach was followed for transferring authorities and responsibilities from the project to the NGO. A mutually agreed schedule for such transfers was linked to capacity development interventions. These included comprehensive systems development in addition to training. ACLEDA now functions as an autonomous organization, and the limited technical assistance it still receives is being phased out. Full self-financing is expected to be achieved by 1999, mainly on the basis of the income from credit, which subsidizes business training and counselling.

4. Long-term commitment
Long-term commitment on the part of both the donor and the counterpart to the process of institution building is another characteristic of successful interventions. Both the donor and the counterpart need to recognize that institutional development in general is a process that requires caution and time. How much time depends, of course, on the starting point and the
objectives to be realized, as well as a host of other factors. For comprehensive institution building projects, a duration of five to 10 years is not uncommon.

5. Orientation phase
Some experience indicates the importance of an initial period of orientation, of perhaps six months to a year, during which the donor and the counterpart organization learn more about one another and gradually give shape to the overall strategies to be followed. Projects which do not have such a orientation period, and are designed during a brief mission, often find that their project documents require significant change. This period can be extended into a pilot phase, giving both donor and counterpart BDS organization the opportunity to test strategies before deciding on a future direction.

6. ‘Think sustainability’ from the very start
Activities to achieve sustainability should start with the project’s inception. Postponing hard decisions on organizational change, the charging of fees or other factors which affect sustainability, generally results in such issues not being addressed at all, or too late. In such situations, a project mentality of dependence on foreign funds and expertise becomes ingrained and sustainability is unlikely to result.

7. Donors take no direct responsibility for service delivery
From the start, final responsibility should lie with the counterpart BDS organization. The role of donor staff is as technical assistants and advisors, i.e. a staff function rather than a line function. This will force both donor and counterpart to actively work for capacity building and plan for the time when the project is no longer there. If the counterpart organization is to be set up from scratch, programme implementation responsibility should be gradually transferred to the new organization as soon as it has developed the necessary capacities.

8. Being consistent over relationships
While donors may preach the virtues of a business-like relationship between BDS organizations and their clients, this message is clearly undermined if the relationship they aspire to develop with the BDS organization is contrary to the business-like theme. It is important that the relationship that evolves between donor and BDS organization encourages the latter to be business-like. This has implications for, among other aspects, reporting arrangements, flexibility of action and target setting (see Box 20).

9. Recognizing individual vision
Just like SMEs, BDS organizations are often dominated by an individual with a strong sense of personal ownership over the organization and its work. In many ways this is both the strength and weakness of these organizations. Eventually SMEs have to create management teams to permit further development and the same has to occur with growing BDS organizations. However, for most of them, a key individual still exerts huge influence and her or his own sense of worth may well be inextricably bound to the organization. This defines the BDS organization. It is important that donor interventions seek to build and strengthen this vision rather than undermine it.

10. Use financial support with caution
Successful projects at the meso level use financial support with caution in tandem with institutional development interventions linked to a decrease of funding over time. This is in
agreement with the need for organizations to be business-like. The time scale over which financial assistance is eventually fully phased out depends on the situation.

11. External legitimacy for private sector BDS providers
Gaining external legitimacy, especially with governments, is particularly important for NGOs. Governments in many countries regard NGOs with suspicion, as competitors for funds, difficult to control and possibly working contrary to government policy. Donors can play an important role in convincing governments of the effectiveness of NGOs and in developing more constructive relations between them. On the other hand, supporting NGOs to strengthen their political dimension, as has been the objective of some donor interventions, is probably counterproductive as regards the delivery of SME development services, although it may be justifiable in other terms.

**Box 19: Developing services at Chambers of Commerce and Industry in Brazil through a dynamic partnership**

This GTZ project was conceived as an intervention at the micro level: SMEs would receive training and advice from German artisans, who would come to Brazil or receive trainees in Germany. Chambers of Commerce in Germany and Brazil were considered appropriate intermediaries. However, the project developed into a meso level intervention as it was found that institutional change was required to enable the Chambers in Brazil, which functioned as an interest group for larger enterprises only, to provide needs-based services to SMEs in a sustainable manner. An orientation phase at the start of the project made this re-direction possible. Introducing participative approaches to planning, decision-making and training, without infringing on the organizations' autonomy, the project allowed a new sense of mission to develop with regard to SMEs, which resulted in the Chambers opening up their membership to SMEs and offering services specifically aimed at this group. Organizational change occurred in the context of concrete activities for SMEs initiated by the project as part of a dynamic process. SMEs as well as the Chambers were involved actively in all stages of identification, planning, implementation and evaluation of services. The organizations have started to view themselves as enterprises which offer advocacy and services as their products, while SMEs have started to recognize them as their legitimate representative and an important source of support.

12. Increasing specialization while maintaining a broad offer
Specialized agencies have generally been found to be more effective in serving SMEs. This reflects the development of the micro-finance sector towards ‘minimalism’ and support to financial institutions rather than integrated programmes. It is also supported by greater emphasis on focus in business management (doing what you do well and not being diverted to other areas). One consequence of the trend towards specialization is the growing attention to the development of networks. Organizations linked through networks can refer clients to each others' specialized services, and thus meet a diversity of needs. In its most extreme form, this has resulted in the setting up of institutions whose only service is referral. Like any provider of knowledge-based non-financial, non-hardware services, it is important to balance focus with broad awareness of other services.

13. Increasing capacity while keeping fixed costs controlled
Another basic business message in institutional development is the importance of maintaining a ‘tight’ fixed cost base which is commensurate with longer-term organizational ambitions
and sustainability. Inevitably, this will mean, among other steps, seeking to use external resources for particular tasks and using them to build appropriate relationships.

The above principles are valid for all institution-building interventions in support of SME development organizations, including membership organizations. However, membership organizations are, in many ways, a special category because they are made up of SMEs themselves, generally have advocacy as their primary objective and suffer more than any other group of organizations from a lack of capacity.

1. Building capacity without destroying self-reliance
Donor interventions to build capacity in such organizations should be undertaken with extreme caution, to avoid developing a dependency on external assistance, to which membership organizations have proven particularly susceptible. Such dependency not only detracts from sustainability, but has also been shown to kill initiative in membership organizations: self-help and dependency are, after all, natural opposites. In addition, moving the process of institutional development along too quickly may easily destroy what are often very fragile organizations. Assistance should therefore not push an organization beyond its capacity, but instead develop capacity gradually and cautiously refrain from interference with an organization’s autonomy and limit financial assistance to a minimum. Donors should ensure that they do not overload an organization with assistance and tasks.

2. Building from the base upwards
It is important to assist membership organizations build organizational and management capacity from the base upwards, rather than from the management level downwards. This can be done by assisting organizations to set up more transparent and formal procedures for electing their leadership, introduce mechanisms for members' active participation in decision-making and establish two-way communication between members and management.

3. Beyond the advocacy core
Successful interventions have shown that improving service delivery is important to provide members with tangible benefits and to strengthen the membership base. Advocacy is seldom enough by itself. Donors can be particularly useful in developing the required technical capacity. It is particularly important, however, for donors not to view membership organizations in isolation from the support network and environment for SME development. Membership organizations are not necessarily the answer to all SMEs' needs, and should not be expected to deliver all possible services. The advantages of specialization apply to membership as well as other organizations.

4. Beware of big and bureaucratic
There are indications that assistance to small membership organizations may be more successful than to those that are larger in scale, if donors are sufficiently cautious not to smother them in assistance. It can be difficult to overcome the distance between leadership and members in large organizations just as it can to revive a vision of self-reliance and service to SMEs. The potential for business-like service delivery may also be better with the smaller organizations, where the leadership is often more entrepreneurial and unhindered by the bureaucracy of big organizations. However, small organizations find it difficult to realize economies of scale and may therefore be more costly.
5. Beware of politicized institutions
While it is important for membership organizations to find allies among influential people and maintain widespread political contacts, party politics should be avoided if at all possible. In some countries, for example, chambers of commerce and industry have become highly politicized organizations with elections becoming divisive occasions. Invariably in such organizations, political concerns prevail over those of the membership.

Box 20: Extending the business-like principle to donor-counterpart relations
SDC in Ecuador and Peru pursue an approach to SME development which is based around a business-like relationship with BDS providers. BDS organizations are invited to bid for particular contracts such as investigating and monitoring service markets and the provision of services to SMEs. Payment for these contracts is performance-based with agreed incentives for good performance according to defined criteria (similarly, institutions which do not meet agreed targets receive no more contracts). The purpose of these contracts is to try and develop improved offers of services from BDS providers to meet the demands of SMEs and to stimulate this demand in the long term. Early evidence suggests that the offer of services has been upgraded by the stimulus from SDC.

In each case, the programme is administered by Swisscontact. Their involvement as a second tier institution is important; it would be extremely difficult for a donor (with all its attendant rigidities and lack of closeness to the SME situation) such as SDC to develop the kind of relationship with BDS providers (first tier) which is necessary for the business-like basis to be established.

4.3.5. Unresolved issues
1. Are meso level organizations always necessary?
Meso level interventions have been considered above generally in terms of building the capacity of SME development organizations. However, such organizations have reached only limited numbers of businesses. Many more entrepreneurs start or improve their businesses by emulating others. Informal learning, on a commercial as well as a non-commercial basis, is the normal process of development for SMEs. SME owner-managers learn from their colleagues and competitors by copying technical and business innovations, and many have first learned their trade through long periods of paid or unpaid apprenticeship. They also learn from their customers, who provide feedback on their services or products. Overall, private learning mechanisms are relatively more important than formal learning from BDS organizations. Indeed, it should be acknowledged that when most industrialized countries were at comparable levels of development to the current situation of developing economies, SMEs had few formal learning mechanisms available to them.

In the context of wealth differences (based on purchasing power parity comparisons) typically of between 10 and 50, one key question to be answered is the extent to which the whole SME development infrastructure which has evolved in industrialized nations is appropriate for economies with relatively few resources. As with microfinance, where ‘indigenous’ approaches have blossomed into major institutions, perhaps BDS has to be considered along similar lines. Otherwise there may be a danger that donors will ‘load’ an unrealistic cost base onto the under-resourced framework of weaker economies.
2. The efficacy of different meso level instruments
‘Institutional development’ or ‘capacity building’ are generic terms covering a variety of different (although related) instruments (training, technical support, financial support etc.) While there is an emerging consensus on the principles of how capacity building should be undertaken (see 4.3.4), there is much less agreement on the relative merits of particular instruments. It may be that this distinction does not matter and that instruments are effective if they observe the broad principles described above. However, given the priority which the meso level is now given, it may be useful to find out more about the performance of each type of approach.

4.3.6. Innovations

1. Developing informal networks
A small number of SME projects are experimenting with ways in which informal learning relations among enterprises and between enterprises and their markets can be improved, or used for the delivery of better or new services. These projects define the sustainability of their interventions as their adoption by the private sector (for example, copying business or technical improvements). In theory, such interventions would become fully self-financing without small enterprise development organizations having been set up. These projects therefore challenge the view that meso level interventions have to be concerned with formal institution building only.

It is premature to assess their success. However, it is becoming clear that interventions which aim at private sector replication do require a project or organization to initiate and promote them, at least initially. There is no evidence yet that, once the private sector has been provided with a successful model on a small scale, a self-sustaining process of replication will be set in motion. Private sector replication may in the long term result in greater outreach, but the small enterprise development organization is likely to continue to have an essential role to play as an innovator, facilitator and catalyst.

2. Exploring ways of making the business-like message consistent
While most donors now talk the language of being business-like, in practice it is often difficult for them to actively encourage BDS organizations to behave in this manner because of restrictions arising from their status (often government departments) and the pressures of accountability. The legacy of ‘traditional’ semi-charitable donor-recipient relationships is also a key barrier. There are now some innovations (see Box 20) through which donors are trying to develop ways of forming an incentive-based, contractual, mutually-beneficial and target-driven relationship with BDS organizations (sometimes through using a ‘first tier’) intermediary.

3. Getting the private sector involved
Until recently, the idea of working directly with private sector commercial BDS organizations was unthinkable for many donors. Yet, the logical corollary of the business-like message is to work directly with these kinds of organizations. This is complementary to the idea (4.2.3) of setting up new commercial entities. As yet, this area remains relatively unexplored.

4. Developing SME professional associations
This idea appears to have most relevance for transition and middle income countries. The objective is to improve the quality of services available by developing recognized quality assurance standards and a system of accreditation; i.e. professionalizing SME development consultancy (see Box 21)

**Box 21: Developing self-regulating professional associations in the Czech Republic**

There has been significant growth of private sector commercial services and consultancies of all kinds in the transition economies of Central and Eastern Europe. In general, they have a poor image, caused by lack of business discipline and highly variable quality, particularly in areas not subject to government regulation. There appears to be considerable scope for the development of self-regulating professional associations and a number of donors have supported these through accreditation schemes. One example is the assistance provided by the UK Know-How Fund to the Czech Association of Management Consultants to develop a quality assurance system that will establish minimum standards for accredited consultants. The scheme is planned to be compatible with international standards and should eventually be self-financing through associated training and referral services. Similar schemes are being developed in Poland. These initiatives represent a major step for the organizations concerned and need to be developed step by step, in consultation with members who need to be convinced of the business benefits of accreditation in fragile markets.

5. Action research as an implementation method

A number of SME projects (particularly in Africa) use action research as an intervention method. Basically, this means that the type of services provided by the partner organizations are not specified in advance, but determined by the clients according to their needs. The services of the BDS organization are then confined to providing the necessary stimuli, creating appropriate conditions and enabling action to be taken (facilitation), leaving all decisions and action to those affected by the given situation (the clients).

The staff of the BDS organization thus act as facilitators. They offer the users or their representatives some form of opportunity to state their most pressing problems, seek potential solutions, work out plans of action and determine activities. They encourage them to act in line with their plans and intentions.

The facilitators never impose their own ideas on the clients and never act for them or in their stead. They confine themselves strictly to a participatory approach.

In all cases, the BDS organizations contribution to problem-solving involves providing information, e.g. setting out ideas developed elsewhere and experience gained elsewhere. In some cases, support is also provided for the implementation of the actions determined by the clients.

**Box 22: Action research as an implementation method**

A number of GTZ supported projects in Africa (Côte d’Ivoire, Ethiopia, Ghana, Guinea, Mauritania, Niger, Tanzania) apply action research methods to support the formation of self-help groups of artisans and micro and small entrepreneurs. These groups are encouraged by trained facilitators to gain an awareness of their problems, enhance their knowledge, develop their self-confidence and subsequently develop ideas and action plans to solve these problems.
and implement them on their own or turn to people and organizations in a position to help them. The facilitators that accompany the continuous process of ...- reflection - action- reflection - action - ... of the self-help groups are usually the staff of BDS organizations, such as chambers of commerce or crafts, small enterprise associations or NGOs that receive specific training for the purpose.

Problems the self-help groups (e.g. blacksmiths, metalworkers, joiners, electricians, motor mechanics, radio repairers, photographers, leather workers, seamstresses, makers of handicrafts) seek to solve include: procurement of materials, access to credit, infrastructure (electricity supply, transport, business premises), establishing capital resources, technology improvements, improving product quality, marketing, acquisition of contracts for the group, business management and representing their interests to governmental bodies.

4.4. The macro level

4.4.1. Definition
This section is concerned with interventions aimed at the macro level - i.e. national policy and regulation. Potentially, the impact of these is very significant, since policy (by definition) has a large outreach. Certainly for some donors the macro level is a priority area for action and all donors acknowledge its importance.

Macro level interventions are best understood in relation to:

1. the general shape of the macro picture related to SME development which donors are seeking to facilitate; and
2. the actions which donors may take in pursuing this aim

a) The shape of the ‘desired’ macro-economic picture
The overall ‘market-friendly’ strategy for macro-economic development which receives broad support from most donors has four main pillars (Duval, Waterfield, 1996):

1. A stable macro-economy: financial discipline by governments, a prudent approach to fiscal management, a commitment to low inflation, tax reform, financial sector reform, exchange rates which reflect the true strength of the economy and the privatization of State-owned enterprises. This is the foundation of the macro-economic framework and shapes the economic environment for SMEs.

2. A competitive micro-economy: freeing prices and markets so that prices act as key signals to producers and consumers, developing a regulatory framework to ensure competition, including eliminating unnecessary barriers to market entry; developing legal and property rights that facilitate the enforcement of commercial contracts and investment in information and in physical infrastructure, such as transport, to minimize transaction costs.

3. Global linkages: openness to trade, investment and ideas through a reduction in trade (tariff and non-tariff) barriers, encouraging foreign investment and the transmission of
4. **Investing in people:** strong private and public investment in people’s health, education and nutrition, and particularly targeted investment in primary education and preventive health care. In this respect, donors have become increasingly aware of the role which the education and training systems can play in developing entrepreneurial attitudes, behaviour and skills, and thereby directly contributing to the development of an entrepreneurial culture and a thriving small enterprise sector.

These four points form the basis of the structural adjustment packages which a high proportion of developing economies follow and which define the framework for business generally, including SMEs. In general, the macro-picture that is advocated envisages a less intrusive role by government and a re-focusing on a more limited number of functions (regulation, health, education, infrastructure, etc.)

However, while most donors would not disagree with the main tenets of this approach *per se*, there is no real consensus on the adequacy of these measures in themselves to generate the conditions for SME development. Some donors point out the continued absence of a vigorous response from business to ‘supply-side’ improvements in African economies and question the ability of *neo-classical* approaches to bring about major economic growth. They therefore propose a more pro-active role for government.

One specific revision to the standard framework which has been proposed concerns *infant industry protection*. It is certainly the case that economies which have achieved the greatest growth in the last 30-40 years have done so with the help of some degree of protectionism for key industries. Furthermore, in East Asia, the protection offered by favourable tariff or non-tariff shields provides the opportunity for major investment, technological advancement and growth.

Against this argument, there are practical concerns over how to implement such a policy. Previous attempts at protection in some countries have actually made businesses more isolated and less competitive. Instead of using a temporary and declining shelter of protection for rapid investment and learning, it can be used as a revenue-raising measure. Moreover, the capacity of many countries’ public administration systems to actually implement trade protection regimes effectively - especially in Africa - is questionable. In general, a key problem of advocating more active government interference is the capacity of under-resourced government departments to deliver in developing economies. Reforms which remove or reduce the role of government are therefore more likely to be successful. Indeed, the interventionist successes of East Asian economies can be partly attributed to the efficacy of their civil service systems.

Other crucial areas of policy and regulation on which there is more or less consensus include issues such as government recognition of the informal sector, relatively liberal policies towards the zoning of economic activity, the reduction of specific barriers to entry into some trades, relatively unrestricted labour markets and using the education system to promote an *enterprise culture*.
b) Donors’ actions
In order to pursue the development of the above macro-economic picture, donor actions can broadly be put into two categories:

- Donor with government
- Donor with other organizations

Clearly the first form of initiative is most common. The relationship of donors with governments can range from conditionality-enforcer, to influencer to technical assistant. In many cases, the kind of policy reforms which are required from structural adjustment have taken place grudgingly rather than out of a sense of intrinsic belief. There are competing claims as to the value of changes brought about by specific conditionality pressures, about durability and about the degree to which the removal of ownership from local political processes actually reduces political responsibility and may even hinder long-term change. Conversely, it is argued that changes brought about by influence or technical assistance may bring about more lasting change. It is clear, however, that in many instances, major economic reform has been accelerated massively by the strong pressures brought to bear in conditionality relationships.

The rationale for donors working with organizations outside of government is based on two premises:

1. Working with and through private sector organizations, such as business associations or researchers, helps to create an advocacy voice and capacity in the SME community. In the long-term, this kind of capacity will play an important role in creating pluralist, more democratic and more efficient societies.

2. Pressure applied through local organizations is more likely to be heard and to be acted on.

In practice, donors usually pursue both of these broad approaches to macro-level change.

4.4.2. Application
Donors have sought to pursue macro-level change using a number of related approaches:

- Setting up national SME agencies, whose objectives include the development of an overall strategy and framework for SME promotion, the coordination of programmes, including donor supported initiatives, and sometimes acting as a conduit for funds (see Box 23).
- Supporting high profile/level conferences, working groups and publications to bring SMEs onto a country’s political agenda.
- Establishing regulatory committees which, on an ongoing basis, monitor and review regulations germane to SMEs and which can, for example, seek to ensure balance between appropriate regulations (say on working conditions and safety) and eradicating unnecessary ‘red tape’.
- Initiatives to decentralize the conception and implementation of SME development policy and regulations to a localized level.
• Initiatives to support dialogue at a national and local level among the main actors with regard to specific strategies and measures to promote SMEs.
• Establishing improved procedures to ensure that SMEs enjoy appropriate access to government tenders, export credits, bank credits, etc.
• Supporting efforts to develop a cultural environment which is conducive to the promotion of SMEs. This may involve encouraging the development of more enterprising approaches to children’s education or through national media campaigns.
• Building capacity in trade associations, employers organizations and other representative organizations to enable them to assess the impact of policy and regulation on their members better and to articulate their members’ wishes more effectively.

4.4.3. Lessons

As with the meso level, it is generally not possible to isolate the relative benefits of particular instruments. Donors tend to look upon their support for the macro level not in terms of individual instruments, but as general ‘technical assistance’. It is also very difficult to be precise about good practice in the area of policy reform since, perhaps more than at the micro and meso levels, the path from intervention to change is seldom straight and free from other effects. Bearing in mind the difficulty in being categorical in this respect, there are a number of good practice points which emerge from donors’ experience:

1. Decentralizing to an appropriate level
A key principle influencing the roles of different ‘players’ in the SME environment - in particular government - is subsidiarity (see Section 5). In practice, this means that responsibility should be delegated to the lowest possible level. This has several implications for macro-level interventions; in particular, where possible, private sector organizations (for-profit or not-for-profit) should take responsibility for delivering services to SMEs. If government has to be involved, it should seek to be as close as possible to SMEs by decentralizing its services.

2. Creating permanent pressure for change
One of the biggest problems faced by BDS organizations pursuing macro-level change is that civil servants in key positions may change on a regular basis, meaning that they are facing a moving target! Investments in personal relationships and the development of capacities are then rendered useless. Overcoming this might be assisted by creating a more general movement for change (see Box 23), perhaps through high profile publications or targeting influential politicians, and not just civil servants.

3. Find a ‘champion’
Advocacy is more likely to be successful when a key individual assumes the challenge as a personal responsibility. This is especially the case in (common) situations where responsibility for SMEs does not lie directly with one department, but is split between a number of sometimes competing ministries. Unless one person takes ownership for initiating and organising activities aimed at policy and regulatory reform, responsibility may be lost, with inactivity being the result.

Box 23: Maximizing influence on government policy makers in Poland
Efforts to influence government policy-makers are often frustrated by frequent government reshuffles and rapid turnover of both political representatives and officials, for example at times of radical change, as in the transition economies of Central and Eastern Europe. These problems are exacerbated by the fact that SME development policies are generally of only intermittent political interest, so that even where government units are set up to improve the regulatory and business environment for SMEs, they lack the confidence and skills necessary to influence more powerful ministries with direct responsibility for business regulation.

These problems can be mitigated if project outputs are published, or at least given wide dissemination outside government. It is less easy for incoming ministers or new officials to ignore published recommendations, and they can also provide a basis for representations to government by business lobby groups. One example from Poland is the report of the G-24 Task Force for Small and Medium Enterprise, *Investing in the Future*, published in 1993. Despite a change of government at the time of publication, and various subsequent ministerial reshuffles, it has remained a landmark report and its influence can be traced in successive government policies. Other examples are the *State of Small Business* reports published in several transition economies in recent years, often with direct or indirect donor assistance, which include objective statistics and surveys of small business trends and concerns. Donors have also helped to sponsor national conferences of representative SME organizations, which help to articulate and publicize business concerns and demands for reforms.

4. **Encourage harmony in business associations**
While there may always be some conflict between business associations, it is important that, where there is a common interest, advocacy issues are not undermined by narrow vested interests. Politicized associations should generally be avoided. The comments made in 4.3 on how to work with membership organizations are relevant here.

5. **There is an objective statistical core to many policy discussions**
Advocacy needs hard evidence to avoid discussions becoming overly-abstract. Organizations should be supported in monitoring and assessing real trends among SMEs.

6. **Advocacy at the top is necessary**
Although not sufficient in their own right, key individuals often exert a huge influence on policy issues. Successful strategies will target them, understand the pressures upon them and their own views and, on that basis, seek to influence.

7. **Promoting public awareness**
The collective voice of business - articulated through action - can be a very strong force for change. Learning to use the media effectively can be a useful resource to influence SME opinion.

8. **Do not expect significant payment**
While participants expect to pay for key events, such as workshops, it is not reasonable, for example, to expect business associations to pay for advocacy. Activities aimed at ‘public goods’, such as advocacy, are seldom able to cover their own costs.

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**Box 24: Creating a national framework for SME development in South Africa**
For most developing countries, the development of services for SMEs is a piecemeal and incremental process which is not necessarily coordinated. However, some middle income countries’ governments have tried to play a more pro-active role in developing a national framework for SME development, which seeks to provide a comprehensive guide for SME development institutions of various kinds to work effectively towards common goals. South Africa is currently engaged in developing such a framework. Among the key features of this process have been the development of a national SME promotion agency (the Ntsika Enterprise promotion Agency [NEPA]), a national grid of accredited non-financial service providers, the establishment of a wholesale finance agency, setting up a National Small Business Council for discussion and consultative purposes and the establishment of Small Business Desks in provincial governments. Ultimately, such a framework will - it is hoped - develop a policy, regulatory, service and institutional environment which encourages SME development. It is too early to judge the South African experience. It is interesting because it advocates a degree of government coordination which runs contrary to the neo-liberal tendency of recent years, but is closer to the interventionist approach pursued by some East Asian countries, all of whom had competent public administration systems.

4.4.4. Unresolved issues

1. How pro-active should government be in creating a conducive environment for SME development? The trends in middle income countries, such as South Africa (see Box 23), Thailand and Chile, towards the active creation of a framework for SME development with a national coordinating agency, run slightly contrary to the pervasive neo-liberal message of recent years. It is clear that there is not one unique role for government in every country; different traditions and capacities influence the role of the State. Certainly, in some cases, the pro-active role of governments is an attempt at replicating aspects of the East Asian experience. It remains to be seen to what extent this will be transferable to other situations.

2. How can donor coordination be made more effective? In principle, donor coordination can be a useful tool to engender more effective influence on governments. In practice, it has a mixed record of success and failure. Donors agree that exchange in itself is a ‘good thing’ for donor learning. However, going to government with one collective voice is a more difficult task and requires, inevitably, that donors make allowance within their budgets for this kind of activity and agree to work together (not simply share information).

3. With whom and doing what: exploring macro-level technical assistance in more detail? Within the general heading of technical assistance, comparatively little is known (or at least recorded) of the relative merits of different approaches to macro-level change. For example, is it better to work with civil servants, politicians or business associations? Is ‘hard’ conditionality the best route to change or do more educational persuasive approaches yield more sustainable long-term results?

4.4.5. Innovations

While there are a number of central lessons on how to implement macro level interventions, there is no major discernible current thrust as regards innovation. One noticeable trend,
however, is greater focus on the results of interventions rather than merely counting activities. The *intangibility* of much macro-level endeavour makes this a particular concern.
5. General Principles

The analysis in Section 4 examined good practice with regard to specific instruments and the main lessons learned from experience on how donors should recognize and support good practice, as defined in terms of outreach, efficiency, effectiveness and sustainability. From this analysis, eleven broad lessons emerge which appear to apply across all (or most) instruments and which constitute a set of principles embodying the current state of the art of BDS.

This section draws back from specific BDS instruments and concentrates on these (inter-related) principles, which form an overarching framework for donor-supported BDS interventions. Each is described here briefly; Section 4 offers more detail on what the application of these principles means in practice. Only for those principles which have not received considerable attention in Section 4 is more detail provided here. Figures 5.1 and 5.2 show how these general principles are manifested in specific BDS instruments; it represents an overview of Sections 4 and 5 and summarizes current knowledge of good practice in BDS. Finally, three underlying cross-cutting development principles - gender, environment and working conditions - are examined briefly in relation to BDS.

5.1. Business-like and demand-led

This is the fundamental principle for good practice in the development and delivery of BDS. It shapes decisively all the main instruments of BDS and its influence is felt in the other general principles examined here. It emerges both from theory and hard experience; its essential message is inherently simple:

The best BDS organizations at supporting SMEs are themselves like those SMEs in terms of their people, systems and values.

This principle is manifested in numerous different ways, but the following are some of the most important:

**FOR DONORS**
- selecting BDS partner organizations which are able to develop in a business-like way (donors and governments should generally not be deliverers of micro-level services)
- developing BDS organizations with a vision, culture, motivations and attitudes which reflect a commitment to business-like behaviour
- encouraging BDS organizations to take ownership and responsibility for their work and, similarly, within these organizations, seeking to encourage individuals to be given an opportunity to develop personal ownership
- allowing for flexibility in implementation, so that BDS organizations are not overly restricted in pursuing objectives

**FOR BDS ORGANIZATIONS**
regarding those who ‘receive’ BDS instruments, not as pliant beneficiaries, but discerning clients or customers

- developing transactional relationships with clients (i.e. on the basis of exchange, not charity)
- designing instruments of a sound understanding of the needs of clients and a comprehensive knowledge of their situation
- regarding instruments as ‘products’ and adopting a rigorous and transparent approach to their measurement, both in terms of costs and income
- maintaining close contact with clients, so that the demand-driven impulse is not weakened.

The business-like and demand-led principle does not require the abandonment or dilution of social objectives. Being business-like is not about objectives per se. Rather, it is concerned with the manner in which objectives are pursued. While there will be differences in practice between interventions focused at different groups of SMEs, the essence of the overall approach should be not be different.

### 5.2. Sustainability

This is always an issue of key concern for every donor agency. Every BDS intervention has to address sustainability issues from the outset. However, the meaning of this in practice is far from clear. Sustainability can be assessed at two levels:

- the level of impact (in relation to the SME)
- the level of the BDS provider

All the principles of good practice mentioned in this guideline are aimed at the objective of sustainability of impact in SMEs. It is with regard to sustainability at the level of the BDS provided that most debate arises (and clearly impacts on SMEs themselves may not be sustainable if BDS capacity is not sustained). What should donors’ commitment to sustainability mean at this level?

There is no consensus emerging from current practice on the specific meaning which should be given to sustainability in terms of BDS capacity. There is agreement on the value of charging fees and on being business-like. There is also agreement on the different dimensions of sustainability: organizational, managerial, technical and financial. There is acknowledgement of a degree of awkwardness in promoting BDS instruments which did not really exist in industrialized nations in the early days of industrial growth and which are significantly subsidized in industrialized countries currently. Sustainability requires donors to say: ‘don’t do as we do, do as we say’! Certainly, it is clear that it is pointless to believe that the full panoply of subsidy-supported BDS infrastructure which has developed in wealthy countries can be sustained (internally) in economies with per capita incomes perhaps less than 10% of those prevailing in industrialized countries. This means that the types of BDS which develop have to be appropriate for local conditions, rather than imported from wealthy donor countries. There is a clear and relevant comparison here with the origins and evolution of microfinance organizations, which owed little to the influence of practice in industrialized nations.
In practice, at this stage of understanding of BDS, two points can be made in considering how the sustainability principle should be applied:

The priority in BDS should be to support interventions which appear to offer a credible path to sustainability through, for example, incorporation into private learning mechanisms or the commercialisation of services; i.e. which are finite and offering a realistic end to donor involvement.

Interventions which do not offer a finite end need to be clear about their rationale and have a realistic strategy for long-term support.

5.3. Tailoring: relevance through focus

SMEs exist in complex and variable situations; generalizing over needs can over-simplify a situation and lead to inappropriate interventions. Knowing specifically what an intervention is trying to do and with whom is an essential feature of BDS interventions. In this sense, being ‘tailored’ means being specific and relevant.

This tailored approach has been dominated in recent years by increasing use of subsector analysis (see Section 2). The essence of this is that SMEs have to be viewed within the economic context of their work, which means the input suppliers, manufacturers, distributors, retailers, customers and supporting government and private institutions which constitute their particular subsector. It thus enables BDS organizations to understand the totality of potential clients’ situations. Many current BDS interventions which appear most interesting have begun with a subsectoral tailored approach.

A subsectoral approach does not preclude targeting on a socio-economic basis. However, it may make it more difficult, since economic systems do not confine themselves to one social group or another. Moreover, it is clear that interventions which do not target a group directly may still benefit it considerably. Nevertheless, there are examples of a particular group - notably women - being the main players in interventions derived from subsectoral interventions.

There is a wider debate among BDS providers on the extent to which access to BDS services should be determined by socio-economic group or by ability and willingness to pay. This is an ongoing debate and at this stage it would appear that both can be valid, depending on a programme’s objectives. However, the overall point to note here is that interventions, whoever they are aimed at, need to know needs and build from that basis. Appropriate, tailored design will, in any case, exclude those to whom it is not relevant.

**Box 25: Subsector analysis leading to successful action in rural Bangladesh**
The Bangladesh Rural Advancement Committee (BRAC) selected the poultry subsector as a focus for analysis for several reasons. It is a traditional activity for many poor women and can be done along with household tasks, requires low capital inputs, has the potential to increase nutritional standards, requires few skills and there appeared to exist the potential for diversification. A comprehensive analysis of the subsector revealed a range of constraints
inhibiting its development concerned with low productivity, high mortality, poor feed, lack of marketing mechanisms and lack of credit.

BRAC’s existing outreach in rural areas put it in a position where, in collaboration with the government, it was able to develop a programme to address these constraints. Women have been trained and assumed roles in hatching, rearing, vaccination and treatment, feed selling and egg collecting and selling. Value is added at each step of the system. Over 700,000 women participate in the programme and both incomes and egg consumption have increased notably. Further inputs in the future will seek to address basic supply constraints of feed and chicks and the programme aims to have doubled in size (in terms of production) between 1996 and 2000.

5.4. Participatory approaches

Social processes are generally triggered by the awareness or realization on the part of individuals or groups that they are disadvantaged by specific circumstances and by the desire to change this state of affairs. If social processes are to prove successful, the parties concerned must therefore be induced to help bring about social change in their own interests. Thus active participation by the clients of business development services and the staff of BDS organizations in planning, implementing and evaluating interventions has nowadays been accepted as the condition without which most of the other general principles cannot be achieved.

The advantages of pursuing participatory approaches to planning and evaluation are well documented and can be grouped under three related headings:

- greater knowledge of SMEs’ situation (understanding needs);
- greater ownership by BDS organization staff, clients and other participating organizations such as business associations; and
- greater possibility of longer-term sustainability (ownership leads to greater responsibility and commitment to maintain services)

More emphasis on participation has questioned the value of some ‘classic’ social science approaches to needs assessment (such as large surveys) and planning in favour of quicker methods which are more integrated with action (such a action research).

One consequence of accepting a participatory approach is that programmes of intervention should allow some flexibility in their design. Clearly, this has to be a matter of negotiation and reasonable limits have to be set. However, it is clearly contradictory for interventions to be, on the one hand, demand-led and participatory and, on the other, inflexible.

The adoption of a rigorous participatory approach to interventions may in some cases mean that the type of services provided are not specified in advance, but determined by the clients according to their needs. The services of the BDS organization are then confined to providing the necessary stimuli, creating appropriate conditions and enabling action to be taken (facilitation), leaving all decisions and action to those affected by the given situation (the clients).
5.5. **Maximizing outreach**

One of the key problems associated with BDS is that, with some exceptions, they are non-standardized and can seldom be replicated in the same way as has occurred, for example, with microfinance interventions. However, BDS interventions need to be concerned with the scale of their impact. Given the difficulty of replication, there are a number of possible leveraging approaches which BDS organizations are trying:

- **Subsector approaches:** although this is not always possible, in some instances, relatively small and focused inputs can have a significant impact in a whole subsector.
- **Supporting indigenous and private systems of learning:** countries with successful SME sectors usually have well-established private networks of exchange and learning which have become embedded in the local culture. Encouraging SMEs to ‘learn to learn’ through better exchange, more association and improved information provision may help to develop improved systems of private learning. SMEs do learn from the demonstrated achievement of others; by supporting entrepreneurial leaders and encouraging people to look at their example ‘natural’ processes of learning can be enhanced.
- **Macro-level approaches:** macro-level policies exert a huge influence on SMEs through the economic signals that the system sends them, their specific policies towards business and in their role as key providers of education for children and young people. This last area in particular may be a key influence on cultural attitudes towards enterprise.

5.6. **Building on demonstrated initiative**

Given the commitment of donors to supporting a development process which is both sustainable and locally owned, it is imperative that interventions seek (where possible) to build on what is already there, rather than supplanting it with an imported vision or model. This, of course, does not mean that donors should not seek to exert influence or that they are passive players in discussions with potential BDS partner organizations. However, it does mean that:

- Individual visions are respected and that the large extent to which individuals’ egos are tied in with ‘their’ organizations is recognized.

The scale of resource commitment, especially if finance or equipment is involved, reflects the capacity of local partners. The typical pattern of SME development is incremental growth on the basis of learning by doing; BDS organizations can be expected to follow a similar path and donor support should support rather than overload this process.

Experiences from the private sector are assessed with a view to learning from them. The microfinance ‘revolution’ was based on learning from the practices of informal credit sources. Similarly in BDS, some initiatives are seeking to learn from current private sector approaches to vocational learning and there may be scope to extend this pattern of learning into other instruments.
5.7. Split and focus in delivery

BDS can learn from the trend towards minimalist microfinance interventions and implement more focused interventions split from other SME development (or other) functions for two main sets of reasons:

Firstly, it allows a simpler and more effective relationship with clients: SMEs relate to other organizations primarily as transactional agents: their first thought (consciously or not) is: what is your offer? By having a focused intervention and a limited range of instruments ‘to offer’, there is more clarity and less chance of sending mixed messages to clients, as sometimes happens, for example, when credit is mixed with counselling.

Secondly, it recognizes capacity limitations: every BDS organization has its strengths and weaknesses and it is extremely unlikely that they will be able to deliver every kind of BDS intervention effectively. It is much better for organizations to focus on what they can do and do this well, rather than seeking to diversify into activities where they have less understanding. Similarly, it is important for donor support not to encourage strategic drift among BDS organizations (although clearly there is a balance between strategic certainty and listening to one’s stakeholders).

The above does not imply a fixed, unchanging view of BDS. Innovation and change are important features of any BDS organization. Nor does it imply that providers of different BDS and financial services should not seek to coordinate and cross-refer (see below). However, it does recognize that BDS organizations have to take a position in their market. Indeed, this trend towards focus mirrors exactly changes in the corporate world in the last decade, where businesses have continued to refocus on what they perceive to be their core role.

5.8. Systemic approaches and programme integration

Donors clearly need to have knowledge of the overall environment within which BDS exists. This means not simply being aware of the links between micro, meso and macro levels, but also between BDS and financial services. While it is the case that BDS providers do need to have significant focus in their activity, this is not in contradiction with a need for broader strategic awareness. There are three clear ways in which BDS can be promoted without resulting in an overall imbalance in the environment for SME development:

• **Coordination between donors:** this should prevent clear conflicts of interest developing between programmes. However, as important as liaising over what donors are doing is consensus on how they are doing it. For example, the existence of another donor-supported BDS initiative in a neighbouring area in itself is not problematic, but becomes a major problem if their method of working is in contrast to, say, the principles given in this guideline. For example, failure to make an appreciable effort to charge fees for particular services could have a very damaging impact on the general market for BDS.

• **Networks between different providers:** in practice, there is (overtly or otherwise) competition between BDS organizations delivering the same kind of service. This is probably inevitable and may not be entirely bad. However, it is important that providers have a wider sense of their clients’ needs beyond what they can deliver and are prepared to refer them to the appropriate provider. This requires them to see the mutual benefits of this
kind of collaboration. Similarly, just as SMEs sometimes need to collaborate for their own mutual benefit, BDS organizations’ best interests may be served by common action for example in relation to policy issues.

- **Joint venture/subcontracting arrangements:** there are nascent signs that these kinds of relationships are developing between organizations, for example between ‘generalist’ development agencies and specialist BDS providers. This is a positive sign and offers considerable potential benefits of focus and specialization, while maintaining a wider perspective.

### 5.9. Renewed focus on costs analysis

Cost analysis has historically been a neglected discipline in the field of BDS. Of course, BDS organizations have budgets and maintain accounts. However, until recently, most BDS organizations did not, and did not see the need to, adopt a more active approach to financial management which actually sought to use financial analysis as a toll for the improved management and delivery of instruments. The main problem has been a reluctance or inability to allocate costs to different activities, so that it is difficult to relate the outcomes of BDS interventions with their input costs. This is a problem for five reasons:

- it means that BDS organization managers do not have the right kind of information on which to make decisions about what they should and should not be doing. Within an organization, it encourages a culture which divorces inputs from results and removes costs from staff awareness.
- it makes BDS organizations less financially transparent (especially in relation to microfinance) and more open to accusations of wasteful consumption of resources.
- it does not allow any progress with comparability and benchmarking, since many of the key measures in this respect have a cost base.
- it offers a misleading picture of what a BDS instrument actually is, implying it has no costs.
- it prevents organizations from adopting a rigorous and balanced approach to cost control; the first step in serious cost management is to measure costs.

None of the above imply that costs should be seen as more important than BDS outreach and impacts or that they should be looked at in isolation from outreach and impacts. However, many BDS organizations have neglected to include costs in their own analyses of performance, their own view of their work and that of others has been distorted unhelpfully.

### 5.10. Continued importance of impact assessment and evaluation

BDS interventions should always have an element of impact assessment built into them as an integral part of the programme. Section 3 dealt with many of the underlying issues related to evaluation and there is no need to repeat them here. However, two general aspects of evaluation should be stressed which underpin its importance:

**Improving comparability and benchmarking:** donors have to make decisions frequently on the respective merits of different BDS intervention proposals and organizations. BDS organizations themselves are also seeking to learn from each other to improve practice.
Unfortunately, much of this process of comparison takes place in a somewhat abstract atmosphere because of the absence of ‘hard’ information.

Improving instrument design: in order to be responsive to demand pressures from clients, BDS organizations need to regularly review their performance with a view to making changes for the future. Combining retrospective and prospective analysis - evaluation and needs assessment - as part of the normal activity of an intervention is a new way of thinking about evaluation. Traditionally, it has been a one-off, end of project event. While there is still a role for this kind of evaluation, it is equally important for organizations to be able to use evaluation/needs assessment methods for regular market research activity.

5.11. **Subsidiarity**

One key principle in SME development in general, but specifically in relation to the role of the State, is subsidiarity. In essence, this principle enshrines a common-sense idea of *who can do what best*. In BDS, this means that responsibility is usually delegated to the lowest possible level, to those who are closest geographically and socially to SMEs themselves.

In practice, applying the subsidiarity principle to the role of the State leads to the following conclusions:

Firstly, the primary role of the State in relation to SME development is to create a conducive environment for entrepreneurship. This means that that it creates an environment characterized by:

- sound macro-economic management, including fiscal and monetary control
- a relatively liberal economic system in which regulations are not an onerous burden or highly distorting
- competent delivery of public services, especially education

No other SME institutional player can perform these tasks.

Secondly, in the main, the State should *not* seek to be a direct provider of BDS for SMEs, given the extreme difficulty government agencies have in becoming business-like. BDS providers should come from the private for-profit or not-for-profit sector.

Thirdly, depending on government capacities and wider traditions, the State *may* be able to play a leading pro-active role (although still facilitative rather than delivery-orientated) in shaping a national framework of policies, practices and institutions to guide SME development. These attempts seek to build on some aspects of the East Asian experience and it is too early to offer any authoritative assessment of their worth.

Beyond these three points, there is less consensus on what the State should do. In particular, there is no widespread agreement over the role of the State in relation to subsidies for BDS, whether delivered to individuals or to the organization. To a large extent, this depends on the resources available. There are strong general arguments for subsidies on the basis of giving disadvantaged groups access to particular services and there are innovative ways in which
State support can be provided which still strengthen BDS providers’ responsiveness to demand. However, it is pointless to provide broad principles guiding State spending when the resources available to governments vary enormously.

5.12. **Cross-cutting development criteria**

For most donors, development interventions of any kind are subject to assessment according to a number of ‘standard’ cross-cutting criteria. Three of the most important relate to:

- gender,
- the environment and
- working and employment conditions.

Of these, gender and the environment are generic concerns; working and employment conditions are more specifically related to SMEs and are our main concern here.

**Gender**

The overriding concern here is that SME interventions should contribute to greater gender equity. This is a vast subject area and one where considerable research work is currently being undertaken. In general, SME development interventions may benefit from the checklist of questions compiled by the OECD Development Assistance Committee’s (DAC’s) Expert Group on Aid For Evaluation. Among the key questions to be considered are:

- How were the interests of women taken into account in the design of the programme? How did women participate?
- What gender-specific data have been collected and how were these used in design and implementation?
- What were the implications of the project for women in terms of: production and markets, income, workload, division of work, role in household and community, and education and training.

**The environment**

For environmental concerns, the same OECD guide (as above) provides some useful, if more generalized questions to be used in considering environmental impact. Clearly, environmental issues are of more direct concern in some sectors - for example brick kilns - than in others and the resources which need to be devoted to environmental analysis will vary according to this and other factors.

**Working and employment conditions**

The conditions of work and employment in SMEs in developing countries are generally worse than in larger enterprises. This is especially true for the informal sector, which largely escapes regulation. Business owners and their employees often work in unsafe and unhealthy surroundings, are not included in social protection programmes, their pay is generally lower than in larger enterprises and employees often work without contracts and with little or no security. Some enterprises use child or bonded labour.

These conditions are of concern to governments as well as donors. Interventions to improve them emphasize the policy level. Of particular importance here is the ILO, within whose mandate the development and promotion of international labour standards holds a prominent
place. Such standards comprise a number of basic human rights, as well as more specific and mundane regulations concerning all aspects of work. National legislation reflects international standards to the extent that governments have accepted them, as well as national policies and priorities.

The main business argument for improving working conditions is made by the ILO (Kogi, 1994):

‘a growing body of evidence indicates that improvements in working conditions and the environment, an equitable income distribution and the security of social protection could be key ingredients of business efficiency and competitiveness’

The main interventions, in addition to policy level change, aimed at promoting improved conditions include:

- strengthening the capacity of agencies responsible for labour and environmental legislation; this has had limited success.
- political and consumer pressure on SME exporters to comply with international standards; this is having some impact on some large multinational corporations which buy from or subcontract to SMEs. Many corporations now have codes to govern their relations with suppliers.
- direct training through the Work Improvements in Small Enterprises (WISE) programme, which has had some success (see Box 25).

Overall, only a limited amount can be achieved by external agents. Self-evidently, major improvements in working conditions will only come about when people feel it is a serious enough problem to act and this opinion is encouraged by economic growth. Currently, sentiment towards improved working conditions, while growing, is not strong enough to engender widespread change.

**Box 25: Work Improvements in Small Enterprises (WISE)**

WISE is a long-running ILO programme. It is based on the concept that working conditions, product quality and enterprise productivity and competitiveness are key, interlinked strategic issues for SMEs. The main instrument is the training programme ‘Higher productivity and a better place to work’. Business owners are made aware of the relationship between working conditions and productivity, and learn how to identify concrete improvements in the workplace. They visit each others’ businesses and work in groups on developing simple and low-cost improvements for their enterprises. In the final training sessions, the participants present the changes they have made and still plan to make.

The programme is implemented in collaboration with employers organizations, universities, training institutes and government safety and health institutions. National capacity is being created gradually by the training of trainers.

In terms of the implementation of businesses' plans to improve working conditions, and the gains in productivity, health and safety realized, the programme is a success. However, it requires significant inputs in expertise (ergonomists and safety and health professionals) and
has limited outreach. It therefore remains subsidy dependent: although the gains at the enterprise level appear to be sustainable, this is probably not so for the programme itself.
6. The Future Agenda

6.1. The overarching themes

In the preceding sections it has been established that there are a broad set of principles guiding the design of BDS interventions and that, when measured against the criteria set out in Section 2, there are examples of interventions which are comparatively successful. However, it is also clear that:

a) this is a relatively loose framework and is certainly not tight or prescriptive;
b) although there are useful interventions, very few of these comply with all the criteria set in Section 2; and
c) there are many unresolved issues associated with BDS.

The most realistic assessment of the current state of art in BDS acknowledges that there is a considerable amount which is known, but possibly just as many questions as answers.

In order to improve practice in BDS, it is important that the above weaknesses are overcome;

**the main objective of the future agenda for donors and BDS organizations is to advance collective learning on good practice.**

While there a number of specific questions which need to be addressed, there are two main themes which need to underpin future activity.

**More benchmarking: rigorous assessment of current practices**

It is clear that there is little more to be learned from further analysis of the existing documentation on current BDS experience. The characteristic lack of specificity of data and the vagueness in defining costs and impacts means that there is very little scope for valid comparison. However, the current weaknesses in BDS data should not be confused with weakness in the idea of benchmarking. BDS analysis is not reducible to series of boxes and there are limitations to the use of seemingly objective indicators. For example, one indicator of cost effectiveness, ‘cost per job’ is prone to a variety of interpretations (and manipulations). There are also legitimate concerns over any threat to abandon the development of qualitative aspects in favour of the apparent simplicity of quantitative measures.

Nonetheless, there is scope for much greater use of benchmarking. This can most easily start with cost based measures related to operational efficiency where there are fewer of the methodological difficulties associated with impact and where it is possible to address the historic (and mistaken) separation of costs from outputs in BDS.

**Encouragement of more innovation**

While there are emerging examples of interesting (if not ‘good’, as it has been defined here) BDS practice taking place, there is a great need to expand the stock of innovative projects from which donors can learn. On the basis of the framework of principles shown in Figure 5.1, donors should support BDS organizations which are seeking to develop new approaches,
while also being committed to learn from this experience and be open to dissemination of key lessons.

In pursuing this more innovative path in the future, donors can be guided generally by the preceding principles of good practice. However, on the basis of existing BDS development programmes which have set out to be innovative, notably the FIT Programme, there are a number of other complementary factors which should be taken into account in design, implementation and assessment.

**The right geographical location**
Although many donors prioritize the lowest income countries and the most disadvantaged groups for their support, interventions which are seeking to ‘try something out’ with a view to learning from it are best located where conditions are generally conducive to SME development; i.e. where economies are growing opportunities exist. In this way, innovations have a chance to develop. Innovative ideas which are put into unfavourable situations are more likely to be still-born. In practice, the route from development idea to workable instrument invariably runs from growing/dynamic area to poorer region.

**Flexible planning and implementation**
Innovative interventions require considerable flexibility of implementation. This fact has a number of implications for their design and management. The planning frame which staff work within has to be adaptable enough to permit change; staff will need to be able to work in (and be happy in) a relatively unstructured situation and be able to change their work regularly in the light of on-going assessment; and reporting systems need to be sufficiently loose to capture unexpected results.

**Mechanisms to allow appropriate guidance**
Like all BDS interventions, those focused on being innovative have to be driven by demand. Ways of allowing SMEs themselves to contribute to the design and on-going evaluation of a programme are therefore important. Unfortunately, in some countries where SME research has become a major activity, SMEs are understandably reluctant to commit more of their time to research activities which may appear to offer no benefit to them. The classic response to this problem is to invite representatives from key stakeholder organizations to be official guides to the analysis. However, experience suggests that not only do these organizations often have their own (competing) agendas, but that they may be remote from SMEs themselves. One way of overcoming this problem may be to approach individuals - rather than organizations - of proven commitment and insight to provide guidance for the innovation process.

**Priority setting**
Learning agendas for pilot or action-research projects can become jammed with multiple objectives, some of which may be conflicting. It is therefore important for the various objectives to be given clear weights so that programme staff can prioritise interventions; i.e. focus is as important here as for other BDS interventions.

**On-going assessment**
The learning objective of innovation projects can only be met if there is a commitment to on-going monitoring. This should seek to capture expected and unexpected outcomes and apply
rigorous cost measurement. Ideally, in order to provide a continual reference point against which to measure change, control groups should be set up. In some cases, there are practical (such as finding comparable enterprises and people, talking with but not influencing them and providing incentives for their participation), resource (allowing time for control group consultation) and ethical (controlling people in poverty) barriers to be overcome before control groups can be set up.

**Using ‘experts’**

External specialists can play a number of roles in an innovation process. Most importantly, they bring experience from elsewhere to a local situation and provide a capacity building technical input to local partners so that they are informed of emerging lessons and trends. They also facilitate the exchange of results between countries and organizations.

The above two themes - benchmarking and innovation - form the **broad** challenges for donors and BDS organizations. In more specific terms, there are a considerable number of gaps in our understanding of good practice; a number of these are presented below.

### 6.2. Specific issues

#### 6.2.1. BDS organizations: creating a business-like (non-profit) organization

In some ways, meso-level interventions have become the core issue for donors. From a donor perspective, much of development in general is about finding and developing good partners. SME development is no different. The general message here is clear: the best organizations and people are business-like. However, there is a danger of this being accepted as a bland truism or ‘buzzword’, without thinking about the practical detail of its application. As noted earlier, there has been comparatively little attention to BDS institutional development, which is commonly appended to a delivery-oriented intervention. How should donors help develop partners? Clearly, some aspects are particularly important:

- creating the right funding environment
- building on the right people
- allowing them to learn incrementally
- building incentives
- supporting their own product development process

However, there is an absence of detailed knowledge about what these may mean in practice. What do we know of the dynamics of creating these organizations, or the actions that donor organizations can take to help effectively? For example, is stimulating BDS supply in both qualitative and quantitative terms, as some interventions are seeking to do, also going to stimulate demand for BDS services? Can specific institution building instruments be identified which show particular promise in developing organizations?

#### 6.2.2. Building on BDS already being provided by the private sector

In many countries, MSEs receive almost all of their support services from the private sector. These might include, for example, training, supply of raw materials and equipment, access to
information, marketing of products, and so on. These services are provided without any subsidy and are therefore self-sustaining. Enhancement or replication of these services through channels which are entirely within the private sector is very attractive, since they could reach far more MSEs than can be reached by the NGO community in many countries.

The first implication of this approach for the research agenda is that we probably do not yet know enough about how these services are provided; for example, studies such as those of Peter Kilby indicate that the traditional apprenticeship system is deeply embedded in the local culture. Similarly, many services, such as the provision of commercial information, are largely provided informally, by relatives or neighbours. Interventions which are not based on a clear understanding of this may risk damaging these mechanisms, particularly by installing an alternative which is subsidized, and therefore temporary.

The second implication for the research agenda is that, if the intention is to build on private sector initiatives, the traditional donor-funded entry points may not be appropriate. Businesses which provide BDS to MSEs can understand approaches which involve a clear gain for all involved; for example, they can quickly grasp the rationale for setting up a joint venture, where both investors benefit. But talk of 'temporary subsidies' and 'impact' can be very confusing.

The third implication is that donors may need to review their traditional portfolio of partners, which generally includes either local governments, or at least institutions which are clearly not-for-profit. If donors are to work through channels which are genuinely business-like, they will probably need to persuade both their constituencies at home, and the host governments in developing countries, of the merits of such an approach.

The design of BDS which are both profitable and of value to MSEs will require innovative and creative approaches. A major opportunity will be to find services which are of particular value to MSEs, and/or are particularly viable when offered to MSEs. An example would be the economies of scale which may be achieved through providing services to thousands of MSEs, but which could not be achieved through providing services to a smaller number of large businesses.

In addition to stimulating the provision of innovative services, donors can also play a catalytic role in establishing linkages between participants in the private sector. Sufficient experience has probably now been gained in various formats to begin to generate some comparative data, for example between programmes which link companies in-country (e.g. sub-contracting exchanges), and programmes which link local companies with companies in the donor country (e.g. sister industry programmes).

6.2.3. Developing indigenous networks and associations

Successful rapid growth economies are all lubricated and driven by private mechanisms of learning, exchange and mutual support. Given the inability or reluctance of the State in many countries to subsidize them, the creation of these institutions of learning is a key priority offering an opportunity to create sustainable learning capacities. There are different traditions associated with business associations and BDS in industrialized nations; in some countries
they are of central importance while in others they occupy a more peripheral role. Not surprisingly, there is mixed experience with regard to donor interventions in developing countries; for example, some promising interventions in Latin America but a generally less successful experience in Africa.

How can these associations be supported without bestowing on them the cost base ‘trappings’ and mentality of a dependent bureaucracy? How can genuine capacity be created without raising costs? How can associations be supported - if at all - without undermining the indigenous quality that is their most distinctive feature?

6.2.4. Developing BDS interventions for disadvantaged groups

How will the more rigorous application of the business-like principle affect donors’ general concern over distributional questions and commitment to disadvantaged groups. Certainly, one school pursues the line of thought that:

• using a more demand-led approach inevitably means that those with more demand (better-off owner-managers) benefit most;
• the self-selection implied by this approach means that those with most ability, drive and resources select themselves, while those without these qualities are left behind;
• the self-employment into which many people have fallen in developing countries is a reluctant state. Given the chance, many would gladly go into employment; their businesses are useful in a welfare sense, but are unlikely to contribute significantly to economic growth;
• most businesses operated by poor people are relatively simple and there is actually little scope for BDS to help them;
• if the poor do benefit from BDS, it is primarily as indirect beneficiaries working as employees with larger SMEs.

An alternative view is that, like any product, BDS providers can deliver useful products to disadvantaged groups if they are designed appropriately (and there are examples of successful interventions aimed at the poor, such as BRAC’s poultry programme). The point is to identify a group and find out their needs.

The above discussion mirrors the (as yet unresolved) debate in the microfinance sector. Future interventions need to be clear about whom they are seeking to assist.

6.2.5. Selecting growth-oriented businesses

Although donor interest in the poor remains strong, there has also been a discernibly increasing interest in identifying and selecting ‘winners’. They are perceived to have the capacity and potential to make the best use of some BDS (for example, training), and focusing on them would be more efficient than a blanket approach which inevitably wastes resources because services are delivered to ‘inappropriate’ people. External agencies do not have a good record here. A business-like approach emphasizes self-selection and active marketing, which implies that those with resources and self-awareness are those with most potential. If growth-potential businesses are as significant as is believed, there may be a need to try and develop additional ways of identifying these SMEs.
6.2.6. Deciding on the appropriate balance between different levels of intervention

Deciding on the balance between different types of intervention is a difficult issue and one where there appears to be little ‘hard’ data to inform donors. One dimension of this dilemma is the extent to which some interventions - say with existing SMEs - are really trying to address problems the source of which (and real solution) is more fundamental. For example, technical training and product development: efforts at improving product design and development in SMEs in many countries are hampered (product development as copying) by a basic lack of engineering drawing and design skills. These cannot be developed easily by a BDS organization since they are the result of sustained training and education, which is usually an objective of public education services.

Similarly, while it is widely recognized that a supportive policy and regulatory environment is a prerequisite for successful interventions at the meso and micro levels, there is little hard evidence on which interventions are most critical and what balance should be struck between the macro, meso and micro level portfolio of interventions in a given country.

6.2.7. Entrepreneurship education and training

SMEs perform best in countries and cultures which encourage and support enterprise. While it is widely assumed that education and training systems have a role to play in developing entrepreneurial values, attitudes and behaviours, it is not known to what extent this is in fact the case, nor how it is to be achieved most effectively. More work is needed on critically assessing the impact of programmes which have been implemented to date and identifying strategies for further development and to meet such challenges as curriculum design and development and teacher training.

6.2.8. The troublesome subsidy issue

For most donors, subsidies remain one of the most difficult issues associated with BDS. A general position is that interventions which require a relatively short-term period of external intervention to create capacity, and which then appear to have a realistic chance of being sustainable, are a worthwhile investment. Examples of this kind of intervention might include technology development and transfer, developing new market entities and business linkages. In each case, there appears to be a market gap or opportunity. However, what about those interventions where effective long-term self-financing appears unlikely, or at least more difficult, for example, certain types of business training.

In this context, the common practice of industrialized nations may not be hugely relevant. Defining a ‘legitimate’ role for the State cannot be divorced from the issue of what the State can afford. Even if there are valid reasons related to wider positive benefits, if there is no significant possibility of government taking on a role of supporting BDS financially, how can donor support for them be seen as anything more than a short-term palliative or as one instalment in a series of donor subsidies?

This concern seems to point future interventions in two possible directions:
• seeking to minimize or eliminate external financial subsidies
• providing creative, cheaper and less distorting ways of offering State support (for example vouchers).

6.2.9. Developing generic approaches for later adaptation and expansion

The growth of BDS has been constrained by the contradiction between, on the one hand, focusing and developing specialized products to meet particular client needs and, on the other, replicating approaches and realizing economies of scale by scaling up. Current approaches to leveraging more impact from limited interventions are concentrated around subsector analysis and networks. However, it may also be possible to develop more standardised approaches which can be adapted and delivered with relatively little development cost. The dangers of the thoughtless replication of ‘models’ is well known to most donors, but there is also increasing recognition that, just as principles of intervention may have widespread relevance, so some specific products - such as CEFE - may be developed which have the opportunity to be scaled up with low cost adaptation.

6.2.10. Taking a process approach: Implications for design and implementation

One great strength of the MSE sector is that it is flexible and can respond very quickly to changing market demands and macro-economic environments. Meanwhile, donors are required to show that their funds have been used for the purposes for which they were committed; this requirement may well have stifled initiatives which would otherwise have yielded real benefits, and there is consequently increasing interest in process approaches over blueprint approaches.

One potential solution to the conflict of needs is to quantify the impact achieved through BDS delivery; ability to demonstrate benefits may defuse criticism that a project did not do what it had set out to do. As discussed elsewhere in this document, however, methodologies for quantifying impact reliably are still being developed.

Another potential solution is to provide BDS which are themselves so flexible that the MSE using them can adapt them to his or her specific needs at a particular time. This is a lesson from the microcredit field, in that loans are clearly used by clients for a very wide variety of purposes and the lending agency has little direct interest in what that use actually is. Examples in the BDS field might include networking opportunities for MSEs, whereby clients can choose whom they meet and what they discuss to suit their needs at that time. However, little work has yet been done in this area on the provision of a sustainable and systematic service.

A third solution might be to allocate funds to organizations which are considered trustworthy and competent, and rely on those organizations to achieve the best results. One difficulty here is that organizations providing BDS tend to be small; indeed, in general, smaller organizations are considered to be more effective. Another difficulty is that flexible funding can begin to look like core funding, the anaesthetic effects of which are now well known.
Even donors which are in a position to support projects adopting a process approach are often limited in their capacity to supervise such projects. The technical input required to obtain the most benefit can be high; in particular, an international perspective and links with knowledge, expertise and resources in other countries can enhance the achievements very considerably. Arrangements which involve the sub-contracting of the 'mentoring' function to appropriate organizations or individuals may, in practice, make the process approach more viable for many donors.

6.2.11. Getting the private sector to do more

Many BDS interventions are concerned with highlighting areas where markets have failed to deliver good services. While this can often be attributed to a basic lack of purchasing power on the part of consumers, there are also occasions where this market failure is attributable to the supply-side’s basic lack of creativity in developing solutions to problems. BDS organizations - with donor support - are sometimes in a position to innovate approaches which may even have the potential to become sustainable from market demand.

Having shown that there can be profitable opportunities in serving SMEs or, perhaps of more relevance here, developing technologies which SMEs can service or manufacture, there may be an opportunity to stimulate the private sector generally into looking at previously unfashionable areas - appropriate technologies - in a serious commercial sense. ‘Private sector’ here may include self-help groups, microenterprises and businesses at the upper end of the SME range.

6.2.12. The impact of globalization and technological change on SMEs.

Following increasing liberalization and advances in communications technologies, the globalization of financial, product and labour markets has accelerated. This has led to increasing competition, with firms increasingly engaged in global sourcing pulling even remote regions into worldwide supply networks. At the same time, all countries are becoming markets for other countries’ exports. As the world economy becomes increasingly integrated, local standards are no longer competitive and the pressure to reach international standards increases. There have also been profound changes in the organization of production. Economies of scale have been declining as techniques such as lean manufacturing and just-in-time production have shifted attention to timeliness, and computerized production has allowed smaller factories to produce customized goods at mass-production prices. The plummeting prices of information technology allow SMEs to compete with the giants and give them the added edge of flexibility and information dependent innovation. The Internet is opening up tremendous potential for small enterprises to access mass markets in highly cost-effective and competitive ways.

These changes are profoundly affecting the context in which SMEs have to compete and are bound to have a major impact on the types of support interventions which are required by SMEs and the way in which such interventions can be designed and delivered.
6.2.13. Creating more effective mechanisms for donor coordination

While all donors are committed to finding effective ways of working together, in practice, efforts at active collaboration are still relatively rare. Many donor agencies still pursue a comparatively lonely learning curve, which is aware of some of the lessons emerging from elsewhere but does not learn especially quickly or substantially. One central problem facing donor agencies engaged in the promotion of BDS is how a genuine commitment to greater collaboration, exchange, joint projects and agreements on practices can be turned into a tangible reality. In order for this to happen, practical mechanisms of planning and coordination need to be agreed upon at various levels, both in-country and ‘corporately’.
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