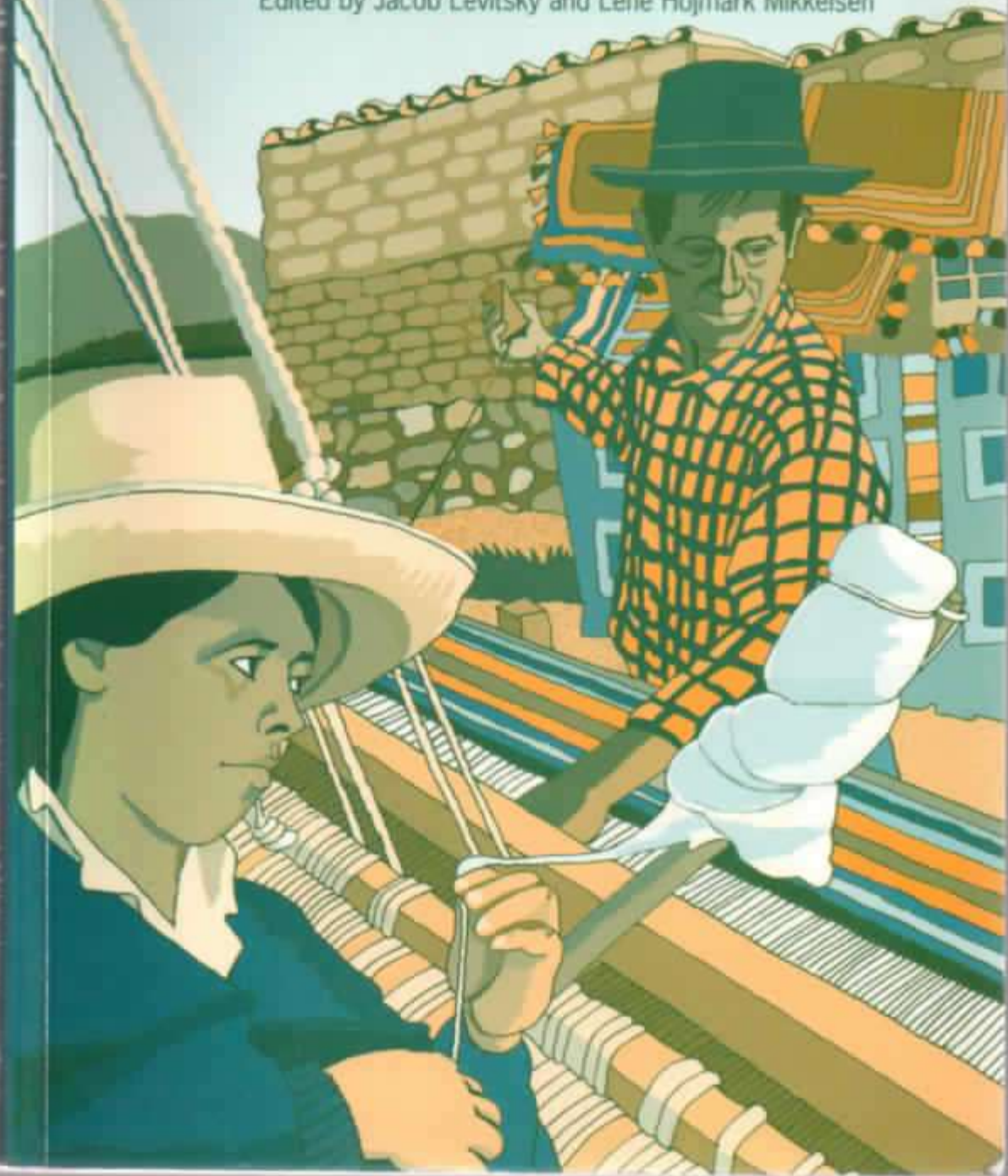


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# MICRO- & SMALL ENTERPRISES IN LATIN AMERICA

Experience of Business Development Services

Edited by Jacob Levitsky and Lene Hojmark Mikkelsen



# MICRO- AND SMALL ENTERPRISES IN LATIN AMERICA

*EXPERIENCE OF BUSINESS  
DEVELOPMENT SERVICES*

Edited by JACOB LEVITSKY  
and LENE HOJMARK MIKKELSEN



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THE INTER-AMERICAN DEVELOPMENT BANK (IDB) hosted the conference 'Building a Modern and Effective Business Development Services Industry in Latin America and the Caribbean' in Rio de Janeiro in March 1999. The purpose of the conference was to establish best practice in the provision of business development services (BDS) in Latin America and the Caribbean. It succeeded in disseminating the latest developments in best practice to a very large audience, and also in paving the way for new research in innovative BDS, as well as identifying new guidelines for future BDS interventions. The proceedings of the conference are being published in two volumes, the first of which contains presentations from the international experience and has been published under the title *Business Development Services: A Review of International Experience* by ITDG Publishing on behalf of the Committee of Donor Agencies for Small Enterprise Development. This second volume represents the Latin American and Caribbean experience.

In Latin America and the Caribbean, the sectors of micro-, small and medium sized enterprises contribute significantly to the local economies through their potential for promoting employment and reducing poverty. The availability of, and access to, efficient and high-quality financial services and BDS are essential in order for these enterprises to acquire new skills, know-how and technology in an increasingly competitive and global environment.

The IDB has developed numerous projects to ensure the availability of BDS, and has been a forerunner in developing new products and modalities designed to accommodate the needs and demands of the micro- and small enterprise sectors. Together with other international development institutions, the IDB has participated in joint efforts to develop best-practice guidelines for the design and delivery of BDS to micro-, small, and medium scale enterprises. These best practice guidelines have been expanded and refined, based on numerous research papers, case studies, and projects carried out by these institutions all over the world. This conference contributed significantly to the further development of these guidelines.

This volume consists of general discussion of important issues and areas of BDS, best practice case studies from a variety of countries throughout the region, the development of a BDS market, and the role of the public sector in the market for BDS. The presentations bring up a number of recurrent themes for re-evaluation, but at the same time new and interesting themes are emerging.

The theme most emphasized during the conference was that of sustainability – of programmes, services, and institutions. Not only have donor funds become scarcer, limiting funding to only the most attractive projects in terms of the potential number of clients reached, but donor funding now focuses on programmes with a potential for a sustained existence beyond donor support. Papers on financial viability explored various business development services and their potential for being self-sustainable, the conclusions pointing to certain services having greater potential for sustainability or financial viability than others. And it remains one of the major challenges of the field to identify ways to success-



fully combine sustainability with outreach to the poorest segments of the micro- and small enterprise sectors.

Two new themes emerged during the conference, that of a market focus, and that of performance measurement. The first signifies a paradigm shift, from that of focusing on institutional development to that of focusing on market development. It was pointed out that many providers of BDS operate independently of donors or investors, and it was agreed that more emphasis should be placed on the need to support and develop the markets for these providers to work in, and on the underlying failure of markets, which is caused by imperfect flow of information. The second theme was triggered by a presentation on performance measurement which proposed a standardized framework for measuring scale, outreach, impact, cost-effectiveness, and sustainability. Donors are increasingly required to show results of the interventions undertaken and investments made, and the conference became the stage for a lively discussion in terms of what should be identified as results and how these should be measured. The performance measurement framework is currently being applied to a number of projects, from which process it will no doubt be refined to become an important tool for donors and other investors in development to assess the efficiency and impact of business development services.

Through assimilation of these new tools and guidelines, the IDB intends to continue its support to projects that contribute to the consolidation of effective and competitive markets for business development services to micro- and small entrepreneurs. Also, the IDB will continue to invest in new research that leads to innovative approaches to the challenges in this field.

The IDB wishes to extend special gratitude to the European Commission for a generous grant in support of the event and this volume.

*Antonio Vives*  
*Deputy Manager*  
*Infrastructure, Financial Markets and Private Enterprise*  
*Sustainable Development Department*  
*Inter-American Development Bank*

For more information on the BDS Conference in Rio, please see our web sites [www.iadb.org/sds/utility.cfm/159/ENGLISH/pub/700](http://www.iadb.org/sds/utility.cfm/159/ENGLISH/pub/700) for the English version and [www.iadb.org/sds/utility.cfm/159/SPANISH/pub/700](http://www.iadb.org/sds/utility.cfm/159/SPANISH/pub/700) for the Spanish version.

## Contributors

ALBURQUERQUE, Francisco: *Development economist at the Institute of Economy and Geography, Consejo Superior de Investigaciones Científicas, Spain*  
ANGELELLI, Pablo: *Researcher at the Industry Institute of the Universidad Nacional General, Sarmiento, Argentina*

CORTES, Mariluz: *Principal operations officer in the Finance Infrastructure and Private Sector Department for Latin America and the Caribbean, World Bank*

DINI, Marco: *Italian consultant with the Programme for Industrial Integration of UNIDO, UNDP in Mexico*

GATTO, Francisco: *Researcher-teacher at the Industry Institute of the Universidad Nacional General, Sarmiento, Argentina. Also co-ordinator for SME at the ECLA office in Buenos Aires*

GIBSON, Alan: *Consultant, The Springfield Centre for Business in Development, Durham, United Kingdom*

GOLDMARK, Lara: *Consultant, Development Alternatives, Inc. USA. Technical adviser to National Development Bank of Brazil*

GONZALO, Rivas G.: *Executive vice-president, Corporation for the Promotion of Production, CORFO, Chile*

HAGNAUER, Juan H.: *Co-director of Swiss Development Co-operation-funded project in Peru*

HERNÁNDEZ, Gary Montaña: *Co-ordinator of SIC-IDEPRO, Bolivia. Consultant specializing in SME development and total quality*

HUMPHREY, John: *Professor at the Institute of Development Studies, University of Sussex, United Kingdom*

LANUSSE, Antonio: *Executive president of INSOTEC, Ecuador*

LEVITSKY, Jacob: *Consultant, Donor Agencies Committee for Small Enterprise Development; formerly Small Enterprise Adviser, World Bank*

McKEAN, Cressida S.: *Consultant to United States Agency for International Development (USAID)*

MIKKELSEN, Lene Hojmark: *Consultant to the Microenterprise Unit of the Inter-American Development Bank, Washington, DC*

PEREIRA, Tamara: *General manager of PROARTE, S.A., Nicaragua*

PEROTTI, Omar A.: *Minister of Agriculture, Livestock, Industry and Commerce of the Province of Santa Fé, Argentina*

PLAZA, Sonia: *Consultant at the World Bank*

RIVERA, Cecilia: *Swisscontact, Peru*

SCHMITZ, Hubert: *Development economist at the Institute of Development Studies, University of Sussex, United Kingdom*

SCHOR, Gabriel: *Managing director of Internationale Projekt Consult GmbH, Germany and Frontier Finance International*

VALCÁRCEL, José A.: *Swisscontact, Peru*

YOGUEL, Gabriel: *Researcher at the Industry Institute of the Universidad Nacional General, Sarmiento, Argentina*

## List of acronyms

AGEXPRONT	Association of Non-Traditional Exporters (Guatemala)
AMPIH	Asociación Nacional de Mediana y Pequeña Industria de Honduras
ATO(s)	Alternative Trade Organization(s)
BDC	Business Development Centre
BDS	Business Development Services
BSC(s)	Business Service Centres (also CSEs)
CAPIR	Regional Chamber of Small Industries (Argentina)
CCE	Chamber of Foreign Trade (Argentina)
CCIDC	Chamber of Commerce and Industry for the Department of Castellanos (Argentina)
CDE	Enterprise Development Centre (Argentina)
CDIE	Center for Development Information and Evaluation (USAID)
CEFE	Competency Based Formation of Enterprises
CENPRO	Center for the Promotion of Exports (Costa Rica)
CEP	Centro de Enseñanza Profesional (hairdressing training – Paraguay)
CEPAL	UN Economic Commission for Latin America (Also ECLA)
CINDE/CAAP	Coalition for Development Initiatives/Private Agricultural and Agroindustrial Council
CORFO	Corporación de Fomento de la Producción (Development Corporation – Chile)
CSE(s)	Centros de Servicios Empresariales (also BSCs)
DESIDE	Desarrollo Eficiente del Mercado de Servicios Incentiva la Demanda Empresarial (Efficient development of the market of services promotes business demand)
ECLA	UN Economic Commission for Latin America (also CEPAL)
EU	European Union
FAT	Fondo de Asistencia Técnica (Technical Assistance Fund – Chile)
FONTEC	Technology and Productive Development Fund (Chile)
GDP	Gross Domestic Product
GTZ	German Technical Co-Operation
IADB	Inter-American Development Bank (also IDB)
ICE	Instituto Central de Electrónica (training in computer repair – Paraguay)
IDB	Inter-American Development Bank
IDEPRO	Instituto para el Desarrollo de la Pequeña Unidad Productiva (Institute for Development of the Small Productive Unit – Bolivia)
ILO	International Labour Office, also International Labour Organization



IMG	Instituto de Arte Culinario Maria Gloria (Paraguay)
INSOTEC	Instituto de Investigaciones Socioeconómicas y Tecnológicas (Institute of Socioeconomic and Technological Research - Ecuador)
INTI	Instituto Nacional Tecnologías Industriales (Argentina)
MEDA	Mennonite Economic Development Agency
MFI	Microfinance Institution
MISES	Micro- and Small Enterprises
MISME(s)	Micro- Small and Medium Enterprise(s)
MSC	Management Services Contractor
MSE(s)	Micro- and Small Enterprise(s)
NGO(s)	Non-Governmental Organization(s)
PDP	Programa de Desarrollo de Proveedores (Supplier Development Programme - Chile)
PREX	Programa de Reestructuración Empresarial para las Exportaciones
PROARTE	Handicraft Manufacturing Company (Nicaragua)
PROCHILE	Chile's Export Promotion Agency
PROEXAG	Non-Traditional Agricultural Export Support Project (now EXITOS)
PROFO	Proyectos de Fomento (Development Projects - Chile)
R&D	Research and Development
SDC	Swiss Development Cooperation
SEBRAE	Services for Support for Micro- and Small Enterprises (Brazil)
SECYT	Secretaría de Ciencia y Tecnología (Secretary of Science and Technology)
SEPYME	Secretariat for Small and Medium Enterprises
SERCOTEC	Servicio de Cooperación Técnica (Technical Co-operation Service - Chile)
SIC	Servicio de Información Comercial (Industry and Commerce Department)
SME(s)	Small and Medium Enterprise(S)
SNV	Dutch Development Service
TPOs	Trade Promotion Offices
UAP	Project Administration Unit
UNDP	United Nations Development Programme
UNGS	Universidad Nacional de General Sarmiento (Argentina)
UNIDO	United Nations Industrial Development Organization
USAID	United States Agency for International Development

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## PART I INTRODUCTION TO BUSINESS DEVELOPMENT SERVICES

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### 1. Principles of good practice in business development services

ALAN GIBSON

The Springfield Centre for Business in Development

#### Introduction

IN 1996, THE SPRINGFIELD CENTRE was asked by the Committee of Donor Agencies for Small Enterprise Development<sup>1</sup> to undertake a study on good practice in non-financial services for small and medium enterprises (SMEs). Six months later, in 1997, after a re-branding/renaming process and the demise of the generally uninspiring epithet of *non-financial services*, we reported to the Committee on good practice in *business development services* (BDS). The basis of this report was a set of guiding, core principles on how BDS should be designed and delivered. These preliminary guidelines sought to summarize donors' views of their own experience and subsequently was summarized in a smaller version that has been widely circulated (Committee of Donor Agencies for Small Enterprise Development, 1998).

Since that time BDS has received a higher profile in development circles and greater attention has been devoted to it by agencies; it is clear that we are in the midst of a significant process of rethinking and learning in BDS. However, while much has changed in the last three years, and although the principles of good practice outlined in the original guidelines may be known to many, it would be a mistake to let this familiarity undermine our sense of the importance of these principles. In practice, the framework of broad principles of good practice still stands up to scrutiny and it forms a valid and logical starting point for the conference.

This chapter is concerned principally with explaining the key messages from these guidelines. More specifically, it has three objectives.

- To explain what is meant by BDS.
- To outline the key principles of good practice in BDS.
- To summarize some key challenges for the way ahead as we seek to further enhance learning and practice in BDS.

However, before addressing these issues, a number of points need to be emphasized in relation to the preliminary guidelines:

- The guidelines reflect primarily donors' views of their own experience. They are therefore a consensus facilitated by an external team rather than an external view *per se*. Moreover, while they are the product of a rigorous



analysis this was not a quantitative, benchmarking exercise based around core indicators. The diversity of BDS and the paucity of data available made this impossible.

- The guidelines were always seen as the first step in enhancing learning and practice and ultimately impact; they are primarily an input to a process rather than an end in themselves.
- The importance of principles lies in their propensity to influence the real world positively. By themselves they achieve nothing. Indeed, it is dangerously easy for principles to slide down an unfortunately familiar path in development circles – from principle to platitude to slogan; *buzzwords* to be chanted loudly and repeatedly at appropriate times and places! For this framework to avoid such a fate, and be relevant, it has to be given specific meaning for particular contexts, services and objectives.

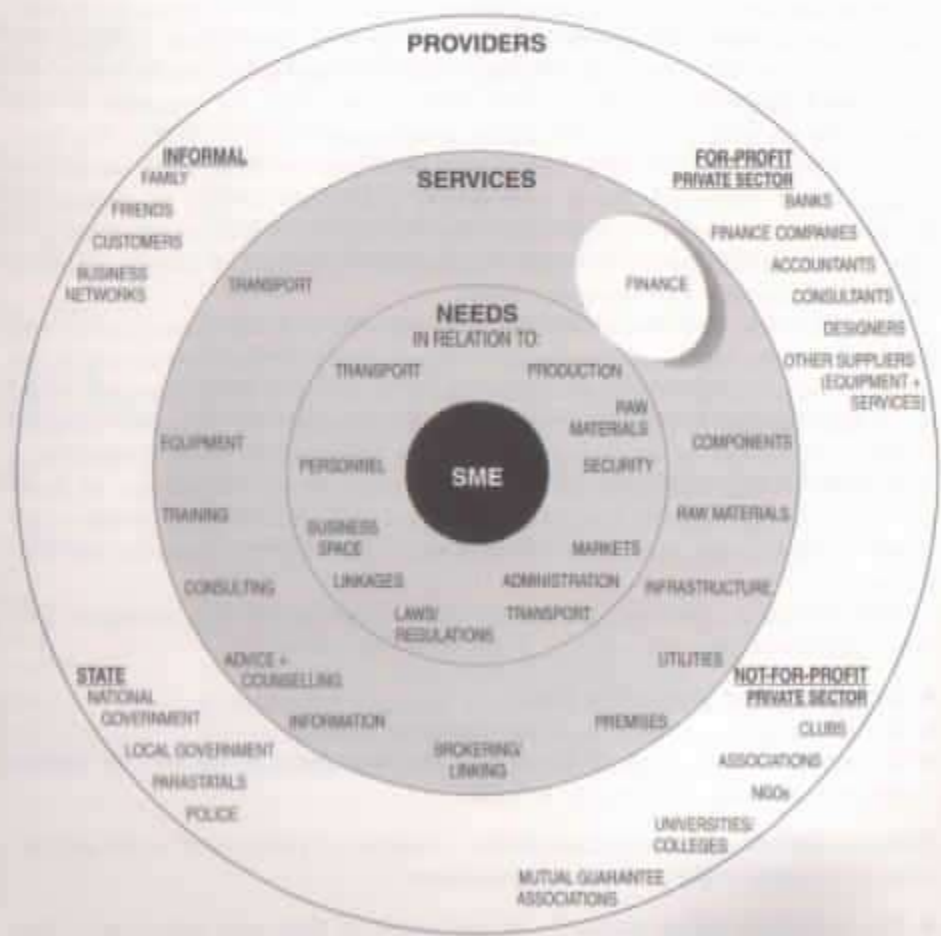


Figure 1.1 The BDS picture: needs, services, and providers

## What do we mean by BDS?

Unlike microfinance, now associated with a relatively tightly defined set of financial products for households or microenterprises, specific definitions of BDS remain elusive. This is not surprising. It is essentially a leftover category, what remains after removing financial services. And while non-financial services was clearly an unsatisfactory title, renaming them BDS still does not avoid the essentially artificial nature of the BDS entity – created by bringing together the unclaimed interventions after financial services' removal.

In practice, there is no universally accepted definition of BDS, yet we do need to have a common understanding of it in order to make progress in improving performance. One way of bringing greater coherence to the idea of BDS is in terms of SME needs, services and providers (see Figure 1.1).

SMEs, in any situation, have a series of needs<sup>2</sup> in relation to various aspects of their business performance. These are generally concerned with skills and knowledge focused on 'how to' and 'who with' questions over the inputs to their business (people, suppliers, technology, premises, etc.) and their outputs (transport, markets, competition, etc.).

Services, offered formally or informally, develop to meet these needs/demands. Of course, one set of services is financial, which allows SMEs to address a variety of needs. Other services may include consulting, training, advising, transporting, linking, informing, maintaining, communicating, etc. Strictly speaking, the term 'services' implies non-transferrable, intangible/non-physical goods – i.e. not infrastructure, components or raw materials supply or direct buying of goods from SMEs. In practice, these distinctions have become blurred and some services – beyond an economist's definition – have been categorized under the BDS banner, such as technology development, incubators and direct trade interventions. This may not matter. The point here is that SMEs require a range of tangible and intangible services and products to be available to them in order for them to operate effectively.<sup>3</sup>

Providers are a range of formal and informal institutions and individuals who supply services to meet the needs of SMEs. This can range from provision under state direction, to commercial provision by the private sector, to informal, unpaid provision through associations and family networks. It is important to recognize that there are very different traditions in BDS providers. In many European countries (most notably Germany), for example, membership of business associations/chambers of commerce is compulsory and these organizations (with state support) are powerful advocates and service providers. At the other end of the spectrum, in some of the most entrepreneurial economies in the world, such as in the Chinese immigrant communities of SE Asia, a strong enterprise culture based around family networks provides the strong institutional basis for the supply of services.<sup>4</sup>

While the precise picture of providers and services varies from one situation to another, the point here is that in any successful economy a productive, efficient environment (of providers and services) exists. As development agencies interested in supporting BDS in lower-income economies, our challenge is to intervene to improve this environment; i.e. to help develop more effective providers and services to meet the needs of SMEs.



Inevitably, what emerges from the above is not the clinical, tight definition that some might like and that is possible in the relatively flat terrain of microfinance. It doesn't serve anyone's purpose to construct a definition currently that is overly exclusive, namely:

BDS are an array of non-financial services offered on a formal or informal basis by a range of providers to SMEs to address their needs.

This relatively broad definition should not be equated with *fuzziness* in how we intervene – which is the focus of our discussion below. It doesn't mean that 'anything goes'. It does mean, however, that there is considerable breadth in what can be called legitimate areas for justified interventions in BDS.

### Principles of good practice in BDS

Ultimately, of course, practice is only a means to an end; what matters is results. As development agencies, this means positive change in the capacity and performance of SMEs leading to the achievement of wider development objectives. The principles, therefore, are concerned with how:

- interventions should be designed and managed by facilitative organizations such as donors or non-governmental organizations (NGOs)
- institutions – providers of BDS – should be developed and how they should operate
- services should be developed and delivered.

The original preliminary guidelines specified 11 different principles as well as broader development criteria that together defined good practice in BDS. These have been summarized into seven core principles, as follows.

#### *Businesslike and demand-led*

Emerging both from theory and hard experience, this is the first and probably most important principle of good practice in BDS; namely that the design and implementation of any BDS intervention should be driven by business-like concerns, skills and values. In practice, this principle has numerous manifestations.

- *Transactional relationships:* 'Conventional' development interventions are based on charitable relationships characterized by a one-way flow of benefits from a benefactor to a beneficiary. Business relationships in market-based economies are completely opposite to this (see Table 1.1). They are transactional based around exchange, mutual benefit (and respect) and response to demands rather than needs. Businesses characteristically do not expect charity; if a product/service has value for them they will pay for it. Indeed, if something has no price it is often seen as having no value. In practice, this has huge implications. For example:

business centres (in Peru and Ecuador) is based on performance-related payment, with higher client payments and greater financial sustainability rewarded by greater funding (Gibson and Hitchins, 2000).

- Charging for services: ensuring that SMEs pay (something!) for services immediately helps to create a more demanding and productive client-provider relationship, forcing both to consider value. Training organizations, in particular, have found that charging improves the quality of their products.
- Developing an offer; designing products: the question at the heart of any business relationship is: what is it that you offer? What do you distinctively bring to a market that others do not? As in microfinance, BDS products need to be designed, marketed and delivered in a way that addresses the real situation of SMEs and which is cognisant of the wider competitive environment in which they exist.
- *Getting (and developing) the right people:* The need to be businesslike forces organizations to reconsider the people they employ. Historically, aid-funded agencies have not been good at delving into business ventures. However, in order to play an active role in facilitating BDS providers, for example, increasingly they need people who are both entrepreneurial and accountable. Similarly, they need to construct financial relationships that encourage the development of people's entrepreneurial abilities (for example, through incentive-based arrangements). Many 'traditional' development people may not be suited for BDS.
- *New partners:* Delivery organizations in BDS that embody the necessary businesslike attributes in their structure, management, systems and status may take a variety of forms. Conceivably they may be NGOs or associations. However, increasingly it is likely that they are for-profit businesses or self-employed individuals. Conversely, they are less likely to be state organizations – experience has shown that these tend to be so far removed from the reality of SMEs that they cannot develop the essential *closeness* that lies at the heart of a productive relationship.

Table 1.1 Characteristics of alternative development relationships

<i>Transactional</i>	<i>Charitable</i>
Provider	Benefactor
Discerning client	Pilant beneficiary
Service/product	Gift
Payment required	Gratitude offered
Demand-based	Needs-based
Exchange	One-directional
Equal	Unequal
Mutuality	Altruism

#### *Developing an explicit picture of sustainability*

One of the main reasons for the advance of microfinance is that interventions here can be based on a clear picture of long-term institutional sustainability. Typically,



such interventions are seeking to turn NGOs into sustainable microfinance organizations or to facilitate the development of smaller village banks/credit unions. The role of the state is that of regulator. This clarity in objectives provides direction and coherence to interventions and, crucially, defines the role of different parties, typically: the state and/or donors; the private sector; and the service provider. Without this broad consensus, drift and inconsistency are inevitable.

In BDS, this clarity and direction are usually not evident. Big issues such as the role of organizations, the extent of, and rationale for, subsidies (if any) and who finances and does product development are left hanging, undecided and ambiguous. For example, matching grant and vouchers interventions – for SME consultancy and training respectively – often fail to make clear whether their real intention is to use forms of subsidy as a short-term impetus to the development of essentially unsubsidized markets or to subsidize markets continuously.

Of what should an explicit view of institutional sustainability consist? At its most basic, this should include:

- A view of the long-term role of the state: there may be many justifications derived from economic theory for intervening, but more important is that the envisaged role of the state matches its capacity. Particularly in less developed countries, where governments have few resources, it is pointless (indeed irresponsible) to assume that they will be able to play an active role in supporting many BDS or to lure them into such a role with donor funds. Increasingly, as the World Bank's (1997) analysis shows, governments need to focus on their own core competence that matches their capacity (Figure 1.2). The BDS Guidelines' principle of subsidiarity (see below) is also relevant here.
- A view of the long-term role of donors: generally, it is unwise for BDS organizations to assume that there will be long-term funding from donors, most of whom inevitably have quite limited project-based funding horizons.
- A view of the long-term role of the private sector: it is clear that in many low-income countries, markets are essentially not working. Moreover, often their growth has been impaired by the distorting effect of external donor intervention. Market development is increasingly seen to be essential for the effective supply of BDS, as it is for other products. Intervention design, therefore, should take, as its starting point, BDS in a market context.
- A view of the long-term role of the BDS organization: among the options are:
  - to develop as a *market player* sustained by revenues from clients, in which case caution needs to be exercised over the potential displacement of others; or
  - to develop as a *market facilitator*, supporting the development of a functioning supply and demand-side.

There should be no illusions over the difficulty of this task. Unlike microfinance, where the achievements of the past decade have been built on large organizations (banks), in BDS our pictures of sustainability will be more diverse, with a wide variety of small-scale private sector and other players and a varying role for the state depending on the context, the specific BDS in question and government's resources. This is not straightforward. Moreover, the experience of many

	Addressing market failure			Improving equity
Minimal functions	<i>Providing pure public goods:</i> Defence Law and order Property rights Macroeconomic management Public health			<i>Protecting the poor:</i> Anti-poverty programmes Disaster relief
Intermediate functions	<i>Addressing externalities:</i> Basic education Environmental protection	<i>Regulating monopoly:</i> Utility regulation Antitrust policy	<i>Overcoming imperfect information:</i> Insurance (health, life, pensions) Financial regulation Consumer protection	<i>Providing social insurance:</i> Redistributive pensions Family allowances Unemployment insurance
Activist functions	<i>Co-ordinating private activity:</i> Fostering markets Cluster initiatives			<i>Redistribution:</i> Asset redistribution

Source: World Bank, *World Development Report, 1997*

Figure 1.2 *Functions of the state*

industrialized (and post-industrial) nations offers very few models to emulate. Characteristically, for example, in the UK a range of rambling government-financed small business 'support' structures are created, of questionable efficacy and often with transparent political objectives.<sup>5</sup> Governments – relatively wealthy and undisciplined – dabble in wider economic development issues that are beyond their areas of core responsibility. Despite this difficulty, developing credible, shared pictures of what BDS should look like in the longer term is a fundamental and unavoidable challenge for all parties involved. In most cases, it has still to be addressed.

#### *Focused with strategic awareness*

Consistent with the first principle of good practice in BDS (being businesslike), it is also important that BDS organizations focus on what they are good at with a specific client group. One of the major business trends over the past two decades has been towards greater focus in business operations. In increasingly complex market environments, businesses recognize that they cannot be experts at everything. Rather, they need to identify their distinctive area of competence – where they add value – and focus on this, avoiding peripheral activity, or subcontracting important but secondary functions to other specialized providers. The huge growth in small-scale specialized consultancy operations in industrialized nations is primarily attributable to this focus on core functions.<sup>6</sup>

This approach differs markedly from that often followed in traditional development interventions, where organizations may appear as generic helpers offering 'integrated packages' of support, rather than as specialized providers. Yet experience suggests that not only does 'mixing' result in services of poor quality, but it may also send mixed messages to clients. This is, of course, particularly the



case when organizations try to mix finance with BDS; these organizations that do appear to be able to do this successfully do so by keeping them operationally apart. In other situations, business associations have wandered into the delivery of training services when it is clear that they don't have the requisite skills or relationship with SMEs to enable them to perform this role. For BDS organizations, this focus principle therefore confronts them with some basic questions:

- What is our distinctive offer?;
- What is it that we are good at, relative to other providers?
- Who is our core set of clients and what characteristics of their situation/problems are we addressing through our product?
- What should be our approach to product development that complements our strengths?

Focus, of course, does not imply being strategically narrow-minded. On the contrary, it requires that appropriate networks and relationships are established so that BDS providers know their position within the wider environment, can signpost clients to other providers and can develop mutually beneficial linkages. As with so much in BDS, there is much here to learn from SMEs' reality. One of the enduring myths about SMEs is that success requires complete independence in thought and deed from their owner-managers; in fact, one of the key determinants of success is managed *interdependence* with key players and stakeholders; i.e. independence within a broader context of interdependence (Gibb, 1987). This truth is also applicable to BDS providers and facilitators, who must be conscious of the bigger picture within which their intervention is located.

#### *Participation: building on ownership*

Participation is a widely used (and abused) word in the development sphere and is generally regarded as being an important principle in designing and implementing interventions. In the context of BDS, however, it has a specific meaning.

First, participative processes are useful in understanding (potential and real) clients' situations, developing relationships with them and developing products. Businesses do this, although without using the development language of participation. Using formal or informal market and customer assessment techniques, they follow a participative approach. Indeed, there are real dangers when participatory development tools are imported into BDS situations. Participatory techniques can easily slide into destructive wish-list creating exercises, raising expectations that cannot be met. Moreover, they are often very time consuming – for hard-pressed SME owner-managers, a major concern. Ultimately, in BDS, as in any business situation, a provider needs to make a product offer to his/her clients and to take a calculated risk in the process. Participative processes can help this process; used wrongly, they can also hinder it.

Second, following a participative approach requires that donors – and/or those playing a facilitative role – recognize the importance of people's *ownership* of their organizations and their ideas. In SMEs, ownership and management are usually manifested in one individual; this is their distinctive feature and their strength. Similarly, among BDS providers, ownership is often manifested in one

entrepreneurial leader. In their approach to selecting 'partners' and managing relationships with them, therefore, donors need to offer suitable space and incentives to encourage ownership and avoid the emergence of donor-created entities. In many ways, donors need to model themselves on business investors rather than on charitable donors; some have coined the phrase *social venture capital* to describe this approach. One manifestation of this approach is the competitive tendering mechanisms developed by Swisscontact to open out selection processes to new types of individual and organization (Gibson and Hitchens, 2000).

Third, particularly for larger-scale providers, it is important that they allow individual staff to have greater ownership of their work. Although it is often contrary to good practice principles to have the state as a direct provider of services, these large and bureaucratic organizations do often exist. One way in which they might be made more effective is to require that individual staff take more responsibility for their work and that a greater proportion of their income is directly performance related, so exposing them to the generally healthy influence of market pressures.

#### *Enhancing outreach*

A major weakness with many BDS initiatives is that they fail to reach significant numbers of SMEs, particularly in comparison with microfinance. With some exceptions, such as voucher programmes, most BDS interventions reach only a few hundred clients; in microfinance, on the other hand, economies of scale dictate that organizations have to reach many thousands of clients. To some extent this comparison is unfair because some types of BDS have a wider influence beyond those who buy a service direct; for example, new skills or marketing approaches transfer to other SMEs through natural processes of inter-firm learning. However, the important point here is that BDS organizations should have an explicit view on how they will enhance their outreach. Several implications flow from this principle:

- If the delivery of a service is subsidized, the only way in which outreach can be enhanced is through more subsidy. There may be other ways in which 'subsidy' can be offered that are less distorting to the provider-client relationship. Microfinance's development has been suffused with subsidy, but mainly in pre-delivery product development or organizational development; the direct delivery of microfinance products has been left predominantly untouched by subsidy. Clearly, as said before, subsidies that are offered need to be consistent with a credible picture of sustainability.
- Product design and pricing need to be more focused on SMEs' priority needs. In the past, SME training products have been developed that assume implicitly that owner-managers had ample time and wouldn't pay for the service; i.e. they are developed as publicly-funded services rather than private products. An approach that does not rely on uncertain subsidies might seek to break down products into modular parts, focusing on specific subjects/problems rather than on more generic issues.
- Donors need to seriously consider BDS market development rather than (only) the development of specific providers. Under this analysis, which is receiving considerable interest, the only way in which BDS will reach signifi-



cant numbers of SMEs is when BDS are offered in self-perpetuating market situations, with a range of different types of entrepreneurial providers offering different types of products to discerning, knowledgeable SME customers. The challenge of intervention is to facilitate the development of these vibrant, functioning markets. While this appears to offer promise conceptually, it requires new skills and disciplines from agencies, for example an ability to understand market structures, to work with different kinds of partners and to develop a consensus among key players on the market development objective. Clearly, markets will not develop if they are undermined continuously by random, ill-considered 'helping' subsidies.

### *Subsidiarity*

This is the key principle guiding the role of government in BDS. Essentially, it enshrines a common sense idea of who can do what best in BDS; meaning – usually – that responsibility is delegated to the lowest possible level to those who are closest geographically and socially to SMEs themselves. In practice, of course, the role of the state can be a complicated issue. As mentioned above, capacities of governments vary greatly from one country to another. However, it is the case that government's role in BDS is increasingly being seen to be most important in relation to policy-setting, basic research and product development funding, infrastructure development and management, and, on occasion, delivery of subsidies for priority groups.

Clearly, a more proactive role for government *can* be justified. For example, there is currently considerable interest in the development of clusters of economic activity and, it could be argued, only a state-supported organization can overcome the information and resource constraints necessary to play such a co-ordinating role. However, two additional cautionary points need to be borne in mind about the role of the state:

- State intervention is usually justified on the basis of market failure (externalities, asymmetric information and market distortion) or equity (opening opportunities to those excluded by market processes). Unfortunately, markets are never perfect and there is always some inequity! Does this mean that intervention is always justified? – clearly not. The point here must be that governments, like other actors in the BDS environment, need to have a sense of their core competence and focus on this, rather than expedient interference beyond their priority functions.
- Many highly subsidized BDS – by the state – are unlikely to achieve high levels of financial sustainability because, in some ways, they reflect basic skills and knowledge that governments should be delivering in children's education. BDS cannot hope to be a substitute for basic education, nor should they try.

### *Tight performance measurement*

There are two dimensions here: first, the importance of better operational measurement of performance in relation to costs; and second, improved measurement of performance from a development perspective.

First, historically, financial management has been a neglected discipline within BDS. While organizations had budgets and maintained accounts, financial information has not been used to improve decision-making. Costs have usually not been allocated to different products and different functions such as product development, systems, monitoring and actual delivery. Without this basic financial information, which provides the basis for performance assessment in any business, it is not really possible to be businesslike. Not for the first time, the lessons of microfinance are relevant. Here, financial information lies at the heart of its development and, while BDS is different, the broad lesson still applies. There is evidence that this lesson is being absorbed and there are now more examples of at least direct cost comparison with revenues for different types of product. However, a clear challenge is to extend transparency to other costs, and reaching agreement on the definition of 'direct costs', where there is scope for confusion (and manipulation).

Second, as development organizations, there is a need to look further than service delivery and provider development to changes within SMEs (and beyond), the levels of impact, which lie closest to the underlying development rationale for interventions. Here there is less to learn from microfinance – indeed one of the enduring controversies in microfinance is the extent to which real change is taking place among microfinance institution (MFI) clients. Elsewhere in this book, contributors have sought to break down these dimensions of performance into different categories – outreach, use of services, perceptions of benefits among clients, etc. – and it is clear that this will be a major area of further development in the forthcoming period. As we look at these issues in more depth, two basic points should not be forgotten:

- Any assessment of change beyond the delivery organization is inherently difficult. As soon as one starts to assess change *caused* by an intervention, the 'big issues' of evaluation – displacement and attribution – need to be confronted. This is always difficult.
- There may be a contradiction in urging BDS providers on the one hand to be businesslike, and on the other to be concerned with impact and therefore with functions and costs that one wouldn't ask of a normal business. In order to resolve this, donors may need to consider paying for evaluations that clearly are for their own (rather than providers') purposes, or seek to encourage the development of information systems that address both impact and client feedback; i.e. combining the development need for insight into impact with the business need for insight into clients' situation, use of products and views on products.

### **Key challenges for the way ahead**

Three years after the Donor Committee first commissioned the Springfield Centre to develop guidelines on good practice in BDS, it is clear that a considerable amount has been learned. There is a positive, palpable sense of direction in BDS that augurs well for the future. However, it is equally the case that BDS remains a relatively undeveloped and immature field. There are few irrefutable



truths in BDS, still less the kind of hard quantitative comparative analysis that drives the microfinance development process. In addition, the development of BDS remains hampered by the absence of a strong theoretical underpinning that can guide the rationale for, and design of, interventions.

As was noted in the preliminary guidelines, the overriding dual need in BDS is for tighter measurement of performance and greater innovation, guided by emerging lessons from global experience. From the preceding discussion, in order to move learning and practice forward in BDS, it is clear that a number of major challenges need to be confronted.

#### *Developing a sustainable 'picture' of the future for different business development services*

Characteristically, BDS interventions are undermined by our inability to answer fundamental questions about the sustainable picture of BDS we are seeking to develop. Perhaps because of the inherently short-term nature of project-based funding, or the sheer difficulty (and effort) of addressing basic issues, there are few interventions that can enunciate clearly their vision of, in 5–10 years:

- who will do what (donors, private sector, not-for-profit providers, associations, government, etc.)
- how services will be developed, and
- how they will be financed.

Without this, the direction of BDS is blurred and it is difficult to develop the specific detail essential to gain a consensus with other players (Tanburn, 1999).

#### *Matching the state's role to its capability*

One central element in the longer-term picture is developing an appropriate role for the state in BDS. What is 'appropriate' will vary from one context to another. Yet there is already enough global evidence to suggest some clear guidelines for what governments should focus on in relation to SME development, if not BDS specifically (World Bank, 1997):

- *The 'Big Picture' is the priority:* SMEs develop best in environments that enhance their access to markets (input and output), do not overly restrict barriers to entry and growth, and do not overburden their operations with regulation and taxes. Governments that emphasize stability and consistency, a credible rule of law, sound macroeconomic management and the efficient delivery of essential services (infrastructure, health, education, etc.) are more likely to create this environment.
- *Not delivering: facilitating the private sector:* just as in wider economic development where the private sector – appropriately encouraged – is increasingly seen to be the engine of development, so the provision of BDS is likely to assume the role of key driver of innovation and delivery. This means in practice that government (or donor) interventions should seek to develop rather than distort private markets and that the assessment of interventions should focus increasingly on market development.

- *Identifying core areas of responsibility:* in terms of BDS-specific roles, this still leaves a variety of areas where a government role is necessary or desirable, given sufficient resources. For example, this might include financially supporting basic research and information provision, procurement processes, strengthening supply-side skills and co-ordinated activity in relation to activities such as cluster development.

#### *Intervention choices: demand-side or supply-side?*

As analysis of BDS improves, it is becoming clear that there are a variety of different intervention options available to potential donors. On the demand-side, key interventions include matching grants (for consultancy) and vouchers (for training) both aimed at overcoming information, cost and equity constraints. On the supply-side, the key interventions include training, product development/transfer, financial support and co-ordination. Case studies are beginning to cast light on the effectiveness of each of these and the conditions under which they are more or less applicable. For example, it is clear that demand-side interventions, while possibly helping to stimulate market development in the longer-term (the data are not really available to make a firm assessment), do appear to run a higher risk of market distortion than supply-side interventions. However, this is a process that has only just started. Furthermore, increasingly these interventions should be assessed in relation to their ability to develop wider markets rather than against direct measures of the supply- or demand-side only. One major challenge for the future is to develop practical and effective tools to assess markets and link market development conditions to intervention design.

#### *Intervention choices: investing in services or organizations?*

Building on the previous point, one of the main choices that needs to be made in any intervention situation is over its focus: in particular, should it concentrate on investing in the development of services or of people and organizations to deliver services? In general, the answer to this question must be driven by the existing market situation. As above, the best starting point of any intervention is a market analysis. On some occasions, the underlying problem is clearly related to an absence of products and service orientation; on others it may be related to capacity – skills, organizational cohesion, etc. One characteristic problem with donor investment in organizations is that it can tend to create large 'donor-friendly' organizations (as in microfinance) that are often not appropriate in BDS. Here, the appropriate supply-side structure may well be small-scale organizations – businesses or freelance individuals or associations; it is important that developing their capacity does not transform them into organizations that mirror their donor funders rather than the SMEs who are their ultimate clients; that capacity is developed rather than distorted.

#### *Donor skills and relationships: accountable and entrepreneurial*

Application of good practice principles in BDS challenges donors – or other facilitators – themselves to develop businesslike, market-aware skills among their



staff, and relationships with their partners that encourage entrepreneurial behaviour as much as accountability. This is difficult to achieve. Traditionally, people from a 'standard' development viewpoint have been suspicious or ignorant of business instincts and 'ways'. Yet in order to play a proactive role in developing a more businesslike environment for BDS, to develop functioning markets, donors must develop this kind of orientation. Clearly, this may have implications for their approach to selection and development of people.

#### *Developing benchmarks for performance measurement*

Unlike microfinance, there are very few common ratios to assess performance on a comparative basis. BDS, of course, will never be like microfinance; it is an inherently broad and diverse field, with BDS products offered in a variety of ways, by different types of providers. This will always be the case. The extent to which it will be possible to wrap BDS in a common performance framework is, as yet, unclear, but it is certainly a process that needs to be attempted. Moreover, it does seem likely that considerable progress can be made, at least in relation to specific BDS and/or where interventions are pursuing common objectives (McVay, 2000). Of course, comparison is particularly difficult when assessing impact and when comparing costs with benefits, but in relation to objectives such as efficiency, outreach and sustainability there are stronger grounds for optimism. In addition, one sizeable benefit from the current thrust of activity aimed at measurement is to force BDS organizations generally into a more rigorous view of their work. This will eventually provide a more solid basis for detailed comparison.

#### *Developing BDS relevant for different client groups*

Most of the experiences of BDS highlighted in case studies concern BDS at the upper end of the SME size spectrum. Yet for development agencies, reaching microenterprises operated by lower-income and/or disadvantaged groups is often a significant priority. Can BDS therefore be relevant to development agencies? Several points can be made here:

- There are examples (Hitchins and Gibson, 1999) of BDS being made available for low-income groups on a relatively sustainable basis. However, it is clear that developing (commercial) products that are appropriate for these groups has not been a high priority thus far.
- In many relatively 'simple' microenterprises operating in highly competitive markets – such as trading – the benefits of more skills and knowledge can be minimal. While financial services may allow bigger volumes and lower costs, it is not clear what BDS can offer. More complex and bigger businesses are likely to be able to use inputs more effectively.
- There is a widespread view that a businesslike approach will inevitably be biased against lower-income and disadvantaged groups. This is a moot point and one that is not supported by the microfinance experience, where micro-entrepreneurs are seen to be as discerning a client group as any other. However, perhaps more importantly, there is a danger that BDS is used as a

vehicle for essentially welfare programmes (which obviously, in their place, can be justified) or as a rather poor second-best to the development of appropriate education services.

- A focus on SMEs that are *not* the smallest and owned *not* by the poorest does not necessarily mean that a poverty focus is diluted. Rather, inherent in many BDS interventions is an explicit view that the poor cannot be the sole agents of their economic development; creating the conditions that allow them to have greater opportunities for higher incomes through employment in other enterprises is a practical and valid route to poverty reduction.

Together, the above challenges (and more) form a formidable barrier to the further development of BDS. Our collective ability to address them effectively will largely determine whether the achievements of the past few years can be built on to enhance learning, practice and, ultimately, impact on SME development.

#### Notes

1. The work was funded by GTZ on behalf of the Committee.
2. The extent to which these *needs* are *demands* is an important issue. Demand implies a willingness on the firm's behalf to pay for a service: need is an idea that is much more nebulous.
3. The distinction between service sector and manufacturing generally has become more difficult to pin down in recent years. For example, it is clear that for many manufacturing operations their real value-added is through the service aspect of their commercial offer to customers.
4. The importance of *social capital* has also been recognized in the development of entrepreneurial economies elsewhere, and particularly in the development of clusters.
5. While there are interesting, specific BDS products from the UK experience, at its worst the UK small business support structure resembles a welfare state for business.
6. For example, the number of consultants in the UK doubled between 1985 and 1992 (Keeble et al., 1994).

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## PART II THE MARKET FOR BUSINESS DEVELOPMENT SERVICES

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### 2. Training vouchers: a tool for market development in Paraguay

LARA GOLDMARK and GABRIEL SCHOR<sup>1</sup>

#### Introduction

ECONOMIC THEORY HIGHLIGHTS an information problem which helps explain the functional weaknesses of the training market: the extreme difficulty with which potential purchasers of 'training' can gauge the quality of training programmes in advance. Training is an 'experience good' whose merits do not become apparent to the trainees until after they have consumed the good and are able to apply the newly acquired knowledge in a successful manner. Glossy brochures proclaiming the benefits of this or that training programme are unable to provide training consumers with the necessary information about quality. Such advertisements can make promises, but their proponents are not necessarily able or willing to keep them.

In the free market, however, no training provider would be willing to allow a customer to delay payment of course fees until the course had been completed to his satisfaction. In such a circumstance, what would compel the training customer to pay? After all, upon completion of the course, the trainee has received what he wanted to acquire (knowledge and skills), and therefore has a strong incentive to refuse payment on the grounds of dissatisfaction, regardless of how satisfied he really is with the service provided. Therefore, the only realistic system is to charge fees up front. This raises an additional problem, since usually the potential customer of training will agree to pay only if the risk of buying a training course of unknown quality is offset by a reasonable (low) price. The result: in order to keep prices low, training providers must minimize their costs, which ultimately affects the quality of the training. Thus, the quality is often poor because: the staff are ill paid, ill prepared and insufficiently qualified; the training materials are inadequate; and no additional thought has gone into addressing the needs of the trainees. The phrase 'you get what you pay for,' in this case serves to reinforce and confirm the consumer's preconception that training is of little value and high risk. Finally, the information deficits on the supply-side of the training market may result in *adverse selection*, and in extreme cases, can lead to the total breakdown of the training market.

The information problem – namely that training providers cannot credibly demonstrate the quality of their services in advance, nor can customers confirm their willingness to pay – has led to an overall underinvestment in training. This is a problem that often the state is compelled to address, typically through the use of permanent supply-side subsidies.



Subsidies, however, are not necessarily the panacea for such market imperfections. Subsidies can induce training providers to offer training despite lack of demand for it, but subsidies do not necessarily prevent providers from offering poor quality courses. An effective instrument, therefore, would not only promote investment in the training market, but also reduce the information gap, improve quality control, and be sustainable in the long term while minimizing the risk of fraud.

In an attempt to overcome problems related to underinvestment in the training market, programmes have often oversubsidized supply (training providers), with the implicit assumption that through this intervention the information deficit on the demand-side is also addressed. This underlying assumption, that both programme designers and training suppliers understand the needs of microenterprises, has been a critical fallacy of many past designs. The reality is that information is lacking on both the demand- and the supply-sides of the market equation.

One final, and important, consideration in examining new approaches to microenterprise training market interventions, is that the externalities argument is not really applicable to the small and microentrepreneurial training market. Experience has shown that when the relevancy and adequacy problems of the training products supply are addressed, the resulting transactions should, and can, be considered as transactions of wholly private goods: assuring that the benefits of the training be totally appropriated by the trainee is an entirely possible result of good product design. There is therefore only a limited rationale for subsidization, which should in fact be geared towards the development and deepening of an ultimately sustainable private training services market.

In the next few pages the specific problems and pitfalls encountered by previous supply-oriented programmes are analysed. Subsequently, a new approach to microenterprise training is described, which uses an information system associated with vouchers. The concluding section highlights the challenges still facing this approach, and touches on expectations for future programme interventions.

### Problems and pitfalls of traditional supply-oriented programmes

When Latin American training institutions were created, the problems of training were mostly on the supply-side. The market would hire as many graduates as schools could produce and trainers were concerned with training materials, training of trainers and funds to pay for increasingly large and heavy systems. The economic troubles which started with the oil crisis in the 1970s and culminated with the 'lost decade' of the 1980s changed forever the landscape of training.<sup>7</sup> The biggest challenge in recent times has been finding a good fit between supply and demand, not simply increasing supply to meet excess demand.

Even now, most course offerings of the large training institutes created throughout Latin America remain tailored to large enterprises with greater specialization of functions, complex divisions of labour, and technologically more advanced processes.<sup>8</sup> Instead of offering practical training, one may more accurately describe these programmes as consisting of an extension of the traditional concept of technical education, the curricula of which are suitable only for peo-

ple who are planning to take up positions in large-scale industry. Furthermore, because the courses are in fact excerpts from an advanced technical education – rather than job-specific training – the examples used to transmit skills are foreign to the everyday reality of small or microentrepreneurs. Finally, the organizational framework of the courses takes no account of the preferences of adults already working in full-time occupations: courses are too long and are scheduled at inconvenient times of day. As a result, only a negligibly small number of microenterprises are able to capitalize on this type of technical training in any truly meaningful way. The majority of small entrepreneurs have no profitable use for it, and they are therefore not willing to take part in such courses, even when they are offered 'for free'.

Some Latin American governments have developed a model for public vocational and technical education and training systems that aspires to assure the relevancy and adequacy of its products through the creation of tripartite technical school boards, which include representatives of government, business, and labour. Unfortunately, experience has shown that the market information that can actually be channelled through the business sector representatives to the board is extremely limited. The actual supply of courses by these institutions ends up addressing – in the best of cases – the demands of the more vocal and active business sectors, and furthermore tends to be expressed as a function of the specific capabilities, experience and interests of the school faculties. The tremendous variability and diversity of the actual training needs of small and micro-businesses just cannot be addressed through such a centralized institutional arrangement.

A more recent supply-oriented subsidization approach has made some strides in promoting competition among training providers, although the programme still falls short of developing an efficient, sustainable market. In Chile second-tier organizations, such as local government agencies, establish criteria and prerequisites for training providers to qualify for participation in their subsidized microenterprise-focused training programmes. Accepted training providers then compete with one another in a course-by-course tendering process. This intervention ultimately works under the assumption that the second-tier organizations know the ever-changing needs of the microentrepreneurs. Information about the training needs of microenterprises may in fact be readily available to the training providers individually, but it is rarely filtered up to the second-tier organization that makes decisions about curricula and training provision for the programme. The model assumes that the crucial dimension for satisfaction of the target group training needs is price, and thus makes no allowance for demand to express its concerns regarding the other training product dimensions – contents and modalities – which are pre-determined by the second-tier institution. The apparent market-orientation of this approach is therefore restricted to price competition (though it is not exempt from oligopolistic price formation), with little allowance for competition regarding quality of products.

In the centralized tendering model the actual buyer of the training product is the second-tier institution, and not the entrepreneur. This produces several sub-optimal effects: a) it promotes the specialization of suppliers as providers to the second-tier institution and not to the entrepreneurs themselves (it promotes ten-



dering capacities rather than demand-identification and marketing capacities); b) the second-tier institution substitutes for the entrepreneurs as clients, thereby preventing their learning process in acquiring training products and in negotiating product adequacy; c) the purchase of training products in a centralized and aggregate manner ultimately distorts market prices.

### The Paraguay experience

In 1995, the Inter-American Development Bank (IDB) financed a pilot information system and voucher training programme targeting microenterprises in Paraguay. The programme was experimental in nature, designed to accompany an IDB loan, which focused primarily on attracting formal financial institutions to microenterprise lending, through a technical assistance package and a line of credit available on commercial terms.

This information system and voucher training programme was conceived with the aim of overcoming the market imperfections cited above, as well as some seemingly intractable problems that the IDB had encountered when financing training initiatives for microentrepreneurs in the past. Typically, training had been obligatory, linked to credit allocation, and focused on general accounting and business principles. Courses were often taught by NGO credit staff with little knowledge of the business world, and all entrepreneurs were grouped together, regardless of sector or level of knowledge. As could be expected, classrooms were empty; when pressured, some entrepreneurs sent family members or other, less busy individuals to attend the training. Results were measured by number of courses given and people trained, rather than by whether skills learned were applied. It was inconceivable for courses like this to recover costs directly (although some training operations were financed through credit revenues), simply because what was being offered was not demanded by microentrepreneurs. Financing institutions like the IDB at times tried to select one institution over another to provide training, without really knowing what entrepreneurs wanted or needed.

The information and voucher programme turned this situation on its head. It produced an unprecedented response from the market, both from training suppliers and from microenterprise owners and employees interested in training. The programme operated independently from the larger microfinance loan of which it was a part, without discriminating between loan clients of the IDB programme and the wider Paraguayan microenterprise sector.<sup>4</sup> Preliminary results show that the programme helped to develop a private sector training market which offers products appropriate for a microenterprise clientele. Clients demonstrated that they wanted to learn specific, immediately applicable, skills and wanted courses broken up into short, easily digestible modules. Once suppliers had got the message and adapted their products, demand from microentrepreneurs was strong, even with a required out-of-pocket contribution. Most importantly, the programme altered the balance of power in the training market, by increasing microentrepreneurs' buying power. Entrepreneurs armed with both information and vouchers could choose what they wanted to learn, when, and from whom. This new dynamic forced training institutions to compete with

each other in order to attract clients, and to innovate constantly in order to keep up with a highly cyclical and rapidly evolving demand.

### How the model works

The key characteristic of this new approach is its multi-dimensionality: it addresses the information problems at the root of training market underdevelopment, while injecting a demand-oriented, partial subsidy that seeks to jump-start investment in product development by existing suppliers, thus setting the stage for a more competitive marketplace, and attracting new microenterprise clients.

The programme sequence is as follows:

Prior to acceptance into the programme, training providers are screened based on the following prerequisites: legal recognition as a training institution, one year or more experience in training microentrepreneurs, and the existence of adequate facilities, materials and staff to conduct the training. Once accepted into the programme, training providers must also agree to unscheduled audits and evaluations. These audits serve as an important measure to minimize fraud, while at the same time the data gathered serve to inform potential trainees, through the orientation and referral component of the programme. The roster of institutions remains open during the execution of the programme, with the understanding that new market entrants tend to place pressure on the leading training institutions to keep innovating.

The orientation and referral service, while also functioning as a voucher distribution centre, provides information on the content, locations, providers, and quality of training. Training providers are ranked monthly according to how many programme clients choose their courses, including information about numbers of repeat clients and year-to-date total sales. Results are made available at the centres, allowing clients to see which courses are most popular with other entrepreneurs, information which is an indication of the relevance and quality of the courses. Most microentrepreneurs hear about the programme by word of mouth, but advertisements for the programme have also run on the radio and in local newspapers. Training institutions also provide information in an attempt to recruit new students.

Entrepreneurs obtain a limited number of vouchers from the voucher distribution centre. Vouchers have a fixed monetary amount and may be used by microentrepreneurs to offset the cost of a training course of their choice. Entrepreneurs pay the difference between the cost of training programme and the voucher's value. The only restriction is that microentrepreneurs must use the vouchers at institutions officially registered with, and rated by, the programme. An out-of-pocket contribution by the microentrepreneur is required in all cases, with course prices ranging from double or triple the voucher amount to just 25 per cent over the voucher's value. In Paraguay, for example, the voucher's value was set at US\$20 and the least expensive courses were \$25 each. Setting the voucher at an absolute amount rather than a percentage favours the lower-income microentrepreneurs, who may not have more than US\$5 to invest in training. Note that if the voucher value in Paraguay had been defined as 50 per cent of the course price, this would have forced all entrepreneurs to contribute at



least US\$12.50, while entrepreneurs choosing to take more expensive courses might have received up to US\$35 in subsidy.

Quality and information are controlled via the market in a number of ways:

First, training providers are not entitled to submit the vouchers to the programme until the customer has completed the course; and even then they will receive reimbursement for only those customers who attended at least 75 per cent of the course. The programme operates under the assumption that the trainee will complete the course only if he or she is satisfied with the training provided. Because the system operates on a voluntary basis – unlike 'past' programmes where training was mandatory – training providers are compelled to be responsive to the needs of their customers. Dissatisfied training consumers will most likely choose not to attend 100 per cent of the course and therefore the voucher portion of the payment will not be received. On the other hand, the customer's co-payment (the fee over and above the amount of the voucher) must be made at the beginning of the course. Whereas the providers of training would incur a 'default risk' if individual consumers were to promise to pay after receipt of services, no such risk exists within the voucher system because the programme guarantees that the voucher will be exchanged for cash in the case of satisfactory provision of the service.

Thus, the design of the programme succeeds in providing support at precisely the points where the market needs help in order to function properly. The control mechanism of *ex post* payment can be introduced without imposing an intolerable burden on the providers because payment is covered by a government guarantee, as long as minimal conditions are fulfilled. At the same time, control is largely exercised by those who are best able to do so, namely the consumers themselves. It would be very difficult for such broad-based and 'expert' control to be achieved by a centralized watchdog, which would at best be able to conduct spot checks.

Second, the programme – again, as distinct from traditional programmes – uses competition between providers in the training market as a control mechanism. The microentrepreneurs are free to decide for themselves which of the recognized training institutions to enrol at, and which courses to use their vouchers to pay for. Thus, each training institution has an incentive to distinguish itself from its competitors in order to attract as many customers as possible. Clearly, the model provides a new financial incentive for all the institutions, and forces them to adapt their training product to the needs of their customers. In practice, this means providing courses in the evenings and during weekends, and also providing hands-on practice sessions from which microentrepreneurs can bring saleable skills back to their businesses. Providers do their best not to make empty promises, not only because their clients would drop out midway through the course if they did, but also in the hope that recommendations from satisfied customers will bring future business.<sup>5</sup>

### Results of the Paraguay programme

The Paraguay programme was executed in two phases, a demonstration phase, lasting two years (from May 1995 through May 1997) and a pilot phase, lasting

from February to December 1998. The two-phase execution was not intentional; rather, it was the result of political pressures in Paraguay and administrative complications within the IDB. It is interesting, however, that data exist on the performance of the three leading training institutions during the programme's stoppage (June 1997 through February 1998), which can contribute to an understanding of the voucher programme's impact on the training market.

Figure 2.1 shows the number of vouchers redeemed per month during the programme's two execution periods. The pattern that emerges is that of strong growth, with seasonal peaks and troughs, in voucher use throughout the programme's life. It is worth observing the low volume during and following May, 1995, the date that vouchers were first issued – the programme required a significant gestation period during which participating institutions were recruited, administrative systems were set up, and the programme was advertised. The second phase was able to 'take off' faster, since a loyal client base and a critical mass of training providers already existed. Although the second phase was less than half as long as the first phase, the total number of vouchers redeemed during the second phase was higher (29 264 as compared to 19 287 during the first phase).

Also important to note is the pattern of increasing numbers of non-voucher trainees, during both phases of the programme. In most cases, non-voucher participants were not microentrepreneurs, and thus did not qualify to receive a voucher. Housewives and students commonly purchased the training services offered through the programme. Some non-voucher participants, however, were first-time trainees who did not know about the programme; a few were also microentrepreneurs who had exhausted their quota of six vouchers, yet wanted to continue purchasing training.

The peaks and troughs in the chart show the seasonal, cyclical nature of the demand for microenterprise training. Voucher usage tended to peak just before the Christmas and Easter holidays, times when microentrepreneurs wanted to learn how to offer new, seasonal products. The non-voucher participants represent a more stable market, growing gradually as supply expands.

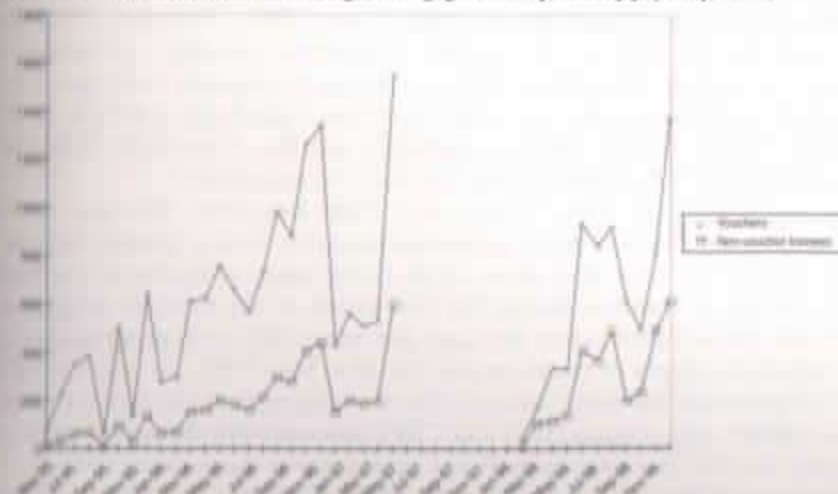


Figure 2.1 Vouchers redeemed per month and number of non-voucher participants



During the first phase of the Paraguayan programme, the number of training institutions participating started small and grew to reach over 60. Of these 60, about 20 participated actively, i.e. redeeming significant numbers of vouchers every month. During the second phase the number of registered institutions was even larger, although the core participants again numbered between 15 and 25 each month, rising as the programme progressed. The leading training institutions, defined as those that redeemed the greatest number of vouchers, were typically small, private, for-profit operations. Directors and instructors were often owners of small businesses themselves, willing to share a few trade secrets with microentrepreneurs whom they knew couldn't challenge their market share. For some institutions, training used to be a side activity performed for extra income. Once the programme provided a financial incentive in the form of vouchers, many providers expanded and invested in their training activities. Most were forced to adapt their training products to the needs of a microenterprise clientele – shortening course length, scheduling training sessions on week nights and weekends, simplifying teaching methodologies, and relying more heavily on hands-on practice sessions.<sup>6</sup> This adaptation process led to the development of a relatively standardized product between and within institutions; a product that had not previously existed on the market.

Another key development was the wide variety in course content that became available. Within sectors, large numbers of extremely specific courses were offered, and even the number of sectors multiplied as the programme progressed. In Paraguay, the course content breakdown during 1998 was as follows: 17 per cent management (accounting, costs, quality control, taxes, etc.); 14 per cent decoration (cotillion arrangements, painting, serigraphy, household repair); 14 per cent textile assembly (fabrics, pillows, clothing, etc.); 13 per cent electricity; 11 per cent culinary arts; 7 per cent electronics; 7 per cent hairdressing, and 2 per cent each for refrigeration, handicrafts, cosmetology, shoemaking, plumbing, auto mechanics, and carpentry.

Several institutions were active in both the first and second phases of the programme. During the programme stoppage (June, 1997 – February, 1998), data were collected on three of the voucher programme's leading institutions: the Instituto Central de Electrónica (ICE – training in personal computer repair, household appliance repair, and other electronic topics); the Instituto de Arte Culinario Maria Gloria (IMG – baking), and the Centro de Enseñanza Profesional (CEP – hairdressing and hair salon management).<sup>7</sup>

The institutions all made a clear shift from long-term, full-time training courses towards shorter, more accessible modules, with a greater variety in course topics. The data also show, in all three cases, a significant expansion in the volume of trainees during the first phase of the voucher programme, which was not sustained over the next few years. All three programmes survived when the supply of vouchers was cut off in May 1997, but only two of the three programmes remained active in the training market throughout phase 2 of the voucher programme (ICE and CEP). Interestingly, these two were programmes that had possessed significant experience in the training field prior to the initiation of the voucher programme. The third institution, IMG, was a start-up with limited experience in training, originally a catering and baking shop.

Although IMG did continue to offer training for some time after the end of phase 1, the enterprise turned back towards baking sales as the training market weakened.

With regard to prices, on the other hand, each institution reacted differently to the end of the voucher programme's first phase. CEP reduced its price as compensation for the voucher's disappearance – ostensibly in order to keep the course accessible to low-income clients. IMG raised its price to compensate for lost voucher clients – and lost even more clients. ICE was able to maintain the same price, with all clients paying 100 per cent of the stated price without the help of the voucher, due to the outstanding reputation it had developed in the market.

Figure 2.2 shows the average course price over the life of the programme. The downward trend may be due to the fact that many institutions had to make an initial investment in the re-adaptation of their course materials and content, teaching methodologies, and delivery strategies as they reached out to attract a new clientele. Once this investment was recuperated, institutions were able to reduce their prices in an effort to compete for additional clients. Stronger competition was present in the second phase of the programme: records show that new training institutions entered popular sectors such as electronics and baking, adding to the variety and number of courses available.

A more detailed set of data from phase 1 of the programme shows, however, that during any given month of operation, the least expensive courses were not necessarily the most popular.<sup>8</sup> Institutions with good reputations were able to charge a premium for their services. In addition, some courses were more expensive due to their content and to the materials required. Courses in electronics and baking, for example, tended to be expensive while business management courses usually cost less.

The subsidy level of the programme was tracked throughout phases 1 and 2, measured as the total value of vouchers redeemed over the total value of sales

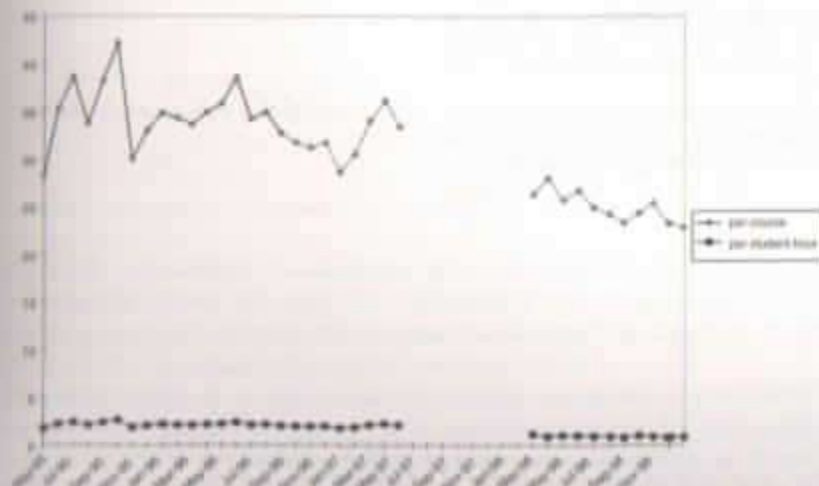


Figure 2.2 Average price per course and per student-hour



for those training products eligible for the programme. For example, if IMG charged US\$30 per person for one course, trained 18 students, and collected 14 vouchers at US\$20 each, the subsidy level for that particular course would be  $(14 \times 20)/(18 \times 30)$ , or approximately 52 per cent.<sup>9</sup> Figure 2.3 shows the evolution of the subsidy level over the programme's history.

A clear pattern of increased subsidy is evident during phase 2 of the programme. This could indicate that participant institutions had become adept at 'capturing' the subsidy, i.e. deriving maximum voucher income from courses by attracting large numbers of voucher holders. Another plausible explanation is that the microenterprise community was better informed about the programme's existence during phase 2. On the one hand, this demonstrates a positive market phenomenon, where the object is to cater to the demand of a large microenterprise clientele. Part of this demand may include pressure to keep the microentrepreneurs' contribution low. On the other hand, this pattern does not bode well for the sustainability of the programme after the vouchers have run out.

In the original design of the Paraguay programme, the idea of reducing the vouchers' nominal value over time had been discussed, but this measure was never carried out. Due to inflation, however, the voucher's real value did decrease: the voucher was fixed at 40 000 guaranías, equal to about US\$20 at the start of the programme's first phase, and to less than US\$15 at the end of the second phase.

In any case, the results shown in Figure 2.3 would seem to imply that a more active effort to reduce the nominal value of the voucher would be healthy. In the Paraguay case, data have not yet been collected to analyse whether the training market that developed as a result of the programme will continue to function, and whether the microenterprise clientele will continue to demand services. The data collected during the stoppage in 1997 are interesting, but too scanty to provide a basis for firm conclusions.



Figure 2.3 Subsidy level over time

## Control and supervision

Both within and outside the IDB, and due in part to the existence of failed and incomplete voucher programmes, there has been justifiable concern about the potential for fraud. One clear lesson from the Paraguay case was that while infractions of the rules will occur, the frequency and impact of these infractions can effectively be minimized through a combination of mutually reinforcing

Table 2.1 Control and supervision mechanisms

Control Mechanism	Method of Implementation
1. Screening of training institutes. Criteria exclude adequate facilities, experience in training, courses that are eligible for inclusion in programme.	Signed contract with each institution establishing clear rules and norms.
2. Client screening at time of voucher distribution.	Interview in which client is asked to give information about his/her business, including sales, supplies, credit, etc. This information can be correlated to form a picture that would be hard to invent if one did not own a business. When available, receipts and tax forms are requested.
3. Client signature on back of voucher.	Clients are asked to show identification and sign the voucher in the presence of the administrator. Training institutes are required to confirm the client's identity and obtain his/her signature at the beginning of each course.
4. Attendance records.	Training institutes are asked to confirm participants' attendance. If microentrepreneurs attend less than 75% of the course, the training institute will not be able to redeem the voucher.
5. Surprise visits to training institutes.	Programme administrators appear without warning during courses, verify course content, participants, and quality. In addition, participants may be asked to fill out evaluation forms.
6. Disqualify institutes from participating.	This last resort measure is taken only after participating institutes have been warned that their performance does not comply with programme standards.

supervision and control mechanisms. These mechanisms are implemented by the executing agency or unit that administers the programme, independent consultants, and the training institutions themselves. The checklist in Table 2.1 shows how the Paraguay programme was kept honest.

The importance of a capable and politically independent executing agency became clear when in Paraguay several institutions had to be disqualified from participating in the programme. Unhappy directors of training institutions tried to rally political support and put pressure on the voucher programme administration unit to give them one more chance. An important factor in the success of



the programme was the fact that the Paraguayan managing agency had the autonomy to make decisions on a purely technical basis, free from interference from interest groups. The question of what type of executing institution has the capacity to impose 'rules of the game' on the training market in a given country is one without an easy answer, and has represented a challenge to programme designers in every country.

### Other voucher programmes

In addition to the IDB-funded programme in Paraguay, several other voucher training schemes for microenterprise have been initiated in recent years. The most well-known examples are programmes in Peru, El Salvador, and Kenya. The programmes in Peru and El Salvador, both operated by European Union-funded institutions, have been discontinued. In the Peruvian case, the programme encountered fraud and other organizational problems.<sup>10</sup> In El Salvador, the programme was so limited in scope that it did not stimulate any adaptation on the part of suppliers. In addition, the information provided to microenterprise clients was too minimal to orient them as to the relevance of the courses available.<sup>11</sup> A World Bank training programme in Kenya, originally approved in 1995, has been recently reformulated to include a voucher programme for small and microenterprises. Results from the Jua Kali Program, as it is called, seem to show a strong response on the part of suppliers and clients. It is still early, however, to glean lessons from this example.<sup>12</sup>

In addition to the three initiatives described above, the IDB has received a number of proposals to finance voucher training programmes in many Latin American and Caribbean countries. In Ecuador, Argentina, and Guatemala, voucher with information programmes specifically aimed at micro- and/or small enterprises have been approved, and in the case of Argentina and Ecuador, have already begun to operate. These were closely modeled on the Paraguayan experience, with an attempt to incorporate lessons learned. Similar proposals for Nicaragua and Guyana are nearing approval, and a proposal for a new programme in El Salvador is being developed. In Venezuela, a programme relying on vouchers with information was designed to serve a specific target population, which had been affected by recent public sector downsizing. Training vouchers are provided after a competency analysis. In Haiti, a recently designed IDB loan package included a plan to reform the country's entire human resources development system by introducing market mechanisms, including the use of vouchers. This programme's approval has been delayed due to country-wide political problems. To date, none of the voucher programmes listed here is advanced enough to provide data on results, although some preliminary statistics should soon be available for the programmes in Ecuador and Argentina.

One ever-present dilemma during the design of these programmes has been the identity of the executing agency. In some cases, such as Paraguay and Venezuela, the agencies operating the voucher programmes have been public institutions, which do not themselves offer training services. In Ecuador and Argentina, the programmes are being executed by institutions that represent

both public and private actors. In Guyana, Guatemala, Nicaragua, and possibly El Salvador, the programmes will be managed entirely by private institutions. Experience thus far has shown that the most important characteristics to look for in a capable executing agency may not be directly related to its legal status. Instead, the attributes that contribute to an institution's ability to implement an information system and voucher training programme successfully are related to administrative and financial capacity, credibility in the marketplace, and ability to withstand political pressures.

### Future challenges and questions

The information system and voucher training model described in this chapter has changed the balance of power within the microenterprise training market, offering greater information to potential purchasers of training, and enhancing microentrepreneurs' purchasing power and ability to voice their preferences to training providers. Equipped with a heightened understanding of microentrepreneurs' needs, training institutions are increasingly competing with one another through constant innovation in their products and services, which in turn increases demand volume, makes the market more attractive for new training suppliers, and thereby creates increased competition, in a 'virtuous circle' that expands and deepens the market.

An important lesson learned thus far is the need to design and implement robust fraud and quality control systems, integrated with extensive information services that serve to orient the microentrepreneurs. Three important challenges and questions remain, however: the question of whether there is a need to support the product adaptation and upgrading phase of market development; the elusive question of programme sustainability, and the importance of finding a credible, impartial institution to administer the voucher programme.

The question of whether actively to support product development or upgrading (i.e. innovation in microenterprise training) has arisen in newer voucher programmes, especially those where the training market is extremely underdeveloped. The rationale for subsidizing this process would be that the same type of information problems that prevent microentrepreneurs from purchasing training in the first place, prevent small training institutions from investing in technical assistance which could help them offer better products, using new didactic methods or materials. The Paraguay programme contained no incentives or financing for institutions wishing to invest in product development. Institutions were expected to invest in new teaching methodologies or materials themselves, because they wanted to compete in the market. This laissez-faire strategy worked in some cases and didn't in others. In general, the institutions with considerable prior experience in training understood that if they were to develop a sustainable competitive advantage in the microenterprise training market they needed to invest substantially in research and development. Start-up training institutions that came from a business background sometimes invested in physical infrastructure such as chairs and video projectors; but these institutions did not always understand the importance of intellectual leadership and constant innovation in training content and delivery. Even in cases where institutions were willing to



invest in product development, however, information about how they could obtain technical assistance in upgrading their course offering was not always available.

Based on this lesson, the designers of the Ecuador programme suggested that a substantial amount of resources be allocated towards a grant fund that could be accessed by participating institutions wishing to invest in upgrading their microenterprise training products, or conduct research in this field. After some discussion, the amount was reduced in order to make sure that most resources were allocated towards the voucher fund. This decision was taken for fear that an over-dimensional grant fund would upset the delicate demand-side balance that should be present in any voucher programme.

A second issue concerns the sustainability of voucher interventions. Since the objective of these interventions is to help develop and strengthen the training market itself, voucher subsidy reduction – and, ultimately, its elimination – is clearly a coherent long-term goal of any such project. However, it is not yet clear what is an appropriate time-frame for a successful voucher-reduction strategy, so further study of on-going programmes needs to be undertaken in order to develop an effective exit mechanism. It is important to note that the initially approved duration of these programmes may be insufficient to allow a full trial of such a mechanism. It is true that, in some cases, national or regional governments may be willing to continue running a pilot voucher programme after its initial funding runs out, but this may not be the most desirable outcome: tens of thousands of voucher clients, along with hundreds of training providers, may ultimately constitute a powerful local political constituency; and the subsidy may be hard to turn off. So it is important to experiment with exit mechanisms now, in order to develop a full-cycle intervention that assures the market-development objective in the long run.

Assuming that programme designers, in the next few years, are able to address the issue of how and when to withdraw voucher financing, a further challenge remains: how to make sure the information gap does not recur. While voucher funding should probably not be a permanent intervention, the continued presence of a reliable second-tier institution fulfilling an information function may be desirable. This leads to the final question, which concerns the role of the second-tier institution. The question of who or what should play this role is important. An important lesson was learned in Paraguay due to mid-stream changes in the second-tier institution. There are difficulties and trade-offs when working with public institutions, such as ministries or government agencies. In some instances public institutions are unable to play this role due to their inability to be transparent and impartial; their limited budgets; difficulties in hiring new personnel and firing ineffective staff; and difficulties in sharing other scarce government resources, such as buildings, automobiles and even staff. They are unable to regulate themselves based on the standards they would need to impose on training suppliers.

There are several important qualities that an institution must possess to serve as an effective second-tier administrator in such a programme: 1) organizational and administrative capacity, 2) financial capacity, 3) a clear separation between technical and political leadership of the institution (which translates into the abil-

ity to withstand political pressures), 4) capacity to convene members of the business sector, and 5) credibility in dealing with policy makers and training institutions.

A variety of institutional arrangements may provide the framework within which a successful information system and voucher training programme can be operated. In the long run, an ideal second-tier institution would be one that could not only administer the vouchers successfully, but which would respond to incentives to reduce the voucher funding over time, and which could potentially continue to play the role of information provider in a sustainable manner. One suggestion is to finance the information function through institutional dues, in much the way that a banking superintendency is financed through dues paid by banks. On the other hand, a public subsidy may be justified to support the continued provision of the information service. In some Latin American countries, training institutions have stepped back from the market, preferring to outsource and regulate training activities rather than execute them directly. This more limited, regulatory function may correspond with the voucher administration and information service role. In countries where training institutions are serious about redefining their role and fostering private competition in the market, these institutions may initially be the best candidates to serve as second-tier voucher programme administrators, and eventually as permanent information suppliers in the market.

## Notes

1. The authors wish to acknowledge the technical staff of GAMA S.A. for their support in gathering data for this chapter and for their comments and suggestions during its preparation.
2. Claudio de Moura Castro (1997), 'The Stubborn Trainers Vs the Neo-liberal Economists: Will Training Survive the Battle?', Inter-American Development Bank.
3. *Ibid.*
4. In fact, programme records show that fewer than a third of voucher training clients were borrowers from the IDB loan programme. Approximately another third had obtained credit from another source (usually local credit unions), and the remaining third did not use credit.
5. See Schor G. and Halty M. 'From Supply-side Paternalism to Demand-oriented Market Development', GAMA S.A., published in *Brainstorm CEFE* magazine, GTZ, July 1999.
6. See Part II, 'Case Study: The Paraguayan Voucher Training Program' in *Preliminary Results and Case Studies on Business Development Services for Microenterprise*, Microenterprise Unit, Inter-American Development Bank, Washington, DC, February 1997.
7. For more details, see Schor, Gabriel and Goldmark, Lara, (1999), *Voucher Programs: Potential, Problems and Prospects*, Inter-American Development Bank, Rio de Janeiro, Brazil.
8. Goldmark et al., 1997, Table 21, (see Note 6 above).
9. To be completely accurate, adjustments would have to be made for the institutions participating in the programme, which received operational subsidies in addition to voucher income. During phase 1, these were: MICROS, a credit-NGO which offered management and tax courses, and SNPP (Servicio Nacional de Promoción Profesional), which offered business management courses. In phase 2, MICROS was no longer present, but SNPP continued to participate and a few other NGOs joined the programme.



10. Interview with programme manager, Lima, November 1998.
11. Interview with programme manager, San Salvador, January 1999.
12. For more details on this programme see Riley, Thyra, and Steel, William, *Kenya Voucher Program for Training and Business Development Services*. Paper to the International Conference on BDS, Rio de Janeiro, Brazil, March 1999.

## 3. The Argentine matching grant programme

MARILUZ CORTES and SONIA PLAZA

### Introduction

THERE IS CONSENSUS on the important role that small and medium enterprises (SMEs) have in generating growth and employment in developing countries. SMEs can also play an important role in a country's efforts to develop a more diversified non-traditional export base. However, SMEs tend to have a slow export response to trade liberalization due to lack of export experience and knowledge of sources of export-related information, the prevalence of outmoded production technology, low product quality and deep-seated attitudes that work against exports. It is within this context that a matching grant programme, Programa de Restructuración Empresarial para las Exportaciones (PREX), supported by a World Bank loan of US\$27 million, started in Argentina in August 1996. The objective of the programme was to help increase the international competitiveness of SMEs by facilitating their access to export-related services and information.

The PREX programme design was based on the findings of a sample of 339 SMEs and interviews with 20 export focus groups, carried out in Argentina as part of the project preparation. The interviews revealed that SMEs had limited ability to compete internationally because: 1) exporting activities tended to be a relatively new and secondary for them; 2) few firms made organizational changes before entering foreign markets; 3) firms overestimated their managerial capabilities relative to exports; and 4) few exporters sought professional advice to improve their export competitiveness. The basic assumption in the design of the programme was that greater access to information about export markets, technology, and business practices would help improve the ability of SMEs to make wiser decisions about export activities and improve their export performance in the long run. This programme was viewed as a temporary government intervention to assist a significant number of SMEs to use consulting services to improve their export capabilities. The expectation was that the example of the assisted firms would help to overcome the reluctance of other enterprises to use this type of service.

### The PREX programme

The PREX programme was designed to finance 50 per cent of the cost of export-related consulting services and information obtained by SMEs with export potential in the context of an export plan approved by the programme. The types of service co-financed under this programme included market research, product and process development, quality upgrading (including ISO 9000 certification) and other relevant export-related services. The grants were for up to US\$75 000 per export plan and up to a maximum of US\$125 000 per assisted enterprise. The overall programme was under the co-ordination of the Secretariat for Small and Medium Enterprises (SEPYME), through a Project Administration Unit (UAP). A private agent administered the PREX under a management service contract.

## Main design features of the PREX programme

The PREX programme pioneered in Argentina the use of a private management service contractor (MSC) to deliver a government-sponsored programme. The MSC was selected through competitive international bidding. Under the management contract signed with the government, the MSC was responsible for determining if the interested SME had the potential (both technical and financial) to become an exporter; assisting the interested SME in identifying the consulting services that it required to enter in the export business; and providing the SME with access to information about potential export-related service suppliers, if the enterprise did not have a specific supplier in mind. The contract required the MSC to open offices in Buenos Aires, Cordoba, Rosario and Mendoza.

The MSC was responsible for assessing the bona fides of the service suppliers selected by the SMEs (that is, of ensuring that they had a proven record in the field); signing an agreement with the SME for the implementation of an export programme (defined as the consulting services that would be necessary to help the firm improve its export capability); obtaining the 'no-objection' from the UAP to the financing of the export programme with a matching grant, overseeing the contracts signed between the SME and the service providers; and overseeing the implementation of the export programme. The MSC was also in charge of reimbursing the assisted SMEs for half of the cost of the consulting services provided under the programme, after verifying that they had been received and paid for by the enterprises. For this, the MSC had access to an escrow account that was replenished periodically with loan funds. This was an important feature of the programme aimed at generating confidence among the assisted enterprises on the rapid disbursement of the matching grants.

Although the MSC had autonomy to decide which SMEs could participate in the programme and of approving their export plans, the UAP had to give its 'no-objection' to the export plans approved by the MSC, and approve the proposed matching grant. The UAP also had the responsibility of auditing the performance of the MSC through external auditors; evaluating the client's satisfaction with the programme through firm-level surveys; assessing the impact of the programme through enterprise surveys carried out by a third party; and of preparing periodic implementation reports for the World Bank.

An innovative feature of the management service contract was that the MSC was paid based on explicit performance criteria, instead of consulting fees as in other matching grant programmes. The payment of the contract was divided into: 1) 60 per cent as a fixed amount paid monthly; 2) 33 per cent as an incentive payment paid quarterly based on the fulfilment of quantitative and qualitative targets by the contractor; and 3) 7 per cent as a final payment, paid at the end of the contract.

## Results of the PREX programme

The PREX was originally designed to assist 900 firms in three years. By June 1999, the programme had approved grants to 968 firms, with 1060 export projects. In total, US\$26.6 million in matching grants was approved, equivalent to export

projects for about US\$52 million. However, the Brazilian devaluation at the beginning of 1999 affected the export plans of the firms that had Brazil as their main export market.<sup>1</sup> Many of these firms decided not to implement their export plans and cancelled their participation in the programme. As a result, only US\$17.7 million had been disbursed in matching grants by the end of the programme in July 1999.

From the beginning, the PREX programme underestimated the time it took the assisted firms to implement the agreed export plans, particularly in the case of more complicated plans such as those involving obtaining an ISO 9000 certification, which took an average of one year. Although the project closing date was extended to allow for these delays, when the PREX programme was closed at the end of July 1999, a number of firms were still in the implementation stage.

A survey was carried out in mid-1999 to assess the impact of the PREX on the assisted SMEs. The focus was on the effect of the programme in changing the enterprise's approach to exports as a result of the information and export consulting services received under the programme. Although it was thought that it was too early to expect a significant impact of the programme on exports, the survey also tried to identify if the assisted enterprises had increased their exports as a result of their participation in the programme.

The survey, designed and conducted by a consulting firm, covered a sample of 300 enterprises. One hundred of them were selected from a group of assisted enterprises that had already received at least 25 per cent of the matching grant amount approved for them. Another 100 enterprises that had not participated in the programme were selected as a control group. These were enterprises similar in activity and size to those of the first group. Enterprises from both groups were asked questions regarding exports and export markets from 1996 to 1998. They were also asked to describe changes in products, production processes and organisational changes with respect to their export operations during that period.

The results of the impact assessment show that many of the enterprises that participated in the PREX programme had made behavioural changes in areas likely to affect their future export performance, such as the adoption of quality control programmes, the introduction of cost-reducing measures and diversification of their export marketing channels. However, the differences in behaviour between the assisted enterprises and those of the control group are not significant enough to conclude that the change in behaviour was the result of having participated in the matching-grants programme. As expected, the survey results did not show a significant impact of the programme on the firms' export performance. A more conclusive assessment of the impact of the programme on export performance should be conducted later on, once the assisted enterprises have had enough time to put into practice the advice of the consultants co-financed by the programme. Some of the specific results of the impact assessment are the following.

### *Impact on the introduction of new or improved products*

The survey looked at the effect of the programme in helping enterprises to introduce new products and to improve the quality of their products, both for the local



and export markets. More enterprises in the PREX group had introduced new products into the markets since 1995 (77 per cent) than in the control group (64 per cent); also, more PREX enterprises (85 per cent) had introduce significant improvements in their products than in the control group (72 per cent). It is unclear, however, to what extent participation in the PREX had accelerated the introduction of new or improved products into the market, since only 17 per cent of the PREX enterprises reported that the introduction of new or improved products was made only after joining the programme.

#### *Impact on the use of new channels of distribution*

More enterprises in the PREX group had used new international channels of distribution since 1995 (59 per cent) than those in the control group (26 per cent). About 49 per cent of the enterprises in the PREX group reported that they had diversified their export markets since 1995.

#### *Impact on the use of training programmes*

PREX enterprises were more likely to have adopted training programmes for their staff in 1998 (78 per cent) than those in the control group (44 per cent). In both groups the number of enterprises with training programmes had increased between 1995 and 1998.

#### *Impact on cost reduction*

About half of the enterprises in both groups had adopted cost-reduction programmes since 1995, but the number of those that adopted these programmes was somewhat higher in the PREX group (54 per cent) than in the control group (46 per cent).

#### *Impact on the use of quality control programmes*

About 80 per cent of the enterprises in both groups had adopted quality control programmes since 1995, although a higher percentage of the assisted enterprises (61 per cent) had adopted international quality control programmes compared with those in the control group (36 per cent). The assisted enterprises were the only ones that had obtained ISO 9000 and ISO 9002 certification. Enterprises that received assistance on quality upgrading introduced several changes, such as information technology for quality control, changes in the plant lay-out and training programmes for their staff. The immediate results were a decline in production defects by an average of 20 per cent and a reduction in operating costs by an average of 10 per cent.

#### *Fulfilment of the enterprises' objectives*

About 70 per cent of the PREX enterprises indicated that they had achieved the objectives they had for participating in the programme: 13 per cent indicated that all the objectives had been achieved and 58 per cent indicated that they had

been partially achieved. Among the reasons given for not having fulfilled their objectives under the programme, the most important were: lack of working capital (37 per cent); crisis in international markets (20 per cent); lack of experience in international markets (18 per cent); and barriers in importing countries (8 per cent).

#### *Impact on exports*

About 69 per cent of the SMEs in the sample of assisted enterprises had exported at some stage, compared with 42 per cent of the non-assisted ones. Nearly half of the PREX enterprises that had exported, did so before joining the programme. In both groups, the number of enterprises that had exported increased every year between 1995 and 1998. In each year the percentage of enterprises that had exported was larger in the PREX sample than in the control group. In 1998, about two-thirds of the enterprises in the PREX group had exported compared to only one-third of those in the control group. Exports increased for the assisted enterprises from 26.8 per cent to 32.4 per cent of sales (for the group). Enterprises exporting over 30 per cent of sales increased from 31 per cent in 1995 to 30 per cent in 1998, in the PREX group.

#### *Qualitative evaluation of the programme*

The consulting firm conducted in-depth interviews with groups of assisted enterprises to get their opinions about the programme and its impact on their activities. Most enterprises indicated that the real impact of the programme had to be assessed later because of the time required to develop new export markets. However, some of them reported that the programme had already helped them to initiate some export activities. Enterprises that had completed their export plans, indicated that the financial support provided by the programme was significant for them to decide to use consulting services. Most enterprises thought that the programme had been implemented with great transparency and that the advice that they had received was useful. Many thought that the programme had helped them to learn how to handle consultants, to understand what to request from them, how to write terms of reference, and how to evaluate their services.

#### *Impact on the supply of consulting services*

Interviews with local consultants revealed that many had benefited from participation as service providers under the scheme. They had been incorporated in a roster of export consultants managed by the UAP, which was made accessible to SMEs. There is some evidence that by stimulating demand for business support services, the PREX programme helped to expand the supply of these services in Argentina. Anecdotal evidence suggests that markets for quality control systems and related advisory services benefited greatly from the scheme. One indicator of the programme's success was a reported decrease in the fee for obtaining ISO 9000 accreditation.



## Experience with the use of a management service contract to manage the PREX programme

An assessment of the management arrangement of the PREX programme has to focus on how effective the management service contract was in helping to achieve the programme's objectives. The use of a private MSC to manage the PREX programme was essential to ensure independence in the approval of the grants, and to provide technical assistance to the SMEs to prepare their export plans. The use of an incentive scheme was also important to ensure that the MSC continued working to meet the performance targets, despite changes in the government unit (the head of the UAP and the location of the UAP in the government changed three times during project implementation) that may have implied changes in personnel and changes in approaches and expectations about the programme.

The incentive scheme in the management service contract was a powerful tool to achieve the programme's targets. However, it was not always easy to interpret and apply. The incentive formula tried to reach a balance between quantitative indicators, such as the number of export plans approved in each quarter, or the percentage of grants approved that met the expected disbursement schedule; and qualitative indicators such as whether the SME was a first time exporter, or if it was located outside Buenos Aires. However, in practice, the incentive scheme put strong pressure on the private operator to meet the contract's quantitative targets, sometimes to the detriment of the quality of the export plans.

An assessment of the management arrangement of PREX has also to focus on how well the MSC and the UAP performed their respective roles. During the implementation of the programme, the UAP had difficulties in delegating full responsibility for the administration of the programme to the private operator. The UAP scrutinized the export plans presented by the MSC and reviewed all the documentation presented by the MSC prior to the disbursement of the funds. This scrutiny created delays in the implementation of the programme and tension between the UAP and the private operator. The MSC believed that the review process was unnecessary because the contract's incentive scheme allowed the UAP to suspend payments if an ex-post evaluation revealed that the export plans did not meet the agreed criteria. In addition, the bank guarantee on the escrow account would have allowed the UAP to suspend payments and call the guarantee if the external auditors found any wrong use of the funds. However, the UAP considered that this level of scrutiny was necessary to meet its fiduciary obligations.

There are some lessons that can be drawn from the PREX programme.

- The management of a publicly financed programme by a private operator through a management service contract was very innovative in Argentina. In practice, however, it was difficult for a government agency to delegate the management of the programme to a private operator and limit its role to that of ex-post evaluator of the performance of the MSC. Future use of this type of management arrangement should ensure that the contract is very clear in the delimitation of the respective roles of the government and the private operator to avoid imprecision that could lead to disputes.

- In the PREX programme, the UAP had the responsibility for giving its 'no-objection' to the grants approved by the MSC. Consequently, the UAP felt that it had to analyse each one of the grants and export plans, with the resulting delays. The role of the UAP should have been limited to only ex-post evaluation of the programme at two or three stages of project implementation (i.e. every six months).
- It is difficult for a private operator to understand the amount of information that a public sector agency requires prior to taking any decision involving the use of public resources. Conflicts concerning the provision of information can undermine the working relationship between the government agency and the MSC. In any future use of management service contracts, the information requirements should be clearly specified in the contract.
- The use of an incentive scheme in the management contract is important to ensure that the MSC strives to meet the performance targets, even if changes in the government management unit change the approach and expectations about the project. However, if the incentive scheme is difficult to interpret and puts too much emphasis on quantitative targets, the quality of the outcome may suffer. An incentive scheme in this type of contract should be simple to interpret and have realistic targets. The incentive scheme should contemplate the possibility that performance targets may be affected by external factors beyond the control of the MSC.
- The management contract should have provisions to ensure the use of high quality staff by the MSC throughout the life of the contract, and that enough effort is devoted by the MSC to supervise the implementation of the agreed export plans by the assisted enterprises.
- The impact of a matching grant programme has to be evaluated, providing sufficient time for the assisted enterprises to be able to implement the recommendations of the consulting services co-financed by the programme.
- The impact of the matching grant programme can be hindered by lack of access to credit to implement the changes recommended by the consultants.

### Note

1. Given that Brazil absorbs over 50 per cent of Argentina's manufactured exports, the recession in Brazil hit Argentine exports harder. Total exports to Mercosur fell by 25 per cent in 1999.



## 4. The consultancy and training services market for small and medium enterprises in Argentina<sup>1</sup>

PABLO ANGELELLI, FRANCISCO GATTO and GABRIEL YOGUEL

### Introduction

GLOBALIZATION, LIBERALIZATION and subregional integration and the rapid consolidation of the new technological developments in the field of information have raised the competitive pressures that enterprises have to face, especially small firms. The patterns of competition are being redefined with an increased importance of 'non-price' elements of competitiveness, such as quality assurance, after-sales service, design and responding to the needs of customers and sub-contractors, the speed of delivery, availability of supply, etc. These factors, combined with increasing uncertainties and segmentation of demand based on globalized patterns of consumption, have meant that the ability to create and expand 'competitive advantages' will be a key element, not only in attracting world markets, but also in consolidating share of domestic sales. This challenge is particularly critical for smaller industrial firms, which have to confront these momentous changes and the entry of new and larger competitors, some from overseas, with new technical and organizational strengths.

To build up their competencies, small and medium enterprises (SMEs) have to absorb new techniques which, in addition to the normal process of implicit learning carried out in-house, require them to bring in new knowledge and experience from outside. These are generally transmitted through external associations, through networking with other firms and through training and consultancy institutions. They enable the SMEs to increase knowledge and skills, to improve production by linking previous internal knowledge with the new external contributions. In other words, enterprises need to be constantly updating their capabilities through a twofold learning process – internal and external. The quality and extent of this flow of new knowledge, and how it is incorporated into the production and management process, will determine the real capacity of the SME to compete effectively.

There is a strong correlation between the strategies of the SMEs and their internal organization. A firm's achievement in the market is not only the outcome of the opportunities it faces, but depends to a greater extent on what the firm can create, manage, and produce. These elements depend on its specific competencies and capabilities. While the knowledge transmissible through the market depends mainly on the environment in which the firm operates (competitors, customers, and the business climate), the implicit elements are 'firm-specific', cannot be bought, are the essence of the technological differences between businesses and are at the root of the competitive advantages of each firm.

However, the development of technical know-how in the firm and the possibility that the company may incorporate new knowledge – in a context dominated

by the limited knowledge of the firm, imperfect information flow, uncertainties about the market and the speed of technical change – is affected by the labour skills of the company's employees and, especially in SMEs, by the personal characteristics and behaviour of the owner. The situation is much more difficult in SMEs in which the owner does not delegate the internal circulation of information and the incorporation of knowledge from outside, than in those firms where the employees are encouraged to become involved in all aspects of the firm's operations. The first type of firm usually has greater limitations in developing learning processes, since this requires that the owner 'un-learn' old ways of operating and entrenched attitudes associated with the operation of the business.

In this framework, a study was undertaken in Argentina by Fundes and Universidad Nacional de General Sarmiento (UNGS) which tried to analyse – from the employer's perspective – the importance of consultancy and training services as tools for developing the competitive capacities of firms.<sup>3</sup> Aspects of the demand for these services were examined, such as the subject area on which they are focused, the costs involved, their duration, the type of supplier and the performance and behaviour of the recipient firms. A market for these services among SMEs has begun to emerge in Argentina: unfortunately, the traditional supply of these services has generally operated on the premiss that the required knowledge in firms is of only a theoretical type, which gives rise to an excessive standardization of the services offered.

This chapter is divided into four short sections. The first gives an account of the principal external restrictions faced by SMEs in an open economy, as in Argentina at the end of the 1990s, including the limitations of access to training and consultancy services. The second section examines different situations of SMEs that use training and consultancy services to a greater or lesser extent. A hypothesis is put forward on the possible development of a firm, from a position of no demand for either service towards a situation where it uses both services. The third section discusses predominant characteristics of the consultancy and training services requested by SMEs, as emerged from the survey. Finally, the fourth section comments on the results of the research as related to policies aimed at supporting SMEs.

### External restrictions on SME in an open economy

The business environment in which an SME operates is governed by a number of factors: financial and legal regulatory frameworks, overall macroeconomic policies, industrial strategy and policy, availability of access to factors of production and infrastructure, complexity of the productive environment and technological and organizational characteristics of the major companies in the leading manufacturing sectors, etc. The competitive framework is influenced by the decisions, actions and basic features of small businesses. In this process of interaction, each business and participating institution designs and implements strategies that may produce advantages or limitations for the other participants.

In this economic framework, the ability of SMEs to deal with the limitations of the business environment depends, among other things, on the internal development achieved. Thus, firms with an unequal degree of development of tangible



and intangible competencies are affected differently by similar environments or by the behaviour of other businesses. However, the effects of the business environment can be so severe that the limitations confronting firms generally cannot be resolved entirely within the firm itself. They represent a formidable external barrier to business development.

The study carried out by Fundes and UNGS tried to identify, in the first place, the main environmental restrictions facing Argentine SMEs. A survey was made of 337 firms, using a questionnaire focusing on topics such as: financing, services (especially consultancy and training), matters relating to tax and employment, foreign trade and market conditions. The questionnaire also asked employers to express the extent to which they agreed on preventing external barriers to success and growth, and to list them in order of importance.<sup>4</sup> Of particular interest was to discover the point of view of the business owner as to the relative importance assigned to the development of the services market, particularly technical assistance, training and consultancy.

The two main barriers considered most important by the firms were two elements of a macroeconomic nature: the operation of the commercial banking system (private and public) and the relative price of the privatized utility services. Sixty-two per cent of the SMEs indicated that the rates, terms and guarantees required by banks restrict access to financing and limit the development of their businesses; 42 per cent of SMEs also expressed the view that the high prices of infrastructure services (roads, energy, communications, etc.) adversely affect the competitiveness of firms (see Figure 4.1).

In the third place, around a third of the firms stressed that the lack of control of imports has had a negative impact on their performance; while fourth in importance as an external factor was the legal insecurity affecting their business (non-performance of contracts, high costs and the time required for settling disputes through the courts, etc.). Finally, around 30 per cent of firms indicated that

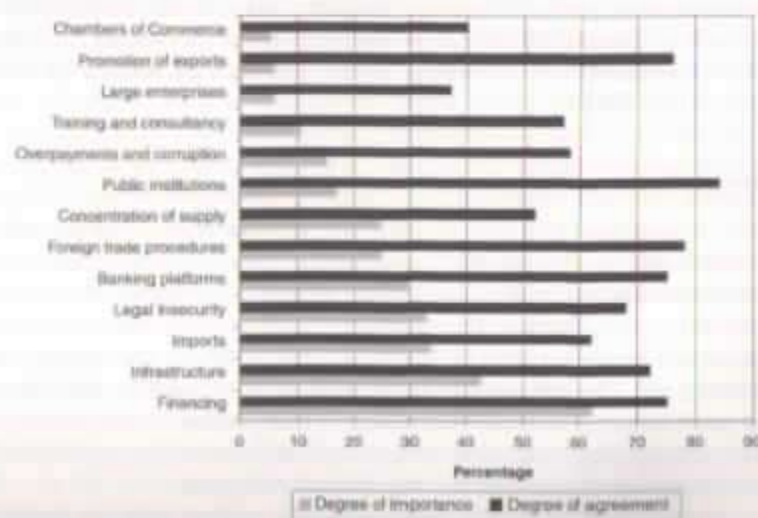


Figure 4.1 External restrictions on Argentine SMEs: degree of agreement and degree of importance<sup>7</sup>

financial institutions do not have the appropriate structures for dealing with SMEs and that this constitutes a major problem for small businesses, since they are not given the proper treatment appropriate to the nature of their businesses.<sup>5</sup>

The subjects on which firms expressed a high level of agreement are matters that directly affect the daily running of their businesses.<sup>6</sup> Among these, the difficulties of access to financing and, to a lesser extent, the relative price of the privatized utilities are more important than all others.

On the suitability of the training and consultancy offered for the needs of the firms, while 57 per cent considered that this was inadequate, only 11 per cent replied that this problem was among the five most important ones for the development of their competitiveness.

There was a high level of agreement according low importance, to factors such as the lack of help in the promotion of exports, the difficulties in using public support institutions and the complexity of foreign trade procedures. This could be because they have low expectations of assistance in these matters and from the role of public institutions altogether. They recognize that foreign trade procedures are very complex and costly, but this situation is not an urgent problem, due to the fact that they sell mainly to the internal market.

An initial conclusion that can be drawn from this information is that the SMEs – although in a relatively stable business environment,<sup>8</sup> in an expanding economy over the last few years – are mainly concerned with short-term issues that have a direct impact on their costs and profits. These replies reflect the business outlook predominant among Argentinian SMEs, which also indirectly indicate the type of commitments that companies are prepared to make to actions that may eventually make them more competitive. As will be seen later when analysing the small group of firms that ask for technical assistance and outside consultancy, one of the reasons that makes it difficult for SMEs to decide to hire these services is the uncertain results they may derive from them and the long time it takes for the benefits to be realized. Moreover, in the case of Argentina – on the basis of this survey – a majority of SMEs seem to show a general lack of interest in turning to outside help in the development of their capabilities and in strengthening their competitiveness for the future.

### The difficult process of firms entering the training and consultancy market

In business environments characterized by intense competition within world markets, the continuous improvement of technical capabilities and business skills becomes indispensable for enabling SMEs to maintain their position and to expand their share of the markets in which they are competing. Experience shows that SMEs cannot completely internalize the development of their competitiveness within their small business framework because they lack the resources and they do not have the necessary expertise within the firm. From this point of view, the use of consultancy, technical assistance and training services needs to form part of the business strategy of the firm. The existence of hindrances or obstacles to accessing and using those support services can be viewed as a restriction that adversely affects the competitiveness of the firm, and can



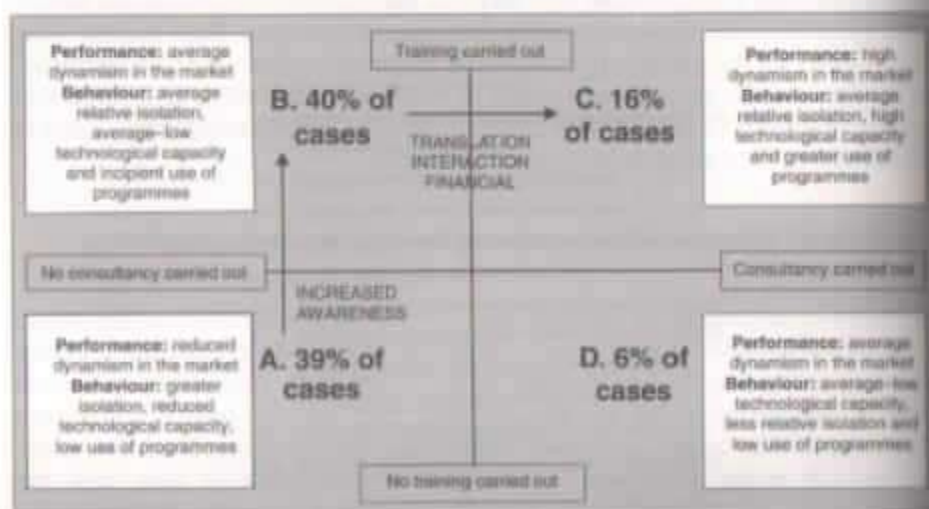
have a major impact on future performance, ability to exploit new production opportunities, the capacity to acquire and use new equipment and technologies, etc. It will be a determining factor of the quality and scope of the learning process referred to earlier.

Figure 4.2 presents a synthesis of the results of the survey showing the degree to which training and consultancy services were used in 1997 and 1998, distinguishing between the SMEs that did not carry out any training or consultancy (quadrant A), firms that carried out only training activities (quadrant B), firms that hired and used both services (quadrant C) and those that carried out only consultancy (quadrant D).

In the first place, the SMEs that carried out no training or consultancy activities constitute a very high proportion of the sample (39 per cent) that is to say about 40 per cent did not use any external training or consultancy service, private or public, in the last two years. This group is characterized by SMEs whose sales fell over the last years and had a significantly lower average export ratio than the rest of the group.<sup>9</sup> Other distinctive features brought out by the survey within this group are a lack of financial planning, low technological capacity, little use of public support programmes and a high degree of isolation.<sup>10</sup>

When companies were consulted about the reasons why they did not carry out consultancy activities, the internal and external factors had equal weight (see Table 4.1). As can be seen, there is a recurrence of 'I do not need consultancy replies, which hardly fits the unsuccessful progress of this large group.

With regard to the non-use of training services, (see Table 4.2), there is a predominance of replies stating that the services are expensive and that the company does not need training. These firms have problems of competition in the market, cannot recognize what their problems and weaknesses are, and also



Source: Compilation for 1997 and 1998 on the basis of *Competitive Environment and Restrictions to the Development of Argentinian SMEs: The view of the firms. First Report of Results*, Fundes-UNGS Project and Rabelino and Yaguez (1998)

Figure 4.2 Distribution of SMEs in the market for training and consultancy services

Table 4.1 Reasons for not using consultancy services

Reasons	% of firms out of total cases in quadrant A	No. of firms
<b>External factors</b>		
consultancy is very expensive	28	37
no existing offer is for larger companies	22	29
should need more information about the consultancy offer	18	24
technical level is inadequate	15	20
<b>Internal factors</b>		
company does not need it	43	56
company does not have personnel to act as counterpart	18	24
does not use outside assistance for fear of information leakage	16	21

Source: Database of Fundes-UNGS Project

Table 4.2 Reasons for not using training services

Reasons	% of firms of total cases in quadrant A	No. of firms
<b>External factors</b>		
training services are very expensive	30	39
should need more information about training	18	24
technical level is inadequate	17	22
do not find people competent	11	14
<b>Internal factors</b>		
company does not need it	27	35
no time available for training	20	26
cannot divert people's time into training	22	29
no resources available to hire it	20	26

Source: Database of the Fundes-UNGS Project

Table 4.3 Reasons for not using consultancy services

Reasons	% of firms of total cases in quadrant B	No. of firms
<b>External factors</b>		
consultancy is very expensive	51	69
no existing offer is for larger companies	35	47
should need more information about the consultancy offer	22	30
technical level is inadequate	18	24
<b>Internal factors</b>		
firm does not need it	27	36
firm does not have personnel to act as counterpart	22	30
firm does not use assistance for fear of leakage of information	11	15

Source: Database of Fundes-UNGS Project



continue to remain largely isolated. This reinforces their perception that their problems are due to external factors that are outside the firm's control, and they do not see any need for training or consultancy.

Some additional conclusions that arise from the interviews with employers are: 1) owners do not clearly understand the need to retrain, and have difficulty in facing a process of change, the outcome of which is uncertain, 2) short-term problems are the only ones in which the employer considers it important to invest time and money, especially in a situation of a shortage of both resources, 3) some new knowledge and techniques go beyond the formal education of the owner, confronting him or her with a challenge and problem of a personal nature, which is related to power and control within the firm, and 4) the turnover of staff is high and, therefore, it is feared some of the knowledge will be lost with the people unless it is introduced quickly into routines.

A second group of firms is made up of SMEs that carried out training activities but did not use consultancy (quadrant B). This set also constitutes a large group (40 per cent of the total) which means around 80 per cent of the firms surveyed had not used external consultancy services in the past few years. Unlike the first group of SMEs, these have a dynamism in the market and better performance in external integration, technological behaviour, financial planning, use of programmes and contacts with other firms.<sup>11</sup>

The decision to carry out only training activities may be explained by the fact that these activities have a lower degree of complexity than the consultancy activities, are less costly, last longer and generate far fewer business commitments. When asked about the reasons that prevent them from using consultancy, these firms claim that the external reasons are more significant than the internal ones, the high price of the consultancy being the most relevant (see Table 4.3).

The third group of firms among the SMEs, those that carried out both consultancy and training activities (quadrant C), comprise only 16 per cent of the total. This group of firms has had, on average, a better performance than the rest of the sample during the period of economic transformation in the country. They are the SMEs with better technological behaviour, less relative isolation, that make better use of programmes and have better financial planning.<sup>12</sup> They are the firms that have the highest skills, which would make them more likely to overcome the external restrictions they have to face and more able to optimize the use of the assistance programmes provided over the past few years.

### Main features of the training and consultancy services requested by SMEs

Consultancy activities carried out by the firms in the survey can be broken down on the basis of the field on which they are focused, their duration, the costs involved and the type of supplier of the services. Out of the total number of consultancy activities carried out by the firms in the sample between 1997 and 1998 (see Table 4.4), which amounts to 200, the most important subject areas were: product quality and technology (a third of the total) and management and marketing, which together amounted to 69 per cent of the total. The number of cases of demand for quality and technology services can be partly explained by the quality assurance requirements of SME's customers.

The average duration of the consultancy activities was around nine months, with an average monthly cost of approximately US\$2400 per company. The technical assistance consultancies involving quality, finance and information technology were the longest, with an average duration of about one year. On the other hand, the consultancies in management, marketing and foreign trade show shorter periods of duration, averaging around seven or eight months.

Table 4.4 Subject area, duration and cost of consultancy services

Area	% of cases	Average duration (weeks)	Average cost (US\$'000)
Quality <sup>a</sup> and technology	33.0	44	31.0
Management	18.0	29	16.6
Marketing	18.0	28	6.4
Information technology	15.5	40	17.7
Foreign trade	6.0	32	17.2
Finance	5.0	42	8.5
Others	4.5	8	21.2
Total	100.0	35	20.5

<sup>a</sup> Includes ISO 9000, total quality, environment and industrial health and safety.  
Source: Database of the Fundes-UNGS Project

As to the cost of the services, there were differences between subject areas. The most costly were services relating to quality and technology, while the cheapest were for marketing and finance. These differences may be associated with the current state of supply and demand for each of these services and with the professional levels and qualifications of the consultants involved.

The consultancy providers were mainly consultancy firms (53.9 per cent of cases), although individual consultants were also used in a significant proportion of cases (see Table 4.5). On the other hand, public institutions carried out only 10 per cent of the consultancies, a proportion that is even further reduced if the activities carried out by municipal bodies are excluded. Linking the type of supplier and the subject area, there is a relatively high participation of consultancy firms in the areas of finance, quality, technology and marketing, while individual consultants were used more frequently for management advice.

These data seem to show a low level of contact between the firms and the public support institutions, especially in the area of quality and technology. Anecdotal evidence on the high proportion of consultancy companies offering different types of services raises some questions on their effectiveness, in view of the number of business failures of these services, resulting in the poor matching of the supply to the real demand and needs of the firms. As already stated they have difficulty in identifying their real requirement. There is a problem regarding the accreditation of the consultancy companies (SECYT – Secretary of Science and Technology, 1997).

Most firms identify and contact suppliers of consultancy services through the recommendation of a colleague or fellow entrepreneur or by direct advertising or promotions by the consultants. Chambers of commerce seem to play quite an important role in bringing together SMEs and consultancy services.



On the other hand, advertisements, recommendations by banks and the public sector, and directories of consultants seem to be most ineffective (see Table 4.6). This should be borne in mind by public and private institutions offering services, which have in recent years launched major promotion programmes. A significant problem of the consultancy market is that it excludes a very large sector of the firms that are most in need of it.

The survey results also show that the firms that carried out training and were positive about the programmes were a much larger group than those hiring consultants who were satisfied with the outcome. One may say that the matching of the training services to the users' requirements has been significantly greater than in the case of consultancy, which raises an issue of the development of the supply of competent consultants. The private training market is relatively more developed.

If training activities are broken down in a similar way to consultancy, the most important subject areas were production, automation and design; administration, management and planning; non-specific courses (languages, negotiation, etc.); computing and marketing (see Tables 4.7 and 4.8). These five activities together accounted for 78 per cent of the training activities carried out by the panel between 1997 and 1998.

**Table 4.5 Suppliers of consultancy services**

Area	Supplier				Total %
	Individual consultant	Consultancy company	Public institute	Contracting company	
Finance	11.1	66.7	22.2	0.0	100.0
Quality* and technology	22.6	62.9	11.3	3.2	100.0
Marketing	38.9	58.3	0.0	2.8	100.0
Information technology	35.5	54.8	6.5	3.2	100.0
Foreign trade	33.3	50.0	16.7	0.0	100.0
Management	42.9	37.1	17.1	2.9	100.0
Others	50.0	25.0	0.0	25.0	100.0
Total	32.6	53.9	9.8	3.6	100.0

\*Includes ISO 9000, total quality, environment and industrial health and safety.  
Source: Database of the Fundes-UNGS Project

**Table 4.6 Methods of selecting consultancy services**

Selection method	% of cases
Suggestion of an adviser or colleague	35.1
Direct offer from the consultant	33.5
Referral from a chamber of commerce	12.4
Press articles and specialized magazines	3.1
By offer from the public sector	3.1
By offer from banks	1.5
Directory of consultants	1.0
Others	10.3
Total	100.0

Source: Database of the Fundes-UNGS Project

**Table 4.7 Subject area, duration and cost of training services**

Area	% of cases	Duration (hours)	Participants
Production, automation and design	23.1	138	14
Administration, management and planning	15.3	99	15
Computing	13.3	58	8
Marketing	11.3	25	18
Quality	9.8	188	23
Health and safety	5.3	12	28
Foreign trade	2.7	55	5
Tax	2.2	48	12
Economics, finance and accounting	2.2	70	2
(Others a)	14.9	124	14

Source: Database of the Fundes-UNGS Project

Note: a) Language courses, negotiation, general seminars on topical issues, etc.

**Table 4.8 Suppliers of training services**

Area	Supplier					Courses	Total %
	Individual trainer	Training company	Public institution	In-house	Contractor abroad		
Marketing	10.2	69.4	12.2	4.1	2.0	2.0	100.0
Foreign trade	9.1	63.6	9.1	9.1	9.1	0.0	100.0
Economics, finance and accounting	0.0	60.0	30.0	0.0	10.0	0.0	100.0
Administration, management and planning	12.7	57.1	19.0	4.8	4.8	1.8	100.0
Production, automation, and design	7.9	54.5	17.8	5.0	7.9	6.9	100.0
Tax	33.3	44.4	11.1	0.0	11.1	0.0	100.0
Quality	25.0	43.2	18.2	9.1	4.5	0.0	100.0
Health and safety	26.7	40.0	6.7	20.0	6.7	0.0	100.0
Computing	35.1	35.1	12.3	5.3	10.5	1.8	100.0
Others	19.7	57.4	8.2	3.3	0.0	11.5	100.0
Total	17.1	52.9	14.8	5.5	5.7	4.0	100.0

Source: Database of the Fundes-UNGS Project

This comparison is based on the number of weeks involved in training and technical assistance tasks. Thus, in similar activities, the number of weeks of consultancy is between 11 (Information Technology) and 30 (marketing) times greater than those of training. Finally, considering the number of companies and the average number of weeks dedicated to consultancy and training, the total number of hours for training is equivalent to only 15 per cent of those spent in consultancy.

Finally, the comparison of these results with earlier studies carried out in Argentina shows two things: on the one hand, the number of training and consultancy activities commissioned by SMEs in recent years is on the increase; on the other hand, the expenditure – or investment in activities associated with



raising competitiveness – in relation to the turnover of the companies is still very poor.

This is expressed in the presence of a market, particularly in technical assistance, characterized by few customers and suppliers, a lack of co-ordination between firms and an excessive standardization of the services offered.

## Conclusions

Where firms are willing to confront problems and external factors constraining their development, gaining access to training and consultancy services is not perceived as a serious problem. This study shows that industrial policies must give attention to solving the more general problems of businesses, as well as expanding the support services market. The development of the technical support services market is an important complement to a wider policy of strengthening the business environment. This can help mitigate the effects of barriers faced by SMEs due to imperfections in the markets, unequal treatment between firms of different sizes, regulatory frameworks, legal uncertainty, lack of positive industrial strategy, inadequacy of infrastructures, etc.

The data provided by the sample seem to show that firms are following a path – with many stops and starts – that sets out from a point where firms carry out no training, consultancy or external consultancies to the other positive extreme of firms for which these services form part of their normal practice and are built into their learning process and the strengthening of their competitiveness. The journey from one position to the other is not automatic, simple or linear, and rarely the result of a rational approach by management.

Many firms come into the technical assistance services market through training, but a significant proportion of them do not go much further. One of the major problems relates to the fact that many training services stress the transmission of knowledge and formal information without adapting the teaching programme to the learning style and experience of the participants. In such cases, companies participate passively in the training and have great difficulties in adapting and incorporating the acquired knowledge into the running of their business. It is common to hear the criticism that the training is very 'theoretical' and does not come down to the SME's reality; frequently, however, the problem is one of method.

The problem of technical or management skills, or weaknesses in the firms' abilities to compete cannot be resolved in a conventional way, with the SME company as the passive recipient. Recognition of the deficiencies in skills, attitudes, knowledge and techniques have to be created, stimulated and developed. They should include an ability to be selective in the knowledge learnt, the abandonment of previous attitudes, the ability to experiment with the new inputs and the incorporation of this new knowledge into intangible assets available to the firm. The strengthening of competencies cannot be achieved by a simple action, an event, by acquiring an item of knowledge, it is a learning process through a long road of external and internal activities. Many of the SMEs consulted found this process frustrating, when the results of the training could not be translated rapidly into the company's performance.

The study also shows that although training and consultancy services can be important tools for developing the competitiveness of firms, this process is not automatic. There are restrictions both in demand and supply of services for SMEs. A large group of potential users do not clearly identify their requirements nor the possible positive results of hiring external services to provide technical assistance. This group of SMEs need to develop an awareness and critical self-diagnosis which would enable them to recognize their own limitations and the need to widen external contacts as a means of resolving their problems.

In conclusion, the survey showed that the providers of business support services are mainly private companies specializing in training or in certain consultancy services. The participation of the public sector as a direct supplier of services is very limited, in spite of the fact that there are several national and provincial institutions dedicated to generating SME support programmes throughout Argentina. Most firms would also support the proposal that the public sector should take the role of facilitators in the field of support services, stimulating the extension of the market, raising awareness among firms, creating situations that encourage the use of services, helping in the improvement of supply and quality of providers and their adaptation to the specific needs of SMEs. The public sector should establish technical standards for the services, rather than participating in the market directly, except to monitor and control the cost effectiveness and value of the services offered.

## Notes

1. This chapter is based on the first report on the results of the Fundes-UNGS project 'The framework conditions of Argentine SMEs: the view of the firms' (Yoguel, Gutman and Angelelli, 1999). The aim of this project is to analyse the restrictions that face companies in different areas, such as financing, training, consultancy, tax problems, appropriateness of public policies, the labour market, the conditions of the internal and external market, access to infrastructure and the degree of isolation of firms. This project forms part of a wider programme being developed by Fundes Argentina, which also includes a survey of the views of institutions (chambers of commerce, banks, service centres, public organizations) on the limitations of the services market and on SMEs. Fundes is a Swiss-based private organization working in Latin America to help SMEs by providing financial support and technical aid. It has focused, in the past, on developing credit guarantee schemes for SME.
2. These skills can be defined as the body of knowledge of diverse origin and nature that implies a permanently changing set of properties and operates in a situation of uncertainty. These properties involve the ability to solve problems, to learn and to spread knowledge to the organization on the basis of certain basic skills to manage resources and information, to develop interpersonal relationships, to have a good knowledge of technology, to diagnose and to select options from an available set of alternatives.
3. The sample used in this study is made up of 337 SMEs in industry and services, interviewed between October and December 1998. They are among the 600 Argentine SMEs that provide the basis of information for the Fundes-UNGS study.
4. The restrictions presented to the firms were as follows: 1) The conditions of access to financing (in respect of rates, amounts, terms, guarantees, etc.) limit the development of the business; 2) The costs of the use of infrastructure services (roads, energy, communications, sanitation, etc.) are detrimental to the competitiveness of the company; 3) The lack of regulation and control on imports has a negative impact on the company's production; 4) Legal insecurity affects business; 5) Financial institutions do not have the appropriate commercial structures to deal with SMEs; 6) The procedures relating to



foreign trade (customs, Senasa, DGI [tax dept.], banks) are very bureaucratic and limit the speed and flexibility of operations; 7) The concentration of supply and/or demand in the market for product/services makes it difficult to develop the business; 8) The services offered by public institutions (Inti, CNEA, EXPORT-AR, FONTAR) to SMEs are rarely used, due to a lack of promotion and publicity and red tape; 9) In most dealings with public bodies there are overpayments and corruption; 10) The training and consultancy services offered to SMEs are characterized by not being suited to the SME needs; 11) Large companies have an attitude which does not encourage the technological upgrading of customers and/or suppliers; 12) The development instruments have not stimulated exports; 13) The business organization(s) to which you belong do not respond to your requests for information, services, advice and representativity.

5. It is worth recalling the arguments of Walsh and White (1981) and Storey (1987) that SMEs are not smaller large companies, they are economic agents that are different in their nature and culture, their business logic and their concept of success itself.
6. As has already been stated, employers were asked to indicate both the degree of importance and the extent to which they would agree with the limitations set out in the questionnaire. This would make it possible to analyse both the seriousness of the restriction expressed by the relative importance assigned to it, and the extent or degree of generalization in terms of the group of SMEs.
7. Figure 4.1 illustrates, on the one hand, the degree of agreement expressed by firms on a panel of 337 cases about a set of 13 external restrictions that were presented to them and, on the other hand, the proportion of firms which placed these restrictions among the top five in order of importance.
8. The research and survey were carried out before the onset of the macro-economic crisis in Brazil and the devaluation of the currency, when the Argentine financial situation was in a stable situation.
9. While external sales represent 3.6 per cent of the total sales, in the rest of the groups they fluctuate – on average, between 8 and 9 per cent.
10. In this group there are no firms with a high technological capacity, the isolated firms constitute around three-quarters of the group, and scarcely 5 per cent used support programmes.
11. The firms with a high technological capacity represent a quarter of the group; 53 per cent can be considered isolated, 15 per cent used some policy instrument and a little over a third of the firms have experienced falls in turnover since the beginning of the 1990s.
12. Thus, 67 per cent of the firms in this group recorded increases in their sales over the decade; a quarter have adequate financial planning, which is a high proportion compared with the rest of the groups; 27 per cent used support programmes, which is almost three times the average percentage for the two previous groups. Finally, two-thirds of the firms in this group have a high technological capacity and the proportion of isolated firms is slightly lower than half of the group, which is also a significantly lower proportion than that of the other groups.

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## 5. Promoting networks of small enterprises in Latin America

MARCO DINI and JOHN HUMPHREY

### Introduction

MANUFACTURING INDUSTRIES IN DEVELOPING COUNTRIES are facing greater competitive pressures than in the past as a result of the opening up of previously protected domestic markets to manufactured imports and intensification of competition in export markets. Trade liberalization has a double effect on small and medium sized enterprises (SMEs) in developing countries. On the one hand, import penetration has increased in their local markets. On the other hand, new export opportunities are opening up, and with the right organization and contacts even smaller enterprises can access export markets.

Twenty years ago the idea that SMEs could enter export markets would have been ridiculed. But the success of Italian small firms in global markets has changed perceptions of what is possible for the small firm. Researchers and policy makers looking for ways of promoting the efficiency of small-scale industries have started to see the Italian experience as a model for policy.

This model has aroused worldwide attention. It seems to offer the chance to make SMEs more competitive. However, drawing policy lessons from the Italian experience and applying them to developing countries is a complex and difficult process. Trying to apply the lessons of the industrial district experience in the broader context of business development services can be frustrating. In many situations, clusters of firms do not exist, while in others firms that cluster together do not display the trust, co-operation and division of labour that are taken to form the basis for success in Italy.

This chapter starts from the position that it is possible to increase the efficiency of SMEs through inter-firm co-operation. Inter-firm co-operation can be developed and enhanced through the creation of networks. The chapter discusses various Latin American experiences of network promotion and identifies some of the factors that contribute towards successful networking programmes.

### What can we learn from Italy?

One of the most striking features of Italian industrial development from the 1960s to the 1980s was the export success of small firms. In Italy, smaller firms were able to establish a strong position in world markets in a number of so-called traditional products – shoes, knitwear, leather handbags, furniture, tiles, musical instruments, etc. – and also in the industries that supply machinery to these sectors. It is well



documented that clusters of predominantly small firms were able to establish significant positions in global markets. In some cases, small firms clustered together in particular regions were able to thrive while similar industries struggled to survive in other parts of Europe. For example, the value of production in the shoe Italian industry increased by over 10 times between 1970 and 1985 and the quantity of shoes exported doubled. Over the same period, European shoe industries, which had been larger in the 1960s, declined (Rabellotti, 1997).

The concept of the Third Italy was first used in the late 1970s. At that time, it became apparent that while little economic progress was in sight in the poor South (the Second Italy), the traditionally rich north west (First Italy) was facing a deep crisis. In contrast, the north east and centre of Italy showed fast growth. In a number of sectors where small firms predominated, groups of firms clustered together in specific regions seemed to be able to grow rapidly, develop niche, export markets and offer new employment opportunities. In the Third Italy,<sup>1</sup> non-agricultural employment in SMEs rose particularly fast, non-agricultural employment as a whole, and value-added grew faster than in the rest of the country in the 1960s and 1970s. Per capita consumption in these regions moved from being below that of the industrialized north in 1970 to being above it in 1981. One indication of the emerging wealth of these regions was the reversal of migration trends. The Third Italy was a net exporter of population in the 1960s, but an importer in the 1970s, overtaking the industrialized north as a destination for migrants (Rabellotti, 1997).

The Italian experience has been presented as a blueprint for the competitive success of clusters of small firms. While many different analyses have attempted to define the distinctive characteristics of the Third Italy, the following, taken from Rabellotti (1995), appears to reflect widespread consensus on the fundamental factors:

- Mainly small and medium enterprises are spatially concentrated and sectorally specialized districts or clusters.
- Forward and backward linkages among economic agents, based both on market and non-market exchanges of goods, information and people, together make possible extensive and flexible divisions of labour between firms.
- Inter-firm relationships and relations between workers and owners are rooted in a common cultural and social background that links economic agents and creates a behavioural code, sometimes explicit but often implicit.
- The firms in the cluster are supported by networks of public and private local institutions that facilitate interactions and provide specialist support in areas such as technology, materials, training and marketing.

The basic principle is that clusters of predominantly small firms can gain economies of scale and scope and increased flexibility through specialization and inter-firm co-operation. If they cluster, they can be as competitive as, or more competitive than, larger firms. The Italian experience appears to show that small firms in industrial districts can be successful large-scale exporters, and they can do this without resort to low wages and poor labour standards.

The Italian experience was analysed and presented to the world as the industrial district model. It has inspired a new line of research on small-scale industry,

and there was considerable research during the 1990s on clusters of firms in developing countries.<sup>2</sup>

The Italian experience has also attracted attention from policy makers. The idea that SMEs, far from being disadvantaged by their size, might under certain circumstances be more agile and more efficient than large enterprises is very attractive. Not surprisingly, conditions of clustering and small firm industrial districts have been taken up by policy makers in the field of business development services. However, the use of the clustering model for SME policy in developing countries encounters two serious obstacles:

- The literature on clusters and industrial districts usually refers to large agglomerations of enterprises, frequently numbering hundreds of firms of various sizes operating within the same sector. However, such agglomerations are the exception rather than the rule, and most small enterprises are not found within them.
- Agglomeration, by itself, does not necessarily create division of labour, efficiency or dynamic learning. The world is full of clusters of enterprises (large and small) that do not show the dynamic growth associated with Italian industrial districts. Altenburg and Meyer-Stamer (1999) have referred to such groupings of firms as 'survival clusters' in their work on Latin America. Similarly, there are many clusters of small firms in India that show very limited signs of innovation and increased productivity. Policy makers and researchers have frequently found clusters of small firms, but with characteristics very different to those described in the literature on Italian industrial districts.

These are important findings. Anyone who expected to find large concentrations of firms working effectively together in Latin America would be disappointed. Even where concentrations of firms do exist, co-operation is often difficult to establish and sustain, and SMEs are often struggling to achieve competitiveness.

Nevertheless, these disappointments should not lead to a wholesale rejection of the relevance of the industrial district model for Latin America. At the heart of the industrial district model are inter-firm relationships. According to Sengenberger and Pyke:

The crucial characteristic of an industrial district is its *organization*. That is to say that economic success for the industrial district has not come about through advantageous access to low-cost factors of production – cheap labour, land or capital – but, rather from a particularly effective social and economic organization based on small firms. This organization may vary at the margins, but typically there are a number of key elements which help to 'explain' or identify the most successful districts ... Perhaps paramount among these is the existence of strong *networks* of (largely) small firms which through specialization and subcontracting divide amongst themselves the labour required for the manufacture of particular goods: specialization induces efficiency, both individually and at the level of the district; specialization combined with sub-contracting promotes collective capability. Economies of both scale and scope are the result. It is the firm as part of, and depending on, a collective network which perhaps more than anything else encapsulates the essence of the district's character (Sengenberger and Pyke, 1991: 1, italics in original).



This emphasis on networks is the key to developing policy for SMEs. In Europe, this insight has been used to develop programmes aimed at promoting networks of firms. The most significant initiative in Europe was the Danish network programme – a government initiative which ran from 1988 to 1993 and which was later copied in a modified form in a number of other countries (Martinussen, 1995).<sup>3</sup>

The programme was triggered by the recognition that SMEs, i.e. the backbone of the Danish economy, are ill-equipped to deal with global competition. Networking was thought to be the answer and was defined as co-operation between firms aimed at raising competitiveness, in particular at creating new business opportunities, such as developing and marketing new products that deploy significant strengths within individual firms; establishing agents and distributors in new markets; or the pooling of individual products into complete product ranges.

While the Danish programme was inspired by the industrial districts in the Third Italy and other parts of Europe, the idea was not to replicate them but to foster co-operation between enterprises irrespective of whether they belonged to an existing cluster. The central idea is that through working together such enterprises can overcome obstacles and conquer markets beyond their individual reach and that external assistance plays an important role in facilitating co-operation. The key figure is the network broker, who helps to identify opportunities, brings participants together and assists in implementing new ideas or projects. The programme was designed by the Danish Technological Institute, funded by central government and carried out by the National Agency for Industry and Trade in conjunction with local institutions.

One of the major problems in Denmark was that inter-firm co-operation of this nature was not a part of the country's industrial culture. The network programme aimed to stimulate Danish enterprises to overcome their resistance to co-operation (Chaston, 1995). In order to create an interest in networking, examples need to be found of initiatives that have some relevance for, and strike a chord with, the local enterprises. The next critical gate is that of identifying a viable network idea. The third hurdle is that of convincing a group of firms to pursue the idea and take ownership of its progress. Convincing firms that they need a feasibility study before they push ahead is also critical. These are the main challenges for the network broker. Best practices are methodologies, tools and promotion material which help brokers to overcome the above mentioned barriers (Martinussen, 1995).

Overall, it seems that the programme has been successful on various counts:

- It achieved scale over the five years of the programme's existence, 5000 enterprises became involved in forming networks out of a target group of 10 000–12 000 enterprises.
- This high uptake has helped to make networking part of the Danish business culture. The idea and often also the practice have disseminated widely, such that networking has become a natural option to consider in the face of new business challenges.
- In the interim survey, 75 per cent of participating enterprises expressed that the networking was raising their ability to compete, and 90 per cent of respon-

dents expected that they would continue the practice of networking beyond the subsidy period.

- The know-how of promoting networks has been exported to a number of other advanced countries, particularly regions in Spain, Portugal, France, UK, Norway, USA, Canada, Australia and New Zealand.

The results of the Danish networking experience, as well as other experiences of network promotion in Europe, suggest that networking can help firms to gain concrete competitive advantages that are not available to them as isolated firms. Those advantages include mutual support, better access to best practice, increased division of labour and specialization, and access to markets which require resources beyond the scope of the individual firms. However, such networking schemes have to overcome start-up problems – in particular, the start-up costs involved in developing the network and the problem of trust.

The remainder of this chapter will discuss experiences of networking and provide examples of network promotion in Latin America.

### The practicalities of networking

The basis for the development of networks is threefold: mutual trust between the participating enterprises, long-term relationships, and mutual benefits. If these conditions can be fulfilled, then the firms involved in the network can reap the benefits of the economies of scale, more rapid learning, increase flexibility and greater bargaining power in relations with both suppliers and customers. However, there is a start-up problem. Why should firms commit themselves to participation in a network when the benefits will be reaped only in the future, and the risks and costs are likely to occur at an early stage in the process? Furthermore, how can SMEs become involved in networks when their owners are frequently devoted full-time to ensuring the survival of the enterprise?

These problems point to the need for an external agent to initiate the process of network development. There is also a good case for this external agent not being provided through the market. SMEs do not have the knowledge to assess the various providers of networking services that the market might provide. Institutionally, this is usually the small enterprise development agency. In practice, the network broker has a key role to play in network development. The role of the broker is to start the process of building the network by overcoming the start-up problems. This means:

- Identifying potential networks: Network schemes may work on the basis of responding to initiatives from groups of SMEs or proactively identifying potential networks. In either case, the network broker has to undertake a diagnostic exercise to evaluate whether or not there is a possibility of developing a network which would provide mutual benefit to the participating enterprises.
- Overcoming the scepticism of participating enterprises: Small businesses are sceptical of outside agencies. One of the tasks of the network broker is to overcome this scepticism. This might be achieved by providing immediate benefits to participating firms. For example, the network broker might act as an interface between firms in the network and the external institutional framework. It



is well known that SMEs often lack the knowledge and resources to develop access benefits provided by the state, and the network broker can establish credibility by enabling access.

- Creating commitment to the network among the participating enterprises. This is perhaps the most difficult task. The participating enterprises will have doubts about the capability of the broker (who is unlikely to match the technical expertise of the firms in the network), doubts about the good faith of the other enterprises in the network, and doubts about the benefits that might derive from the network. These legitimate doubts can be overcome only by a slow process of establishing credibility, diagnosing the challenges and opportunities facing firms in the network, and outlining areas of potential co-operation.

Even after these start-up problems have been resolved, the network may still require continued intervention by the broker, who will act as a 'referee' in disputes between enterprises. However, the support for most enterprise networks is time limited. If the broker is to continue playing a role, eventually financial support must be provided by the enterprises themselves.

It follows that the broker has a key role in network formation. The person with responsibility for this task must have credibility in the eyes of the participating enterprises, be capable of diagnosing the competitive condition of firms, be able to design projects for co-operation, have good negotiating skills, and be able to take a leadership role within the group.

### Networking in Latin America: Chile and Central America

Various initiatives for inter-firm networking have been adopted in Latin America. This chapter deals with two cases. The analysis of these cases is based on the participation of one of the authors, Marco Dini, in each of the experiences.

#### Chile

In the 1990s, Corporación de Fomento de la Producción (CORFO) developed two networking initiatives: the Proyectos de Fomento (PROFOs) (Development Projects), and the Programa de Desarrollo de Proveedores (PDP) (Supplier Development Programme). The aims, resources and achievements of the programme are summarized in Table 5.1. The analysis in this chapter will focus on the PROFO initiative only, as the PDP programme was established only in 1993.

The PROFO programme seeks to promote direct co-operation between firms and to provide a focus for the supply of support services by Servicio de Cooperación Técnica (SERCOTEC), an agency of CORFO. PROFOs are based on the assumptions: 1) that the biggest problem facing small firms is isolation, not size, 2) that the take-up of all of SERCOTEC's services needs to be improved, 3) that dynamic clusters of firms can have a positive impact on the locality as a whole, and 4) that the co-operation of the private and public sectors is essential if localities are to develop. The role of the state (SERCOTEC) in this process is to stimulate the participation of private and public sector

actors in the locality, to promote the co-ordination of activities of various agencies, and to promote change and innovation in the relationships between actors (Dini, 1993).

There are three stages of PROFO development:

- *Preparation:* This involves work by SERCOTEC to identify firms in a particular locality, diagnose their problems and establish the credibility of SERCOTEC itself as an agency that can offer useful support. SME owners are not easily convinced that state intervention is good for them, particularly in a highly individualistic and anti-state entrepreneurial culture of the type seen in Chile (Montero, 1992). Scepticism has to be overcome by personal contacts and problem-solving directed at individual firms. Any group of firms can ask to form itself into a PROFO, but SERCOTEC must be convinced that a basis for collaboration exists and that there are clear short-term and medium-term goals which might be met. The number of firms will be small – usually between 10 and 30.

Table 5.1 Networking programmes in Chile

	PROFO	PDP
Objectives	To create networks of SMEs that would allow the firms involved to obtain competitive advantages not available to them individually.	To create stable relationships and enable collaboration between large and small enterprises.
Type of support	A partial subsidy for operation costs, decreasing over time (from 70% to 50%) for maximum of three or four years. Support from external brokers to initiate and consolidate the group and to develop plans for co-operation.	
Start year	1993	1998
Reach	By 1998, 325 PROFOs had been approved, involving a total of 2959 firms.	The pilot project developed in 1998 involved 20 large firms and 1600 suppliers.
Resources	In 1998, CORFO provided approximately US\$9.3 million.	CORFO invested US\$250 000 in the pilot project.
Stages	Identification of groups, diagnostic exercise and elaboration of the project. Development of activities. Evaluation of results.	Identification and diagnostic exercise with buyer and supplier firms, and elaboration of a development plan. Development of activities. Evaluation of results.
Results	Social return: \$4 for every \$1 invested. Fiscal return: \$2 in tax revenue generated by every \$3 invested in the network. Major improvements in the performance of participating firms.	Too early to judge the results of the project.



- **Consolidation:** This is the main part of the process. The first step is to appoint a manager. The manager's role is, initially, to act as an interface between the PROFO's members and their institutional and market environment. One first task of the manager is to improve the delivery and take-up of support services, and this requires co-ordination not only with SERCOTEC but also with other local agencies, both private and public. Henriques (1992) argued that once firms are organized into a group they can more easily make their needs felt to institutions and markets. Their size has more of an impact in the market for services to firms. Training providers, banks, suppliers and local and regional institutions will be more willing to respond to the demands of a group of firms articulated by the PROFO manager. A second task is to develop better relations between the participating firms. This is done through such activities as visits to each others' factories, group workshops and group travel. The manager will also work towards building the self-esteem of the group and promoting its activities. Once this is achieved, the participants and the managers can work towards developing competitive advantage based on co-operation. At the same time, the work of the PROFOs is directed towards particular areas of improvement through the bi-annual evaluations of progress, which focus on particular areas of activity, such as product design, process improvement and human resource management (Dini, 1993)
- **Independence:** The aim of the PROFO initiative is to create groups of enterprises that can develop and sustain their competitiveness, and at the same time encourage other firms in the locality to emulate the experience and inject dynamism into the local economy. For this reason, the managers are appointed for a period of three years, after which the participating firms must take over all support for their salary. The aim is that each group of firms will be self-sustaining. The benefits to the participants should be great enough for private initiative alone to sustain it.

The success of the PROFO initiative is shown clearly in Table 5.1. For every one dollar invested in the programme, it is estimated that a social return of four dollars was generated. Further, the programme generated considerable tax revenues, so that the tax burden on the state was reduced substantially. However, the real test of the programme is the extent which the networks continue after state finance has been withdrawn.

#### Central America

Two projects for network development in Central America are considered here. The first was established in Nicaragua, and the second in Honduras in association with the National Association for SME (AMPIH). The details of the two programmes are presented in Table 5.2. Both programmes were supported by UNIDO, with financial support from European governments. It can be seen that both programmes are less ambitious than the PROFO programme in Chile. Once again, network brokers played a central role in developing group activities, particularly in identifying areas where technical assistance was required.

The success of these projects is hard to evaluate. Altenburg and Meyer-Stamer (1999) provide evidence that the project in Honduras had mixed results. On the one hand, it was possible for the programme to help groups of small entrepreneurs to identify common problems and look for collective solutions. They cite the case of furniture makers who identified that quality problems arose from using wood that was insufficiently dry. With credit provided by UNIDO, the group bought a dryer. Just as important, 'The dialogue also helped to build trust among a group of rather individualistic microentrepreneurs and encouraged them to specialize complementary tasks in order to achieve economies of scale.' (Altenburg and Meyer-Stamer, 1999). However, some of the initiatives undertaken by the same project failed. In particular, groups suffered from opportunistic behaviour, and Altenburg and Meyer-Stamer suggest that 'as long as the participating entrepreneurs are not personally liable for project failures, they will pretend to be interested in many projects which in reality they do not need' (Altenburg and Meyer-Stamer, 1999: 1698).

Table 5.2 Networking programmes in Central America

	Nicaragua	Honduras
Objectives	To promote the development of SMEs through the creation of networks of firms specializing in complementary activities.	To support the creation of SME networks and to spread networking methodologies.
Type of support	Technical support from professional staff directly involved in the programme.	
Start year	Part 1: 1995-97 Part 2: 1998-2001	1992-1997
Reach	250 firms in 16 groups. Sectors covered: leather, footwear, agro-industry, timber and furniture, metalworking and textiles.	Approximately 350 firms in 32 groups. Sectors covered: leather, footwear, agro-industry, timber and furniture, metalworking and textiles, garments and packaging.
Resources	Part 1: US\$700 000 Part 2: US\$1 300 000	US\$600 000
Support for firms	The project covers the total cost of consultancy. The firms pay all the costs of projects developed at the group level.	In 1995 a norm of co-financing for consultancy was established. Firms cover part of the cost.
Results	Introduction of new materials, improvement in product quality, development, brands, standardization of sizes. Three groups began direct exports.	At the level of groups, reductions in investment costs. The development of a technology resource centre, with 20% financing by participating firms in the first year.
Evolution	The development of vertical networks has created greater linkages between large and small firms and has allowed the development of strategies based on competitive advantage to be developed at the regional level.	



This is a critical problem, but not one that is insurmountable. One solution to how collective responsibility can be enforced has been provided by a study of the purchase of school furniture in a scheme organized by the Industry and Commerce Department (SIC) of the State government of Ceará, together with SEBRAE, the Brazilian SME assistance agency. According to Tendler and Amorim (1996), collective action by the SMEs was promoted by various aspects of the programme:

- SIC and SEBRAE offered contracts only to associations of small producers, not to individual firms. Where associations did not exist, SEBRAE helped to form them.
- The Association was responsible for quality and product warranties. While each individual producer was identified on the product, faulty products were returned to the Association, which was responsible for them. If the maker had ceased to exist, the Association was responsible for repair.
- The Association had to co-ordinate the small producers. Orders would be farmed out to individual producers, but payment would be made only once the whole order had been completed.
- The one element of subsidy in the plan was that half of the payment was advanced with the order. This generated working capital for the small enterprises. If one of the enterprises defaulted, the Association had to repay the advance.

Putting the Association at the heart of the process reduced transactions costs – there was one point of contact with the suppliers instead of many. It also ensured that the members of the Association monitored each others' performance. Poor quality, late delivery, or failure to deliver at all, imposed penalties on all producers. At the same time, the grouping together of firms in an Association which shared responsibility gave an incentive for producers to learn from each other. This grouping together also facilitated learning from SEBRAE. Tendler and Amorim (1996) note, for example, that the Association's members met together in advance of visits by SEBRAE's technical staff in order to discuss the issues that were of most concern to them. It was learning driven by the need to satisfy the customer.

Nevertheless, it is important to recognize that networking schemes require a certain degree of capability from participating firms. They have to be capable of negotiating and then meeting agreements. As Altenburg and Meyer-Stamer (1999) point out, this may require considerable technical support of a fairly traditional kind. Networking programmes are not a substitute for technical support for specific enterprises. Indeed, they may generate increased demand for such support.

#### *Generalizing from experiences*

The two cases studied allow certain conclusions to be drawn about how enterprise networks should be developed in Latin America:

- Networking programmes have to create co-operation and show that it works in practice. Talking does not lead to co-operation; only the experience of co-

operation, and the trust built-up between participating enterprises will create co-operation. This co-operation may then allow the 'demonstration effect' to facilitate the creation of new networks.

- The role of the broker is critically important, particularly in the early stages of network development. The broker has to undertake both a diagnostic, 'technical' function and a more social function, involving group co-ordination and motivation. Therefore, the broker has to provide a complex mix of skills. This raises the question of how network brokers can be trained or produced. The lack of network brokers is a major constraint on the expansion networking programmes.
- The creation of trust is critical for the development of networks. Although this topic is beyond the scope of this chapter,<sup>4</sup> it is important for network programmes to draw on the literature on the generation of trust. In particular, there is literature on the rapid production of trust in groups formed by strangers meeting to complete defined tasks.<sup>5</sup> This would be a further skill required by the network broker.
- Support for networks must be time limited, but the degree of support will vary considerably. A much higher degree of support is required in Central America than in Chile. Programmes must be tailored to meet local conditions.

There is no single route to putting a networking programme in place, and the complexities of the task may mean that the goal of 'scaling up' – always an objective of those financing development programmes – may remain elusive. However, given the limited success of many small enterprise development initiatives, networking is worth pursuing.

#### Notes

1. The 'Third Italy' includes the regions of Umbria, Marche, Emilia-Romagna, Friuli-Venezia-Giulia, Veneto, Trentino-Alto Adige and Tuscany.
2. For an understanding of the origins and development of the industrial district model, which uses the literature derived from the Italian experience to analyse industrial clusters in developing countries, see Schmitz (1989, 1995) and Nadvi and Schmitz (1999).
3. For experiences of network promotion in other European countries, see Bessant (1995) and Semlinger (1995).
4. See Moore (1994) and Humphrey and Schmitz (1998) for discussions of the role of trust in inter-firm relationships in developing countries.
5. See, for example Meyerson et al. (1996) for a discussion of how trust to be generated in organizations set up to deal with complex but time-limited tasks involving a high degree of interdependence between group members.

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## 6. Sustainability in the marketing of handicrafts in Nicaragua

TAMARA PEREIRA

### Introduction

PROARTE, S.A. IS A PRIVATE commercial company acting as an intermediary between Nicaraguan craft producers and international buyers. It aims to be a commercial company with social aims, providing marketing and export services for Nicaraguan handicrafts in the best interests of craftsmen and craftswomen, and to help them earn higher incomes and develop their skills.

Achieving a balance between the financial and social aspects, between sustainability and development, is often difficult. In this chapter it will be shown how this company tries to combine these objectives. There is a brief analysis of the people who are its suppliers and the impact that PROARTE has on the sector; there is also a review of the development of the marketing company, the difficulties it has encountered and the challenges it faces. Consideration is given to the possibility of replicating this model in other countries.

### Profile of PROARTE, S.A.

#### Objectives

PROARTE is a business, and as such has to be profitable. Its profitability is an essential factor in meeting its objectives, which are to help craft workers to export their products, thus creating more jobs and increasing the income generated, so that craftsmen and craftswomen can develop their skills without restraint.

#### Background

In June 1993, PROARTE was created as a handicrafts marketing programme of the Mennonite Economic Development Association (MEDA), with technical and financial backing from the SNV (Dutch Development Service). The idea for the programme arose from an analysis by MEDA of a credit programme for microenterprises providing loans to the handicrafts sector. This analysis showed that the craft producers do not take up the loans on offer, because they are afraid of not being able to pay them back, as they have no assured marketing channels to provide them with a stable income. Since the domestic market for handicrafts in Nicaragua is very small, due to the lack of tourism and low level of purchases of handicrafts by the people of the country, craft producers have to export their products to increase their sales levels. PROARTE was therefore created as a marketing programme specializing in exports.

After operating for several years as a non-profit organization, the profits obtained from its operations allowed it to consider the possibility of setting up a self-supporting company, which was formed as the limited company (*sociedad*



*anónima*) PROARTE, S.A. Set up in January 1996, it is owned by the founding organizations: MEDA has a 65 per cent holding and SNV 35 per cent. SNV plans to place its shares at the disposal of the producers. MEDA has also declared that it intends in the future to sell its shares to craft producers and to the employees of the company.

Staff members of PROARTE have expressed an interest in buying shares immediately, but the share transfer has been postponed until the conditions are considered right, both from the point of view of the company and the relationship with the craft producers.

#### *Services provided by PROARTE*

- Purchase and sale:
  - Intermediary purchase of handicrafts at fair prices
  - Domestic sales (10 per cent) and international sales (90 per cent)
- Quality control: this is carried out first by the buyer and then at the packing stage. The aim is to have three levels, with the producer as the first link in the chain of quality control.
- Packing.
- Administration of transport and customs export documentation.
- Financing of production.
- Technical assistance and training.
- Supply of good quality raw material.
- Design and development of new products.

#### *Personnel*

PROARTE employs nine permanent staff members: a general manager, an administrative and sales assistant, an accountant, a buyer, a designer, a warehouse supervisor, a warehouse assistant, a packer and a driver. The packing staff is hired as the volume of work requires. The sales and marketing functions are performed by the general manager. The aim is to have a small specialized staff.

#### *The market*

PROARTE exports mainly to Europe (Germany, Holland and Switzerland) and to the USA. Sales to the domestic market are low (5 per cent). PROARTE's first customers were Alternative Trade Organizations (ATOs) special organizations formed to promote products from developing countries – which were contacted with the help of MEDA, because of their relationship as non-governmental organizations (NGOs). However, to increase sales, it soon became necessary to move into mainstream trade. The ATO/mainstream ratio previously at 1:2, reached a level of 1:5 in 1998.

#### *The products*

The main products for export are 100 per cent cotton hand-made hammocks, copies of pre-Colombian ceramics, traditional country pottery, products made of

fibre and fancy wood, and marble powder sculptures. The hammocks and ceramics together comprise 96 per cent of all sales.

PROARTE's sales represent 45 per cent of all Nicaragua's exports of hammocks and 48 per cent of the ceramics. These statistics make PROARTE the leading handicraft exporter in Nicaragua.

#### **The suppliers of PROARTE, S.A.**

##### *Types of production unit*

PROARTE works with 40 craft workshops, located in both rural and urban areas throughout the Pacific, Northern and Western regions of Nicaragua. These production units include family workshops, co-operative units, and microenterprises. There are machines in some of the production units, but the use of manual tools remains predominant.

PROARTE has no preference for particular types of suppliers, nor for their geographical location. The selection criteria are based on the type of products, their quality, design, price and production capacity. This puts pressure on some groups of producers to maintain quality standards, as they have no guarantee of their handicrafts being purchased by PROARTE on a continuous basis.

##### *Qualifications of the craftsmen and women*

Most of the craftspeople have had their skills passed down to them through a tradition of generations, which tends to make them resistant to adopting more modern techniques.

##### *Income level of producers*

The salaries of producers vary on average between C\$600 and C\$900 per month (approximately US\$55 – US\$80), which compare very favourably with those of other sectors: e.g. agricultural and livestock C\$300; fishing C\$500; mining and quarrying C\$600; manufacturing industry C\$500; construction C\$480; financial institutions C\$700.

The salaries of women, who work mainly in more remote rural areas, do not exceed C\$500 per month on average, but even so, they earn more than their husbands working in the fields. This gives them economic power and a status within their families which distinguishes them from most women farm workers.

It can be said that the income of the craft producers who supply PROARTE is not at the poverty level, but is still low. After the disaster of Hurricane Mitch, the population in the rural areas in the north and west of the country were left in a precarious situation. Strong currents carried away the fertile strata of cultivable land, leaving many agricultural workers destitute. This highlighted the importance of the handicrafts sector as an alternative source of income for families; in some cases, it has become the sole remaining source of income. This situation increased the need to strengthen the marketing company, to generate greater productive activity through international sales.



Apart from the income, there are other beneficial family and social effects. In terms of family impact, most of the handicraft production facilities are located in the home, which can restrict living space. As a result, the income from craft activities is often used for home improvements, not only in terms of building extensions (to both working and living areas), but also in fixtures, fittings and furnishings.

#### *Problems faced by craft producers*

- Difficulties in obtaining good quality raw materials.
- Problems in managing business side (costing products on division of labour).
- Lack of information on the international market.
- Inadequate training in their crafts.
- Lack of access to credit and finance.
- National culture of buying on price rather than quality.
- Resistance to using modern technology because of a lack of funds to experiment, and traditional approach to craftsmanship.

PROARTE tries to play a role and offers services designed to solve these problems.

#### *Gender and producers*

Ceramics represent 46 per cent of PROARTE's sales and 62 per cent of the workshops are run by women; 52 per cent of people working in all workshops are

#### **Making hammocks using a new colouring process**

Regulations in the European countries that are the main market for the hammocks produced in Nicaragua are becoming stricter, and new non-tariff barriers are being created for products exported from developing countries. This has affected producers whose hammocks are exported through PROARTE. They now have to use superior cotton from Masaya, known in Nicaragua for its high quality. There have also been problems with the colouring material. Previously, colouring was done in an artisanal fashion but now, according to the new laws, this would not pass the required standards.

This difficulty has now been overcome by the direct import of much higher quality colouring materials from a large international supplier – CIBA GEIGY – in Costa Rica. The colour is applied to the yarn for the hammocks not in craft workshops but in a large, suitably equipped factory in the town of Granada, close to Masaya. The hammocks are then assembled by the craftsmen in their workshops, according to the colour requested by the customer.

This new process of working has enabled PROARTE to continue exporting to the demanding German market and has, at the same time, made it possible for the artisans to work in more agreeable conditions and obtain improved prices. The yarn of the hammocks is now much more durable and the colouring can withstand much better the effects of the rigorous European weather.

#### **Nicaraguan ceramicists unite to produce US order**

The production of ceramic items by the craft sector in Nicaragua faced a challenge when it got its first order from Pier 1, a well-known retail chain of stores in the eastern USA which sells craft items, mostly from developing countries. At the time of Pier 1's first order, there was not a ceramic craft workshop in the country able to produce more than 500 pieces per month. When the order came from this buyer for 18 000 pieces to be delivered in six months, the first reaction that reached PROARTE was that it would be impossible to take on such a large order and this would end up with problems with this most important US purchaser.

It was decided to make the effort to carry out this very attractive order with the help of PAMIC (Programa de Apoyo a la Microempresa – support programme for micro enterprises) and foreign NGOs that had been helpful in the past, such as Potters for Peace. It was decided to concentrate all efforts on the workshops of the women of Ducuale Grande, a community 180km from Managua that had produced the items chosen by Pier 1.

For several months, intense work was carried out to redesign the production process, to install new kilns and set up provisional warehouses in rural stores. Most important of all was to move the best ceramicists in the country to this small place so that they could work together on this large order.

They gathered together in this locality and experimented in ways of increasing the production. For the first time, men and women worked together in the workshops and even the younger children helped the parents during their school vacations and in their free time. In this way, it was possible to put together six containers of ceramics to match Pier 1's order and this was an historic moment in ceramic crafts in the country. The limits considered previously for ceramic craft production in the country were surpassed.

This combined effort of various groups of artisan ceramic workers proved a stimulating joint enterprise and paved the way for taking on other large export orders of ceramic items produced in the district of San Juan de Oriente.

female, while in family workshops and in microenterprises they make up 32 per cent.

Of hammocks, which represent 50 per cent of PROARTE's sales, 67 per cent are made by men and 37 per cent are by women. It should be noted that women usually work from home, while men are in workshops. This arrangement enables women to combine family responsibilities with work.

#### **Sustainability and development: the keys to success**

The successful combination of financial sustainability and development lies above all in the role played by PROARTE in the marketing chain. This role enables PROARTE to be a viable concern and helps small businesses to develop with the support of the services offered to them.

PROARTE acts as a point of connection joining the network of suppliers and the network of purchasers, providing a centre for information on incoming and



outgoing products. The purchaser has access to a variety of suppliers, while the producer has access to different markets for the products.

With each of the two networks, the marketing company is the focus of a system of relationships; these are two mini-systems on two different levels, in which the parties meet the following requirements:

- *Responsibility of the producer to the marketing company:* Ensuring quality of product, prompt delivery, correct volume of production, appropriate cost price.
- *Relationship of the marketing company to the producer:* Technical assistance and training, financing, design and product development, transport of products, help in purchasing, supply of good quality raw materials.

As these requirements are met, the relationship between the producer and the marketing company is transformed into a long-term mutual business agreement.

- *Relationship of the marketing company to the purchaser:* Delivery of orders on time, product quality, competitive prices, effective packing, credit sales, after-sales service.
- *Relationship of the buyer to the marketing company:* Payment for orders on time, feedback on fashion trends to help development of new products, increasing orders, loyalty to the marketing company and to the product.

#### *Advantages and disadvantages of the marketing company*

*Advantages.* The existence of the marketing company creates a dynamic system with a clear division of labour, which is the basis for success because it facilitates specialization, optimal use of resources, and consolidation of supply of exports.

Respecting the division between production and marketing is the key to the system's success. This division fosters specialization and optimal use of finance, human, administrative and technical resources. Each link in the process does what it knows best. The producer invests in productive infrastructure, in expanding production capacity and in improving technical specialization and the quality of products; the marketing company invests in market research, storage capacity, arranges reliable transport to and attendance at trade fairs, provides office facilities and administrative support.

Export requires access to resources, information and support services, such as:

- material resources: communication facilities (fax, e-mail, telephone), technical resources: computers, means of transport
- human resources: specialized staff, competence in languages
- access to finance, loan facilities, marketing support, warehouses.

The marketing company provides producers with these services and so enables them to reach a much wider market. This is a service to areas that lack even such basic features as drinking water, electricity and telephone connections.

Exporting through a marketing company facilitates combining output from several workshops for a single buyer. It achieves adequate volumes for large buyers. This is one of the greatest difficulties for small producers, that their output is too small for importers to handle on its own.

*Disadvantages.* For the craft producer, however, exporting through the marketing company has some disadvantages too. These are:

- It makes the products more expensive: Each intermediary in the chain adds a profit margin to the product, and PROARTE is no exception.
- The craft producer sells products to the marketing company, who then exports them so that the craft producer is never in direct contact with the final customer. The producer becomes completely dependent on the intermediary and loses all direct contact.

Perhaps the greatest disadvantage for the craft producer is that the marketing company is really interested in the products, rather than in the producer. The relationship with the producer is based on the quality of the product supplied. There is no obligation for the company to buy the whole of a certain output, or even a specified volume of production. If the product ceases to be attractive, the marketer stops buying it. Therefore, the craft producers have to make an effort to keep improving their production both in volume and quality to be competitive. This competition is healthy, and the system more dynamic, but it also imposes stress and insecurity on the producers and deprives them of some independence.

*The relationship between company and producer is based on mutual benefit*

*Committed staff.* One of the keys to the success of the system lies in the employees of PROARTE, who have to be dedicated to their task. They have to be aware that their role goes beyond the buying and selling of handicrafts. They have to keep in their role in promoting economic and social development in co-operation with the producers. The company has to train its staff in social issues, as well as make them aware of gender factors.

PROARTE as facilitator has to arrange technical, financial and business training for producers. PROARTE has no resources of its own to develop training and technical assistance and does not consider this to be its role. Instead, it acts as a facilitator and works in these activities together with organizations specializing in these fields. The alliances that the company has with similar organizations whose experience it utilizes are very important for the development of the craft sector. For its part, PROARTE has indirectly carried out informal training and technical assistance through visits to the workshops, tracking orders, reviewing the design and development of new products and control of production.

Product development is one of the most important areas of marketing, so PROARTE employs a full-time designer in its team. Experience shows that the most successful products are those designed for a particular market. Here all the aspects that make the product a potential success are brought into play: its design, its price, the capacity to produce it in sufficient quantities, etc. The seller, in this case PROARTE – the organization in contact with the buyers – has to set out guidelines for the development of new products. Attendance at trade fairs enables it to keep track of product trends and price levels. But perhaps the most important guide, which can provide the best feedback, is the customer who in the final analysis provides the information that the designers can analyse for trends in colours, shapes, motifs, sizes and where items have to be considered in developing new products.



*Distribution channels.* Choosing the right distribution channel for the export of handicrafts is one of the main features in the success of sales. Channels have to be selected carefully to enable the products to reach the consumer at competitive prices. Nicaraguan handicrafts are not cheap products, so one has to find the most economic way to reach the end consumer.

PROARTE applies a profit margin of 50 per cent on most products (except those from workshops more than 45km from Managua).

Experience in Europe and the USA has shown that the most appropriate channels for craft products are: ATOs, department stores, wholesale importers, retail importers (e.g. Pier 1 Imports). Distribution channels that are generally not so effective are: agents, importers, supermarkets and chains of low-income retailers.

*Promotion.* Attendance at international trade fairs is productive as it allows the company to reach a large interested audience at one time. It is most important to maintain a continual presence at any trade fair, but it is very expensive and requires a great deal of preparation and planning. PROARTE'S goal is to participate in a minimum of two trade fairs per year: one in Europe and another in the USA. Colour brochures and catalogues, product descriptions and prices are distributed directly to prospective and current customers. The company also advertises in the *Directory of Nicaraguan Exporters*, in specialist magazines read by tourists, and in the *Yellow Pages* of the telephone directory.

## Problems encountered

### *Problems in production and/or in exporting*

Quality of service and of products should meet customer requirements and achieve a stable long-term relationship. One of the biggest problems has been the difficulty of maintaining the required rate of production, leading to failure to meet delivery deadlines or sending products of inferior quality.

The quality problem is serious and had led to loss of customers. A group of suppliers has to be formed and trained, who are able to sustain a constant rate of production of acceptable quality or who can be helped to achieve this. It is vital to develop strategic links so that integral training programmes can be provided for the craft producers.

### *Downturn in sales*

There has been a downturn in sales over the past few years, for several reasons.

- Buyers have had quality problems with the products (complaints and rejections of products from customers) and this has become a factor in the decrease of sales. This inability to meet the quality standards of the final consumer results in reduced orders for PROARTE.
- Some buyers become disillusioned with late deliveries or poor quality of the products and stop doing business with PROARTE. Unfortunately, sometimes because of problems with the products of one producer, orders from all pro-

ducers are cancelled. It is then more difficult to win back a dissatisfied customer than to make a new one.

- There is a need for a wider range of products to be developed for international markets. Producers have to keep up with changes in the tastes of buyers in the different markets.

## Facing the future

### *Institutional strengthening of PROARTE*

PROARTE is at a crucial stage in its development, when it has to reverse the downturn in sales and achieve a profit level to enable it to establish itself as a sustainable company in the long term. It needs to restructure its organization by strengthening two main areas: sales, and product design. These will be key factors in maintaining a growing share of the market. At the same time to ensure that the production units are capable of meeting the supply needs of PROARTE, a training and promotion unit needs to be created to be responsible both for finding new sources of financing for the company and for hiring qualified staff to provide technical assistance and training for the craft producers.

### *Strengthening the production units*

*Training and technical assistance.* The fundamental factor in the growth of the company will be the increase of the exportable supply (in both quantity and quality), through a strengthening and expansion of the production units by means of technical and business development training.

*Gender issues.* There is the firm conviction that women have a leading role to play in the development of this sector. Fostering the capabilities of women in their production units will at the same time promote the empowerment of the women and the strengthening of their workshops, thus using production as a means of tackling gender issues and raising the number and standard of the craftswomen in the country.

- Increased production of ceramics involves greater consumption of timber. Consideration must be given to changing the technology of wood-fired kilns to multi-combustion or gas-fired ones for environmental reasons.
- In the use of colourings and oxides, PROARTE regulates their use to guarantee products that are environmentally friendly and not harmful to the producers.

## Conclusion

Countries do not have identical conditions, nor the same handicrafts or culture. There are similar socio-economic situations, which suggests that the model developed by PROARTE might feasibly be replicated in other countries. The major aspect of the PROARTE model is that it benefits both the marketing company and the producers; the growth of each comes about through the development of the other. The optimum solution is achieved when the two work together and when efforts are combined.



## 7. Market-based services for microenterprises in Ecuador

ANTONIO LANUSSE

### INSOTEC and business development services

THE INSTITUTE OF SOCIOECONOMIC AND TECHNOLOGICAL Research (Instituto de Investigaciones Socioeconómicas y Tecnológicas), INSOTEC, is a private Ecuadorean non-profit foundation, created by a group of businessmen and researchers in 1980 with the aim of promoting social, economic and technological development in Ecuador.

In its early years, INSOTEC's programmes consisted of indirect business development services<sup>1</sup> and policy dialogues with government bodies and other institutions in the private sector, mainly in relation to small industry trade associations. At the end of the 1980s, INSOTEC started on the direct provision of technical assistance and training for small businesses, as part of a project financed by the United States Agency for International Development (USAID). Since then the process of learning and development has progressed and is now aimed at long-term sustainability.

The focus of INSOTEC's work is the enterprise, more specifically the micro-, small and medium enterprise (MISME); it is the perspective of the enterprise that inspires the methods and systems of work used. Small businesses cannot flourish in isolation, but only as part of a productive system (see Figure 7.1). They must aim to be competitive.

### The Institution's mission and the programme to develop competitiveness in MISMEs

INSOTEC's mission is to: 'contribute to the industrial development of Ecuador, with an emphasis on strengthening micro-, small and medium enterprises'. In



Figure 7.1 The enterprise and the factors affecting its performance

order to be able to accomplish its mission, the institution has implemented the MISME Integral Development Program, which is subdivided into two sub-programmes: 1) the sub-programme of competitiveness and environment, and, 2) the sub-programme of competitiveness and business.

The competitiveness and environment sub-programme was created to promote an environment that will be favourable to the development of competitiveness in Ecuadorean industry, especially in micro-, small and medium enterprises. The unit in charge of implementing the competitiveness and environment sub-programme is the Centro de Estudios y Políticas (Centre for Studies and Policies). The aim of the sub-programme is to strengthen the capacity for competition and growth in MISMEs, by increasing productivity and quality. The units responsible for achieving this are the centros de servicios empresariales (business service centres), described below.

### Business service centres (CSEs)

The CSEs operated by INSOTEC aim to improve the competitiveness of MISMEs through the provision of support services. These centres are located in five cities around the country: Quito, Ambato, Pelileo, Riobamba and Santo Domingo de los Colorados.

The CSEs offer financial services and business development services (non-financial services – as shown in Figure 7.2) with the objective of: 1) helping to vitalize businesses by offering credit for working capital and the purchasing of fixed assets; 2) helping to increase productivity in firms by offering technical assistance and training to improve technological and business management; 3) providing marketing services to help businesses to sell their manufactured products and gain access to the factors of production, plant and equipment; 4) offering production services to enable products of better quality and greater added-value to be produced; 5) promoting export marketing for the products produced by businesses; 6) contributing to developing and strengthening entrepreneurship,

	Information		Financing	
Supply of factors of production, raw materials and equipment		Enterprise		Marketing of finished products
	Technological services and plant hire		Training and technical assistance	

Figure 7.2 From idea to action . . . business service centres



particularly in the textile and clothing sectors; 7) enabling INSOTEC to generate the economic resources to achieve sustainability.

The CSEs offer a wide range of services to deal with the main problems faced by MISME.

### **Pelileo: 'The blue city'**

Since 1994, in a project supported by the Inter-American Development Bank (IADB) and based on its own institutional experience and resources, INSOTEC has operated a business service centre in the Pelileo canton, situated in the Sierra area, 120km south of the capital, Quito. The population of the canton is mostly of indigenous origin, but over time they have adopted the customs and values of a mixed race population.

In the urban area, which has around 12 000 inhabitants, the jeans industry constitutes the main source of income. Although agriculture has always been the typical activity of the area, there has also been a tradition of clothes manufacture. Since 1920, groups of families have used simple domestic machines to make shirts and trousers for sale in the markets of Tungurahua and Cotopaxi.<sup>2</sup> From the beginning of the 1980s, however, it began to concentrate on working on denim fabrics in imitation of small clothes manufacturers who were successful in selling such products in small town markets at low prices and without much concern for quality. In this way, a cluster of micro- and small enterprises specializing in such manufacture began to grow up, to the point when, at one time, Pelileo became known as 'the blue city', because of the colour of the clothes produced in the town.

Today in Pelileo there are around 350 enterprises specializing in making denim garments: 20 per cent are category 1 microenterprises (1 to 3 employees), 72 per cent category 2 microenterprises (4-9 employees) 6 per cent small enterprises and 2 per cent medium. It is estimated that the sector provides employment for over 2000 people. From the total number of firms, 72 per cent specialize in making clothes and 20 per cent in making and washing garments; finally, the remaining 8 per cent are enterprises that do only washing. Most of the workers are employed directly in the businesses, although there are others who work for sub-contractors, which makes it easier for production to fluctuate according to market demand.

The breakdown in the relative age of the enterprises is as follows: units in existence for less than three years represented 27.6 per cent, and those that have been operating for between three and five years make up 30.4 per cent; 18 per cent of the enterprises have been in existence for between five and ten years, while those that have been in operation for more than ten years, comprise 23.3 per cent (82) of the enterprises.

Most of the jeans manufacturing microenterprises tend to have between two and four permanent employees. These enterprises use mainly single-purpose machines, usually between one and five upright sewing machines. The main products are trousers (75 per cent).

The products are generally sold with labels that copy other well-known brands, a widely used practice in all countries. However, new regulations concerning intellectual property and legal action by international companies against small

businesses are giving rise to a recognition of the need to promote own brands. The goods produced are sold primarily to the low-income rural and urban population, where consumers are mainly interested in low prices and not so much in quality.

The production of ready-made clothes is mainly aimed at the national market, with only 8 per cent going to foreign markets, mainly in the neighbouring countries of Colombia and Peru. Many observers estimate that the percentage of production that goes to the frontier markets is higher than these official figures.

As regards education, 47.1 per cent of microenterprise owners admit that they only completed their primary education, 14.9 per cent had an incomplete secondary education and 13.8 per cent finished their secondary education. This situation should be taken in the context of the fact that the illiteracy rate in the canton of Pelileo is 12.9 per cent. It should be noted that 23 per cent of the microenterprise owners are women. The business owners of Pelileo acquired their knowledge and skills through work experience. The workforce is mainly characterized by poor educational qualifications, a marked lack of middle managers (in larger enterprises) and of specialist operatives (especially designers and cutters).

### **The Pelileo Business Service Centre**

INSOTEC's activities began with the marketing of raw materials for denim clothes manufacture and then began to offer and disburse credit to the microenterprises involved in this field of production. Subsequently, technological support services were added, including direct consultancy advice in production and training of personnel.

This chapter focuses on the provision of the technological support services. The project aimed not only to offer raw materials and credit, but also to set up pilot training production workshops to show the microenterprise owners the best practices of operation and to offer training in running these manufacturing businesses. In these model workshops, equipment was installed which, because of cost, could not be justified for individual enterprises to invest in, since they would be under-utilized. The services through these workshops offer the use of more modern equipment. They aim to be self-financing through charging for this facility.

It was decided that it was important for the business owners to value the services and it was generally agreed that this would be more likely to happen if they met part of the costs. It was also considered that by charging for the service it would be used only when it was considered to have an immediate return on investment. In this respect, training in business management or production techniques would be less attractive and it was doubtful if even technical assistance would meet this criterion of immediate returns. Production services, however, could be of interest, since a small investment would immediately produce returns. An example is that of a well-made buttonhole for which the business owner would pay 10 cents, which could mean an increase in the price of the product by US\$1.

INSOTEC therefore decided to give priority to the provision of those technical production services that would meet the immediate needs of the business owners. Thus, INSOTEC became part of the production chain. At the start, in



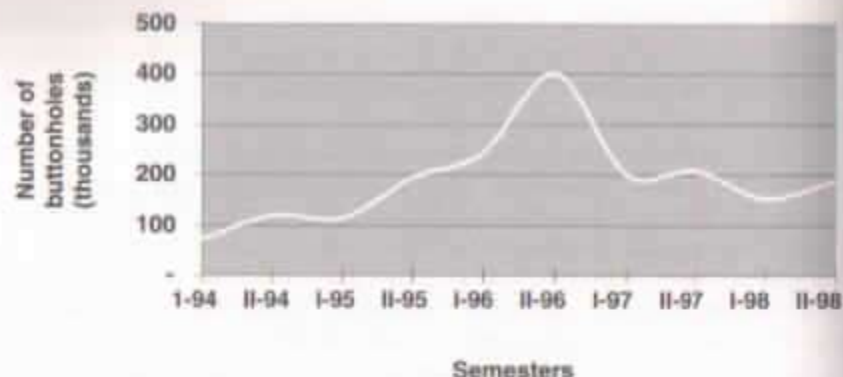


Figure 7.3 Buttonholing service - Pelileo

order to avoid possibly making a bad investment, INSOTEC decided to start the service with a rented machine for making buttonholes. After six months it went on to buy its own machine when it was clear that the service was a great success and in continuous demand.

When INSOTEC was set up there were only two buttonhole machines in Pelileo and all the garments produced in the city made buttonholes manually. The only machines for carrying out this operation belonged to the larger firms and there was a belief that the machines were very expensive and difficult to operate. One business owner spread a story that he had to pay a bribe to the brother of the owner of the firm that had the machine and had the buttonholes made on his garments in secret at night and was charged a high price for them - 15-20 cents each. The machine was under lock and key and very few people had access to it. When INSOTEC installed its own buttonhole machine at the Pelileo Business Services Centre, which was available for all to see, it charged only 10 cents per buttonhole, thus shattering the naïve rumours regarding the machine. The service provided by INSOTEC was a great success and gave some business owners the idea of offering the service themselves and INSOTEC was forced to offer a more rapid and cheaper service to overcome the competition.

The graph in Figure 7.3 shows the evolution of the buttonholing service. It indicates that production on the machine reached its height in the second quarter of 1996. At the end of the first quarter of 1997, because of competition, INSOTEC decided to sell one of its two machines and to retain the other to provide a service still required by the smaller micro-businesses. It was the intention of INSOTEC to pull out of this activity as soon as possible. Soon there were more than 10 buttonhole machines providing services in Pelileo and many of the businesses that had previously been customers of INSOTEC had now bought their own machines. By 1998 over 90 per cent of the clothing producers had their own machines and the price of a buttonhole had fallen to 1.5 cents. This shows how INSOTEC's initiative in installing a machine and offering a service radically changed this operation and reduced the cost of manufacturing the products.

At the beginning of 1995, INSOTEC installed another specialized machine to mechanize further operations with the aim of diversifying the services it offered.

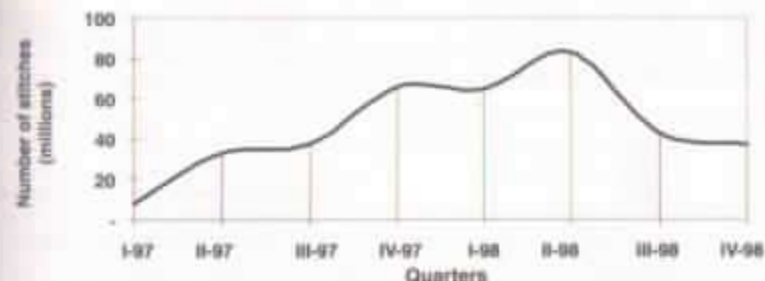


Figure 7.4 Embroidering service - Pelileo

This service has also developed in a positive way, although demand is less than for the buttonholing.

A service to speed the making of waistbands was also started, but this did not last long, as this machine was not expensive and there was on the market a simpler, cheaper machine that could perform the same operations. This was a valuable learning process for INSOTEC in introducing future services.

At the beginning of 1997, a single-head, computer-controlled embroidery machine was installed, which has also been very successful. After only a short time it called for two shift operations and later even three. The following year a second head was installed to meet rising demand. The results of providing this service are shown in Figure 7.4.

It can be seen that after the second quarter of 1998 a drop in production took place, partly due to the emergence of other businesses offering the services. Possibly also the marketing process of the new service was inadequate.

The provision of the embroidery service was the first step to the incorporation of computers into the production process (through subcontracting). This in turn results in having products of greater added-value and better quality, for which business owners can obtain better prices, reach more markets and improve their living conditions.

In addition to the services described above and as part of the technological support, the institution offers microenterprise owners in the area technical training, advice and assistance in machinery maintenance and administrative management. Diagnoses of production processes are provided to improve productivity and reduce environmental pollution in those businesses that have an effluent problem. Furthermore, work experience trips to Colombia are arranged every year for groups of micro-business owners, so that they can observe how things are done elsewhere and so implement changes to their own businesses. All these activities have a cost for the business owner, but the charges are subsidized through the surpluses generated from the profitable services. In the work experience programme the aim is for part of the cost to be financed by the businesses that provide inputs, equipment, tools, raw materials and help in marketing.

New areas are being opened up by INSOTEC where significant changes in the operation of enterprises can be promoted, using consultancy services. Work is being carried out to overcome situations that can result in legal problems for many businesses. For example, currently several of them are in the process of registering new brand names.



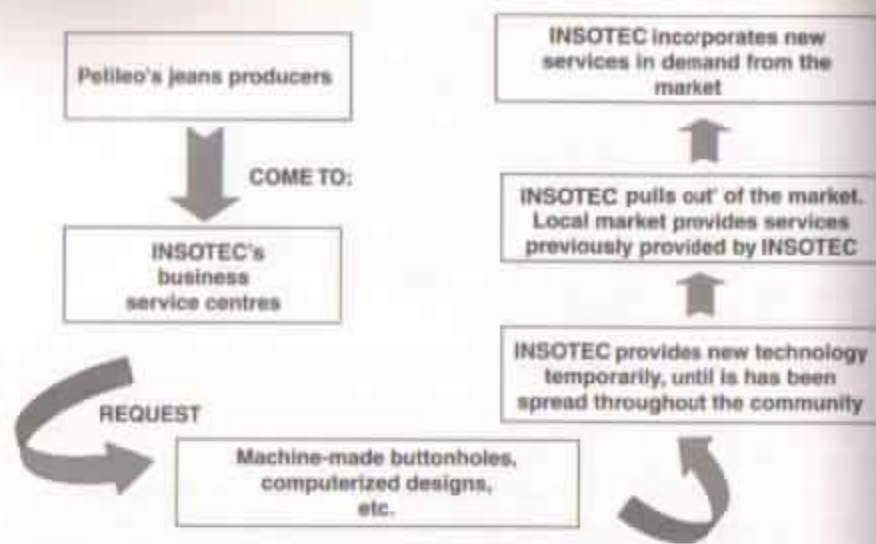


Figure 7.5 Model of business services for Pelileo's jeans producers

At the same time, the institution's Research Centre (Centro de Estudios) has conducted general studies of the sector, specific research into the effluent problem, and has organized discussion forums to discuss the special problems of firms. Since mid-1996 the institution has been working with one of the city's technical colleges, which trains young women in subjects relating to clothes manufacture, to adapt the teaching curriculum so that students will be better prepared to face the reality of work in the sector.

### Results of the implementation of services in Pelileo

After five years of operation in the region, an assessment can be made of the effects the institution has brought about, both in the business sector and within the institution itself. Some achievements include:

- In the institution itself a methodology for the provision of services to the microenterprise sector has been developed. This requires the institution to be constantly in a state of innovation, always linked to the demands of the market. The diagram in Figure 7.5 synthesizes the model that INSOTEC has been applying in the provision of business services.

The following have been some of the impacts of INSOTEC's work on the business sector of Pelileo:

- Services of buttonholing and embroidering, not previously available, are now on offer so that businesses can incorporate greater added-value into production processes through subcontracting. It should be emphasized that this has important financial implications for microenterprises. They can improve the quality of their products by subcontracting to third parties and so can avoid using scarce resources for investment in new equipment, which in many cases will be under-utilized.

- INSOTEC can offer services within the same business sector. This helps to generate trust between the institution and the microenterprises, who can see that the institution is prepared to face the same risks. It also enables the institution to relate to the reality of operating as a microenterprise and how it reaches decisions, which helps to reinforce the effectiveness of INSOTEC's role in working with the sector.
- Knowledge on the new technologies used can stimulate more competition and self-regulation in the market. For example, the price of a buttonhole which was 20 cents at the beginning of the service is now reduced to 1.5 cents. The same process also occurred in the embroidering services, so that INSOTEC is now considering the need to initiate a process diverting investment to other technological projects now considered of greater importance.

Today over 90 per cent of businesses have incorporated into the production process new types of buttonholes, which are now widely regarded as of higher quality. Businesses have access to better raw materials through new sources of supply. Most businesses today have access to fabrics produced in Ecuador, Colombia, Chile, Venezuela, Argentina, etc. INSOTEC is now better able to provide technical consultancies in management, marketing and production processes.

- Locating new suppliers of raw materials, machinery and other inputs in the same areas as the producer companies has reduced transaction costs and so made better use of working capital.
- The programmes have made it possible for a significant group of micro-business owners to familiarize themselves with new markets, new technologies and above all better business practices.
- The offer of technological services and the provision of better raw materials, equipment and tools has made it possible to develop products of higher quality, greater added-value and lower price.

### Provision of business services and INSOTEC's financial sustainability

As has already been stated, one of the objectives of the provision of business services to MISMEs, through the business service centres, is to enable INSOTEC to generate resources to achieve financial sustainability without the need to depend on donor funds.

INSOTEC is now managed as a business and no longer depends on the resources of donor funds, which today represent only 5 per cent of the institution's budget. Its resources are generated from the provision of services at market prices. Surpluses are reinvested to provide more services, or are aimed at promoting activities that encourage initiatives in the firm or that will improve their performance (for example, part-financing of work experience abroad or partial subsidizing of technical assistance schemes) or financing research activities to benefit the sector.

The institution has tracked its sources of income for the period 1996-98. It should be noted that 1998 was a particularly difficult year for the Ecuadorian economy. The wide range of services offered is aimed at diversifying INSOTEC's



income, so that it does not become dependent on a single source. There was a significant upward trend in sales income from marketing services. In the provision of financial services there is more of a downward trend, and in technological services earnings were stable. There was also income derived from projects supported by technical co-operation, which are the non-repayable funds; these showed a significant downward trend.

### Philosophy of action

- To achieve the difficult combination of working for development and being profitable.
- To offer services and products directly linked to the market.
- To recognize local specific features and adapt to them.
- To operate in a decentralized way.
- To develop an effective system of management information and administration for keeping track of operations and decision making.
- To be continually innovative.

### Notes

1. The providers of indirect services are institutions that raise funds, prepare educational material and/or provide technical assistance to related organizations (e.g. chambers of commerce), which in turn provide direct services to micro-, small and medium enterprises.
2. Castro, Nelly and Llerena, Jenny, 'Análisis comparativo de la situación socioeconómica de los hogares vinculados a las microempresas informales de confección de jeans en Pelileo y chompas de cuero en Quisapincha' ('Comparative analysis of the socio-economic situation of homes connected with informal microenterprises making jeans in Pelileo and leather jackets in Quisapincha'), Degree dissertation, Universidad Central del Ecuador, 1995.

## 8. The Business Information Service in Bolivia

GARY MONTAÑO HERNÁNDEZ

THIS CHAPTER PRESENTS, in summary form, the experience of the Instituto para el Desarrollo de la Pequeña Unidad Productiva (IDEPRO) – Institute for the Development of the Small Productive Unit – in the design, setting up and everyday operation of the Servicio de Información Comercial (SIC) – Business Information Service – over the three years of its operation in Bolivia (1996–98).

This chapter aims to share some conceptual guidelines with its readers and to illustrate the viability of the SIC initiative undertaken by IDEPRO. The service described is new for Bolivia, and innovative as regards the non-financial services provided to the microenterprise sector. The chapter covers some of the main lessons from the institutional learning process up to December 1998.

The first section gives the main events leading up to the creation of SIC. The second section describes the development of the design of the services and the basic operation of the institution. The third section covers the evolution of operating and financial results achieved in three years of operation. The chapter ends by setting out the strategic goals for the future that IDEPRO has laid down for the business information service.

### Events leading up to the creation of SIC IDEPRO

The problem areas of development for small businesses in Bolivia, and possibly in other countries in the region, are necessarily affected by the environment and the market. These establish the state of implicit or explicit marginality, in which small-scale economic activities operate. They also influence the strategies of all the organizations and services concerned with the sector.

In the 1990s, appreciable progress was made in Bolivia in the provision of financial services to the small-scale sector. Much less progress occurred in the provision of non-financial services to microenterprises.

In this context, from the time it launched its operations in 1991, IDEPRO set itself the goal of specialization. It aimed to offer services to the sector by incorporating into its offer highly specialized financial and non-financial services.

A central feature of the design of SIC is the institutional strategy adopted by IDEPRO, which takes account of the following aspects.

#### *Intervention on the basis of competitiveness*

Since 1994, this consideration has brought fundamental changes to the pattern of institutional intervention, resulting in the following aims:

- To implement two types of intervention: 1) direct action to help micro- and small business units, and 2) intervention in the environment, through the creation of suitable infrastructures to support micro- and small enterprises in their business activities.



- To introduce models of integration and linkages between enterprises (micro-small, medium and large enterprises).

#### *Intervention classified by type of service*

This produced a change in the manner of intervention, moving from the provision of non-financial services as a way of obtaining access to credit, to the provision of business development services, which would help to enhance competitiveness.

This gave rise to the differentiation of four lines of institutional services: credit, training, on-site consultancy, and business information. Each service can and should be provided separately, in accordance with the needs of the client.

#### *Introduction of a business logic in the operation of services*

A third factor was the aim of achieving, in each line of services offered by the institution, long-term financial results to ensure the sustainability of operations.

The features described have produced two results: first, the transition of institutional financial services within a regulated entity (ECOFUTURO FFP), which would specialize in micro-credit and the mobilization of savings. Second, the continuity and specialization of IDEPRO in the provision of enterprise development services.

The role of the business information service is concerned with:

- Provision of information to microenterprises<sup>1</sup> to enable them to make well based commercial decisions.
- Promotion of goods and services of micro- and small enterprises to potential purchasers.
- Facilitating interaction through information between micro- and small enterprises and large enterprises, to achieve productive linkages.
- Fostering interaction and information between enterprises and institutions supplying services to micro- and small enterprises.

The effects were:

- SIC had to generate its own portfolio of clients.
- SIC had to create its own service, which enabled it to compete with other products and services in the market (such as other newspapers, radio programmes and other information systems).
- The need to complement the various other institutions and services (credit, training and consultancy).

These initial premisses led to the design and initiation of the service and to confronting the challenge of seeing the micro- and small enterprise sector from a new perspective. This involved looking at the entrepreneurial environment as a whole, replacing the perceived marginality of the sector by a more comprehensive view of the interrelated nature of commerce, production and technology transfer.

## **Concepts behind the design of the service**

### *Needs identified in micro- and small enterprises*

The design of the service was based on the knowledge gained through studies previously conducted by IDEPRO, CEDLA and other institutions dealing with the sector. Four business problem areas for micro- and small enterprises were prioritized to be dealt with in the design of the service. These were:<sup>2</sup>

- Problems in the supply of raw materials, equipment and skills.
- Lack of market information on the preferences of consumers.
- Difficulties in obtaining help in improving the productivity of enterprises and the quality of products, as related to the needs of the changing market.
- Problems in expanding access to the local, national and/or export markets.

### *Participants involved in market interrelationships*

The problem area includes the participation of three subjects in the framework of business relations:

- The micro- and small entrepreneur who procures materials, equipment, tools, intermediate goods and services as well as trades in goods and services on the market.
- The supplier of raw materials, tools and services for microenterprises.
- The final consumer or intermediary, who buys the goods or services of the microenterprise.

The subjects identified give rise to the building up of information subsystems. In this sense, the general function of the operating sub-system has as its premiss:

To contribute to and become part of the business dynamic of the market, which produces benefits for the micro- and small enterprise, the central subject of the system.

This statement is put into practice within the functions of the SIC, through the implementation of the information process, in the following ways:

- Information to assist owners of manufacturing enterprises in their decision-making.
- Fast and timely mass communication of sales opportunities as demands arise.
- Promotion of products (goods and/or services) of the micro- and small business sector, to meet the demand.

### *Functions and operational structure of the service*

The operational procedure followed by the SIC in its work goes through the following processes (see Figure 8.1):

- Process 1. Compilation and updating of information; including the incorporation of an individual and his details into the system. As part of this process advertising space is sold to customers.
- Process 2. Systematic storage and processing of information; this is done on computerized databases specifically designed for the purpose.



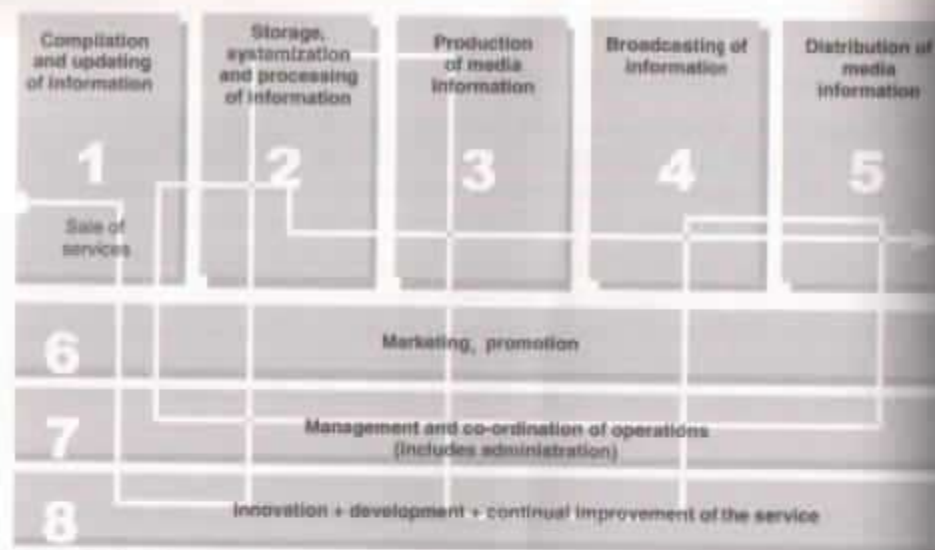


Figure 8.1 Operating procedures of the SIC

- Process 3. Production of information media; using the technological resources of the SIC through subcontracting to third party services, through building up strategic alliances.
- Process 4. Broadcasting of information on radio stations and in the newspaper *Buenos Negocios*.
- Process 5. Distribution and sale of *Buenos Negocios*, through strategic alliances.
- Process 6. Promotion of SIC through *Buenos Negocios* and through pamphlets, information at training centres and personal visits.
- Process 7. Marketing of information services, advertising on radio and in *Buenos Negocios*, through personal visits by SIC staff.
- Process 8. Continuous innovation implemented by SIC staff, using total quality techniques.

Table 8.1

Functions of the operating node	Functions of the centre of operations
<ul style="list-style-type: none"> <li>● Compilation and updating of information on the market to which it caters</li> <li>● Systematic storage and processing of information</li> <li>● Production of local media</li> </ul>	<ul style="list-style-type: none"> <li>● Compilation and updating of national information</li> <li>● Systematic storage and processing of national information</li> <li>● Production of national media: <i>Buenos Negocios</i> and others</li> </ul>
<ul style="list-style-type: none"> <li>● Publicizing of information in local media</li> <li>● Distribution and sale of local media</li> </ul>	<ul style="list-style-type: none"> <li>● Publicizing of information in media with national coverage</li> <li>● Distribution and sale of media with national coverage</li> </ul>
<ul style="list-style-type: none"> <li>● Relating with organizations, institutions or other local agencies, focal points</li> </ul>	<ul style="list-style-type: none"> <li>● Relating with operating nodes</li> </ul>

The operational structure includes the diffusion of operations, as shown in Table 8.1.

In this way two types of coverage have been generated, namely: 1) coverage for the collection of information which, as at December 1998, was installed in six major cities in the country (La Paz, El Alto, Sucre, Potosí, Oruro and Cochabamba); and 2) coverage for the dissemination of information which, as at December 1998 was effected through *Buenos Negocios* and covered 66 larger and intermediate cities around the country.

Along the same lines, in the collection and dissemination of information, two generic types of users of the service are generated: 1) the direct users (those who subscribe or pay for it), and 2) indirect users, those who ultimately receive the disseminated information.

Clearly, most users of the service are in the group that receives the information generated in the media.

### Specific products of the service

The products of the service to which the client has access are as follows:

- Participation in the National Business Information Network - at no cost to the client, only to appear on the service's databases. The target clientele for this network are micro- and small-scale enterprises, suppliers of raw materials and/or services and wholesalers who require goods and services from the MSEs (micro- and small enterprises). Many of the SIC's clients appear on the service's database, but this does not mean that the information will be published and advertised. For IDEPRO, having clients on the database makes it possible to channel opportunities in a focused way to clients. It also means that it has the data to produce additional information, which can be used as inputs for other IDEPRO services (such as the consultancy). The information in the databases is regularly updated as and when the client requests. It gives general details on the entrepreneur and the business, and the types and prices of the different goods and/or services offered or required by clients.
- Advertising in the newspaper *Buenos Negocios*, by payment for space in that publication. Space in the newspaper is bought by the client, who can advertise information as he wishes on the products or services offered.
- Advertising on the radio programmes *Buenos Negocios*, by payment for space on those programmes. Radio space is bought in mini-programmes of three minutes' duration.
- The target audience for the advertising on radio and in the newspaper are suppliers, potential purchaser companies and MSEs. There are also clients who advertise in the media but whose details are not registered on the database. These are short-term clients who pay for space, but are not regular customers.
- The newspaper *Buenos Negocios*, has a tabloid format of 8-12 pages. It is enclosed as a separate supplement in local daily papers. The target audience for *Buenos Negocios* consists of: 1) the end consumer and/or intermediaries and 2) the micro- and small business owners themselves. The price paid for the newspaper covers buying both the *Buenos Negocios* supplement and the main information section of the daily paper.



- Listings to order; there is a payment charged for this information, which appears as printed reports with special information, arranged according to the interest of the client. This service is the only way to gain direct access to the database of the service and is obtained through requests from clients for specific information. Access to the database can be made available to any interested person, for business or research purposes. However, care is taken to ensure that the database is not used to the detriment of any client's interests.

There is no provision for direct access to the database through a computer for two reasons: 1) a lack of demand observed in other systems of accessing information in this way, and 2) due to the connection costs and the type of information culture prevalent in the market.

Around 200 enquiries a year have been made nationally (by personal visits and telephone enquiries) for specific information from the database (600 enquiries over the three years that the service has been operating). The majority of these were made by suppliers interested in potential microenterprise customers and from companies interested in acquiring some specific goods and/or services.

In addition, a pilot scheme has been in operation, producing and broadcasting 60 *Buenos Negocios* television mini-programmes on the state television channel (Channel 7). These programmes give basic supply and demand information on the screen, with comments by the presenter. Viewers are given a telephone number they may call for more information.

### Some significant aspects of the development of the service

#### *Continual innovation in the media of information*

Innovation has been a constant feature throughout the operation of the service. In 1995, the dissemination of information began with the newsletter *Hojas Buenos Negocios* which, after six months, developed into a full newspaper format. In 1996, a year on, a coloured cover was introduced and six months later city editions were published. Newer formats for presenting information were progressively produced, ranging from general advertisements and comparative information tables to 'classified' advertisements.

This process of development has arisen by adapting to the requirements of clients. The result was increased income for the service on the basis of sales revenue from new products.

The innovative approach to radio media products has led to IDEPRO's decision to invest in the design of new programmes, aimed at expanding into general business educational material and a wide range of new publications.

#### *Forming strategic alliances*

Strategic alliances constitute a central feature of the operation of the information service. Since 1997, IDEPRO has entered into a number of agreements with other publishers. One example is an agreement with the daily paper *Presencia*

and with Channel 7 of the national television network, with radio stations in different cities around the country and with the Ministry of Employment and Micro-enterprise.

Among these, the joint venture with the newspaper *Presencia* is the one that has generated the greatest impact. The agreement was based on the following features:

- The business information service produces a specialized information product (*Buenos Negocios*) which, added to a 'conventional' newspaper, generates increased revenue for it.
- The target readership of *Buenos Negocios* (owners of MSEs) is an attractive large readership which generates opportunities for the morning paper to increase its market share.
- The agreement allows IDEPRO to offload some of its costs and take advantage of the distribution systems which the daily newspaper already has in place. Furthermore, it generates synergy in the promotional and marketing activities of both the *Buenos Negocios* publication and the newspaper *Presencia*.
- Finally, in working together there are economies in the costs of both participants (IDEPRO and *Presencia*).

This agreement has enabled the SIC to expand significantly from a fortnightly run of 2000 copies in 1996, to a weekly run of 20 000 copies in 1998, distributed through *Presencia's* network in 66 major cities and intermediate smaller towns throughout the country.

The national coverage makes the *Buenos Negocios* an attractive medium for the advertiser, and the income generated from the sale of advertising space to suppliers, MSEs and other companies has increased substantially.

This national coverage has fostered inter-regional communication between enterprises and their customers and suppliers in cities where their products are procured and/or marketed. This has already resulted in exchanges of technology: patterns and moulds for clothes manufacturing between entrepreneurs in Sucre and La Paz, supply of embroidery services between entrepreneurs in Oruro and La Paz, sales of leather-finished products between suppliers in La Paz and entrepreneurs in Oruro.

Following the agreement between IDEPRO and *Presencia*, other alliances have been formed, such as the agreement with Channel 7 of national television and radio stations in different cities around the country. This has brought the service to television and radio, at a relatively low cost to IDEPRO.

IDEPRO's range of information products focusing on business matters makes it an attractive partner for private and state-owned enterprises (such as private radio stations and Channel 7) to enter into agreements with it. There have been attempts by some radio stations to produce programmes similar to IDEPRO's, but they have always been short lived. The design of these undertakings has not succeeded in attracting an audience of entrepreneurs.

Finally, a series of agreements was set up with institutions and enterprises for the dissemination of information relevant to the sector. For instance, the agree-



ment with the Ministry of Employment and Teca (a supplier of products for the finishing of leather clothing and footwear), has greatly increased the information available on the sector. The information is then incorporated into publications.

The Ministry of Employment and Micro-enterprise operates an employment exchange for regulating supply and demand of personnel with particular skills. This information is published in the newspaper *Buenos Negocios*, initially free of charge, but with the intention that the Ministry will pay IDEPRO for the space in the future.

Teca, for its part, compiles technical articles on the treatment of leather and the finishing of products. These are then published free of charge in *Buenos Negocios*.

#### *A contribution to the image of the microenterprise*

With a view to aligning the expectations of enterprises of different sizes and facing various market conditions, new perspectives on the importance and role of MSEs have been put forward through SIC in the means of information it disseminates. Considerable work has been done on building the image of a sector that is capable of integrating with larger enterprises benefiting from the opportunities generated by such relationships.

The contribution to enhancing the image of the MSE is mainly channelled through personal relationships, the media and the promotional and publicity campaigns. These say, for example:

- Be well informed, it's a good way of doing good business, leading to better purchases and better sales.
- It's important to let the consumer know who you are, what you produce, what prices you offer and where they can find you.
- The more information you have about where to buy and where to sell, the better are the chances of improving your business.
- Doing business with micro-enterprises can be beneficial because there are many of them and they represent a good source of supply and demand for products and services.
- All businesses are looking for more buyers, and more suppliers.
- If you are on our database, it will be easier to find you when there are business opportunities in which you can become involved.
- Advertise in the newspaper or on radio. *Buenos Negocios* will publicize your products or services and your prices.
- Buy the *Buenos Negocios* newspaper and listen to the radio. The information gained will be of interest to you.
- Selling or buying the products of microenterprises can be good business for you.

These messages have succeeded in changing the information culture among MSEs and has made them aware of the opportunities that are available in new markets.

## Operating and financial results of the SIC (Tables 8.2, 8.3, 8.4 and 8.5)

**Table 8.2** *Buenos Negocios* media statistics

Item	Result (accumulated to December 1998)
Number of newspapers published	104
Number of radio programmes broadcast	3858
Television programmes broadcast	60
Access to the database (enquiries in person and by telephone)	600
Copies of newspaper sold	1 804 000

**Table 8.3** Evolution of operating statistics

Item	1996	1997	1998
Customers serviced by renewal and incorporation of information on the database	1171	4155	5447
Customers serviced through the newspaper <i>Buenos Negocios</i>	3506	6930	7225
Customers serviced through the <i>Buenos Negocios</i> radio programmes	4940	2615	1889
Enterprises registered on the database (Information Network)	352	1653	3890
These comprise:			
Micro- and small enterprise	201	1237	3339
Suppliers	107	359	491
Companies as buyers	44	57	60

**Table 8.4** Regional concentration of customer service in media (radio and newspaper *Buenos Negocios*)

City	1996	1997	1998
La Paz - El Alto	100%	85%	74%
Sucre	0%	4%	3%
Potosí	0%	2%	3%
Oruro	0%	8%	17%
Cochabamba	0%	1%	3%
TOTAL	100%	100%	100%

**Table 8.5** Evolution of financial statistics

Item	1996	1997	1998
Coverage of direct costs	12.3%	43.5%	64%
Coverage of indirect costs (preliminary data)	12%	16%	26%

### Goals for the future

IDEPRO has set ambitious goals for the SIC. More information will be provided in other areas of interest to the sector, but still concentrating on the technical and technological information, through the established operating frameworks. In the short term its goals are as follows:

- To generate more information channels by incorporating technical and technological fields and by making the existing media more specialized.



- To build up strategic alliances outside the country; to forge connections with information systems in neighbouring countries to extend the range of communication already established. As a first step, SIC will be oriented towards supporting trade on the country's frontiers.
- To improve the cost:benefit ratios of the service, with a view to making it more self-sufficient.

#### Notes

1. It is estimated that in Bolivia there were around 500 000 microenterprise units in 1998.
2. 'Conclusiones del Estudio de la problemática y canales de comercialización de la Microempresa Urbana' ('Findings of the study of marketing problems and channels in the Urban Micro-enterprise'), Zabalaga, Morales, IDEPRO 1993.

## 9. Review of export development services for small firms

CRESSIDA S. McKEAN

A GROWING APPRECIATION of the importance of the world market to small firms led many donors, including the US Agency for International Development (USAID), to expand significantly private sector development programmes offering export and investment services in the 1980s and 1990s. Between 1990 and 1993 alone, USAID provided grants of about US \$250 million a year to finance the provision of such services worldwide. Increasingly, managers in donor agencies raised concerns about the value and impact of business development services. They asked: Are export development services needed for small firms? And, if so, what works?

To respond to these questions, a worldwide assessment of USAID's experience with export and investment promotion services was conducted for USAID's evaluation office, the Center for Development Information and Evaluation (CDIE). The study examined four issues: 1) the rationale for donor intervention in the support services market, 2) the economic impact of USAID's investment, 3) export and investment promotion service strategies, and 4) effective service providers. Initially, the study reviewed projects in Latin America and the Caribbean, where nearly two-thirds of USAID private sector projects were being undertaken. Following a desk review, fieldwork was carried out in Costa Rica, the Dominican Republic, Guatemala and Chile, where successful programmes in relatively favourable policy environments were examined.<sup>1</sup> This effort was followed by fieldwork in four Asian countries: India, Indonesia, Korea and Thailand, where programmes in a variety of policy environments were examined.<sup>2</sup>

Two key study findings highlight the importance of the existing market for export services to understanding whether export development services are needed by small firms, and if so, what works.

- Don't ignore the existing market. It is a fundamental and all too prevalent mistake for donors and governments to overlook the existing market for export services when developing export promotion programmes.
- Exporters need a choice of service provider, because results at the firm level matter. To expand exports, business services have to give emerging exporters improved access to providers that they value most – often buyers and suppliers.

#### Background

A fundamental premiss of this study was that assessing the value of different services and providers calls for a better understanding of the existing market for service provision, apart from government or donor inputs. The study undertook a cross-country survey of nearly 300 exporters, including firms receiving services from USAID-assisted intermediaries and those not receiving such services. The



survey took 33 services provided directly to exporters and broke them down into five categories:

- Information (e.g. standardized information on foreign markets, country information on the investment climate).
- Contact-making (e.g. buyer contacts, trade fairs, trade missions, sample preparation, joint venture support).
- Pre-export or pre-investment support (e.g. feasibility studies, support for site visits, firm-specific research, legal, accounting or credit assistance).
- Technical assistance and training (e.g. production support).
- Government facilitation (e.g. customs assistance, help with government approvals, regulatory guidance).

The object of the survey was to determine what types of services exporters actually used, which ones had the greatest impact on their export growth, and who provided these services. The study drew extensively on interviews with more than 90 service providers: consulting firms, trade associations, government trade promotion offices, trading companies, buyers, foreign investors, and private non-profit institutions. The CDIE assessment report *Export and Investment Promotion Services: Do they Work?* synthesizes the findings from the survey and research, and provides insights into how donors might structure assistance programmes.<sup>3</sup>

### Why intervene with export development services?

Why should donors or governments intervene with support services to exporters? This study and other research<sup>4</sup> provide convincing evidence that policy measures do not automatically lead to a supply response. When trade reforms are first implemented, firms new to exporting often need to 'learn' the process of exporting. Even with stable monetary and fiscal policies, there are still a hundred reasons why firms do not export. They include government paperwork requirements, the indifference of shipping companies, corruption in the ports, inadequate legal arrangements for spoilage liability for perishable products between shipper and exporters, the absence of firms specializing in packaging, the inability to reach a buyer by phone, the inability of a buyer to get a visa easily. The list could go on indefinitely, but the central point is that the institutional weakness of countries new to exporting places firms at a serious disadvantage compared to firms in established exporting countries.

Donald Keesing and Andrew Singer<sup>5</sup> have argued that firms in developing countries are often unaware of their own inefficiency. Firms attribute too much of their inability to export to external factors and too little to their lack of efficient production. Import restrictions creating protected domestic markets have given entrepreneurs a false sense of competence. These entrepreneurs only slowly become aware of the critical roles that quality control, price and on-time delivery play in international markets. Once their eyes are opened to these factors, expanded access to buyers and support focused on production constraints can provide a means of lowering costs, raising quality, and increasing exports.

Our study found that filling in specific service gaps can speed up the private sector response to policy improvements, and can accelerate export growth. With

more knowledge and contacts, firms can achieve a higher level of export sales and more firms will enter the market. In short, intervention in the market for export services can be justified based on 'infant industry' and 'learning by doing' considerations.

Export services appear to have a positive impact on export growth and employment. Our survey evidence suggests that service use seems to correlate with strong export performance of firms in outward-oriented economies. Assisted firms (i.e. those receiving services from USAID-supported intermediaries) in Guatemala, the Dominican Republic, and Costa Rica had a significantly higher rate of export and employment growth than unassisted firms did. In Asian countries surveyed, assisted and unassisted firms had essentially the same export performance.<sup>6</sup> The difference in performance can be attributed to several factors. First, the projects in Central America were big in relatively small economies, whereas in Asia, projects were small in relatively large economies. Second, providers in Central America targeted services highly valued by the exporters surveyed (buyer contacts, production assistance) and actively involved private sector providers. In contrast, the survey in Asia concentrated on public sector providers and seemed to focus on services that emerging exporters did not want.

However valid these justifications may be for intervening in the export services market, the question needs to be asked: Are there already private providers extending such services to firms new to exporting? Is there market failure in the export services industry? Market failure was found not to be a compelling justification for donor intervention with support services in Thailand or Korea, where a dynamic private sector and relatively efficient markets already existed. But if policies tend to be favourable to exporting, if information gaps facing exporters are considerable, and the service provider market is still weak and inefficient, there may be a rationale for intervention.

#### Market failure in export services? Korea's experience

In 1960s, the Korean government and USAID assumed that intervention in the export services market through support to public sector providers, such as KOTRA, the Korean Trade Promotion Agency, was warranted. However, fieldwork and interviews confirmed that interventions by both the Korean government and USAID underestimated the considerable experience of Koreans in industry and exports during Japanese colonization. They ignored the substantial technical assistance to Korean firms already coming from Japanese, German, British and Australian firms, as well as the production and marketing assistance from importers and buyers in export markets. The study found that there was no significant failure in the private export services market in Korea, and that public sector providers had little impact on export firms.<sup>7</sup>

### Information gaps and highly valued export services

Information and contacts appear to play a crucial role in export success. The top five services valued highly by surveyed exporters could be considered 'export know-how'. Exporters surveyed reported that foreign market information, buyer



**Table 9.1 Manufacturing export firms: top ranking of services**

Service	% of firms citing as significant to export success
Buyer contacts	76
Foreign market information	63
Technical assistance for production	59
Country information	54
Sector information	53

Source: Survey data

**Table 9.2 Manufacturing firms' service use and value placed on services**

Service	% of firms using service	% of users valuing service highly
Foreign market information	50	91
Production technical assistance	56	90
Buyer contacts	62	87
Sector information	51	76
Country information	51	73

Source: Survey data

**Table 9.3 Export firms' use of government services (average number of services used per firm)**

Country	Total use	High value use	Critical use
Costa Rica	1.4	0.7	0.0
Dominican Republic	1.4	1.1	0.4
Guatemala	0.5	0.3	0.1
India	1.1	0.5	0.0
Indonesia	1.5	1.2	0.5
Thailand	3.3	2.1	1.1
Average	1.6	1.0	0.5

Source: Survey data

contacts and production-related technical assistance, country and sector information were the services that contributed most significantly to their export performance.

Since developing country firms typically produce to buyers' orders, exporters appeared to place a high value on the information and contacts that helped them to develop and sustain enduring relationships with their business partners, such as buyers, investors, suppliers. Study interviews with foreign buyers and importers further confirmed the importance of 'export know-how' on developing country suppliers of exports. This finding is consistent with the results of a survey of US buyers and importers. The survey found the top five criteria for purchasing imports from developing countries included: 1) meeting buyers' specifications for timeliness of delivery; 2) marketing in the USA; 3) meeting production quality standards; 4) providing reliable delivery; and 5) meeting style specifications.<sup>5</sup>

**Table 9.4 Export firms use of government services and service impact, Asia sample**

Service	India		Thailand		Indonesia	
	% of firms using services	% of firms impacted	% of firms using services	% of firms impacted	% of firms using services	% of firms impacted
Buyer contacts	5	0	29	26	15	15
Trade shows	18	14	53	32	48	30
Market information	23	9	12	12	18	18

Source: Survey data

**Table 9.5 Attribution for export success (ranking of sources by export firms)**

Source of Assistance	% of firms citing source as significant to export success
Buyer/supplier/partner	30
Other private sources (Business contacts/non-profits)	51
Domestic government	14
Overseas/foreign government	5
Total	100

Source: Survey data

### How do firms make buyer contacts?

Export firms rely heavily on importers and wholesalers, or on sources within their own firm (e.g. the manager's personal contacts) as their principal marketing channels. In South Korea, when exporters were asked in a 1970s survey how they made first contact with buyers, the most frequent response was through foreign buyers (40 per cent of the time). Exporters surveyed cited Korea's export promotion agency (KOTRA) least. Follow-up interviews with managers of export firms in Korea, Thailand and Indonesia cited buyers, business associates, and Japanese trading companies as the most important source of market-related services.

### Service use and service providers: give exporters a choice

Exporters in our survey obtained nearly 80 per cent of the services they valued most highly from sources external to the firm, but in most cases these firms did not use or value most services from government sources, typically from trade promotion offices (TPOs).

As Table 9.3 illustrates, exporters surveyed in Costa Rica, the Dominican Republic, Guatemala, Indonesia and India obtained few services and did not value highly the services received from government providers. Thailand and Chile were exceptional cases where government TPOs appeared to fill a service gap.<sup>6</sup> In both Chile and Thailand, the TPOs weeded out those not yet able to export, had technically qualified staff; and fully engaged the private sector.



In Thailand, 29 per cent of firms surveyed sought buyer contacts from the government, principally the Department of Export Promotion (DEP), and nearly all placed a high value on this information. Exporters in both Thailand and Indonesia also used, and gave high marks to, their government-sponsored trade fairs. Still, these are the exceptions.

Keesing and Singer came to the same conclusion about government service providers in their critique of TPOs.<sup>10</sup> TPOs, established often with donor support since the 1960s, mistakenly sought to provide a centralized permanent office in each developing country for trade information and market research, providing services free of charge, with little or no results.

The survey found that exporters gave the most credit for their export success to their personal contacts in the private sector, and their business contacts – buyers, foreign investors, and suppliers. Firms rated most of the services obtained through contacts with buyers and investors as having a significant impact on their entry into the export market or the expansion of their exports.

In the countries surveyed in the Central America region, firms credited the non-profit institutions or freestanding projects with mediating their access to highly valued services. The fact that export firms in the survey credited a variety of private suppliers of services suggests that diverse types of intermediaries, rather than one single provider, are needed to meet the varied needs of firms for 'export know-how'.

### Effective business development providers: a few examples

#### *Facilitating access to 'export know-how' through exporter associations*

One targeted export services programme in Central America, the Non-Traditional Agricultural Export Support Project (PROEXAG), later known as EXITOS, has been a successful model for export development services. The programme's strong links to emerging non-traditional exporter associations, such as the Association of Non-Traditional Exporters (AGEXPRONT) in Guatemala, supported its work with lead entrepreneurs with the potential to be successful. The programme created and strengthened private sector capabilities to provide training and technical assistance in skills related to production technologies and market information for small firms. With a clear understanding of firms' needs at different stages in the learning process, they helped local firms to negotiate with buyers and other commercial suppliers of valued export services.

Rather than providing services directly, the project facilitated access to small firms in the industry associations to the 'know-how' of private providers, helping to improve their capacity to produce export-quality crops, ship them on time and deliver them in the required condition on a consistent basis. This programme was effective in introducing commercially viable new crops, new production and post-harvest technologies, enhancing market linkages, improving the use of technical and market information, and significantly increasing exports by small firms.

A crucially valuable outgrowth of these programmes has been the stimulation of the private market for export service provision in Central America. Private sector associations throughout the region have significantly expanded their membership base and service delivery to small firms. For example, in Guatemala

small firms now constitute over half of the membership of AGEXPRONT. Membership fees and fees for services are currently financing the delivery of a wide variety of specialized courses and technical support for small firm's export needs.<sup>11</sup>

#### *Private market for business services through non-profit organizations*

The business service approach adopted by INSOTEC, a non-profit organization in Ecuador with strong links to small industry associations, is another example of a provider that seeks to stimulate the private market for service provision.<sup>12</sup> INSOTEC's technology services programme, which covers its costs, demonstrates the value of 'market-based' approach to business services. Lara Goldmark and Rosario Londono (1997) make this point as illustrated in the following passage:

INSOTEC has developed a business service model in which the provider actually integrates itself into the production process. Microentrepreneurs ... outsource certain production functions to INSOTEC for a fee. Blue jean makers go to INSOTEC's business service centers to have their buttonholes ... made by machine ... What differentiates INSOTEC from any other actor in the production chain is that they play a market development role, identifying services that are needed, providing them for a time while disseminating the new technology to the community, and then *pulling out of the market* once the local market begins taking over INSOTEC's functions.<sup>13</sup>

INSOTEC starts from the premiss that business development services have to be revenue generating and linked directly to the private service provider market. INSOTEC's approach is to offer services to the existing market and to adapt the services to the local situation facing small firms in a specific subsector. Its management and information systems are designed to support responsive decision making, and to innovate constantly. Increasingly, INSOTEC is a cost-effective and potentially financially sustainable provider of business services, with strong ties to the microenterprise sector, access to technical expertise, and sufficient flexibility to respond to services gaps.

### Qualities of outstanding providers of 'export know-how'

Our study examined the performance of some 14 different export service providers, including government TPOs, membership associations, non-profit private export promotion organizations, and highly targeted freestanding donor programmes. The study ranked providers by three measures of performance: 1) effectiveness in targeting the 'right' firms; 2) quality of services delivered; and 3)

#### **Few government trade promotion offices achieve success**

Keesing and Singer conclude that government TPOs are effective only in exceptional circumstances. First, the countries where the TPOs are set up need already to have achieved effective policies and a strong commitment to expand manufactured exports. They argue that TPOs rarely meet four key conditions: 1) the support of the business community, 2) adequate funding, 3) qualified staff that are paid competitive salaries, and 4) autonomy.<sup>14</sup>



### Guatemala: exporter associations help small firms export

Membership associations of exporters represent an important, under-utilized source of 'export know-how'. In Guatemala, small export firms surveyed rated very highly the buyer contact and market information services provided by AGEXPRONT. This exporter association has developed and maintained a strong private sector membership base, and has expanded its membership to smaller firms significantly. The membership exerts a strong leadership role, both through sector and product-specific commissions, and through ensuring that its membership fees cover the bulk of its operating costs.

private sector commitment. The first performance measure rates providers with sufficient autonomy and technical capacity to screen firms; many export promotion programmes fail because they facilitate buyer contacts with firms that are not yet ready to export. The second measure assesses whether firms value the service highly, which is often dependent on staff quality and significance to export success. The final measure examines private sector support and commitment.

The survey indicated that most government trade promotion offices studied are not high performing service providers. On all three measures, India's Export Promotion Councils (EPCs), Indonesia's National Agency for Export Promotion (NAFED), Korea's KOTRA, Costa Rica's Center for the Promotion of Exports (CENPRO), and Morocco's Center for Export Promotion (CMPE) were rated either fair or weak. Only Thailand's DEP and Chile's PROCHILE were rated good to excellent. The study based these rating of export promotion providers on previously completed independent project evaluations, field site visits, key informant interviews, and data on service use and impact drawn from the survey of exporters in each country (with the exception of Morocco, Korea, and Chile).

Ratings of the performance of private trade promotion organizations, private exporter associations, and autonomous targeted programmes (donor-sponsored) were more uniformly in the good to excellent range. They include: Fundacion Chile; Costa Rica's Coalition for Development Initiatives/Private Agricultural and Agroindustrial Council (CINDE/CAAP), Guatemala's AGEXPRONT, Central America's PROEXAG project, Morocco's Trade and Investment Services (TIS) and PACT in India.

What qualities do the higher-performing providers of 'export know-how' appear to have in common? First, the more effective intermediaries tend to be responsive to the needs of firms at a given stage in the exporting process in a specific subsector, be it melons, blue jeans or raspberries. Exporters have different types of information and technology requirements at different stages in their learning process. The advantage of exporter associations and more autonomous private or non-profit intermediaries is their flexibility and responsiveness to specific private sector requirements. Unlike government TPOs, they can facilitate small firms' speedy access to information sources about the market and help negotiate better terms to get high quality services.

Second, effective service providers are generally technically competent, and their management and staff can facilitate access to appropriate sources of 'export know-how'. Learning how to produce and get exports of cut flowers, frozen shrimp or snow peas to developed country markets is product specific, and may be technically complex. Unless the firm can access 'know-how' directly relevant to closing a deal with a specific buyer, it will not be effective. In other words, the practical relevance of the service matters.

Another factor contributing to effective service provision is the programme's linkages to key players in the services markets and the private sector. With high quality technical staff, strong relationships with buyers and other sources of expertise, and ties to industry associations, such programmes had a greater potential for meeting exporters' needs and delivering results. Service providers' contacts and linkages to the business community are crucially important to their effectiveness. Export firms have mostly been dissatisfied with the performance of the government TPOs, principally because they lack a genuine understanding of private sector priorities.

Firms are also willing to pay for highly valued services. Effective providers such as AGEXPRONT in Guatemala and INSOTEC in Ecuador have demonstrated that cost recovery for export services is not just feasible, but can be integrally related to the sustainability of service delivery. Recent cost-sharing initiatives, in which exporters risk their own money and identify their own private sector providers, follow this trend. Such programmes are being piloted in Sri Lanka, Indonesia, Ghana and Kenya.

Service strategies are most responsive to small firms' export needs when they are sector specific, results focused, and linked to the existing support services market. More effective providers have helped mediate the relationship that small firms develop with the market for business development services. It is important that the institutional structure of the support service entity is compatible with the type of service provided. For example, membership-based trade groups, such as exporters' associations, have often been effective in providing basic information on buyers and foreign markets. But given the diverse membership, some associations lack the autonomy, more typical in the case of private non-profit organizations, to respond effectively to sector- and firm-specific needs.

### Some conclusions about structuring export service programmes

The following are some of the lessons on structuring export support services programmes:

- Focus should be on export growth at the firm level. The more successful export support service programmes reviewed were those that focused on facilitating firms' access to 'export know-how', enabling them to secure a buyer and expand exports in that market.
- Build on intermediaries and programmes with a substantive and active involvement of the private sector. The providers typically rated highest had strong ties to the business community and well-established links to information on buyers, suppliers and other private sector providers.



- Ensure that service mix of 'export know-how' is responsive to the export firm's needs in its 'learning process'. Firms in the survey placed a high valued on 'export know-how', and ranked five services as contributing significantly to their export growth: foreign market information, buyer contacts, production-related technical advice or assistance, country and sector information. Intermediaries must have the technical capacity to respond effectively to specific service needs of export firms.
- Structure service strategy to ensure that export firms have access to a variety of sources of 'export know-how'. Export firms in the survey credited a variety of private suppliers of services, which strongly suggests facilitating access to diverse types of intermediaries, rather than one single provider, is desirable.
- Give due attention to the existing market for export services in structuring an export promotion programme. Small firms surveyed valued services from importers, wholesalers and their business contacts, and other private sector sources. Therefore, the service strategy developed must strengthen the ability of the export firm to negotiate access to this 'export know-how', independent of the public sector.
- Government providers are not generally effective sources of 'export know-how'. The majority of export firms in our survey did not value services when they came from government sources, typically TPOs. Most government TPOs studied were not high-performing service providers. However, if considering a government TPO as an option, ensure that four key conditions are met: the support of the business community, adequate funding, technically qualified staff who are paid competitive salaries, and managerial autonomy.

### Challenges to consider

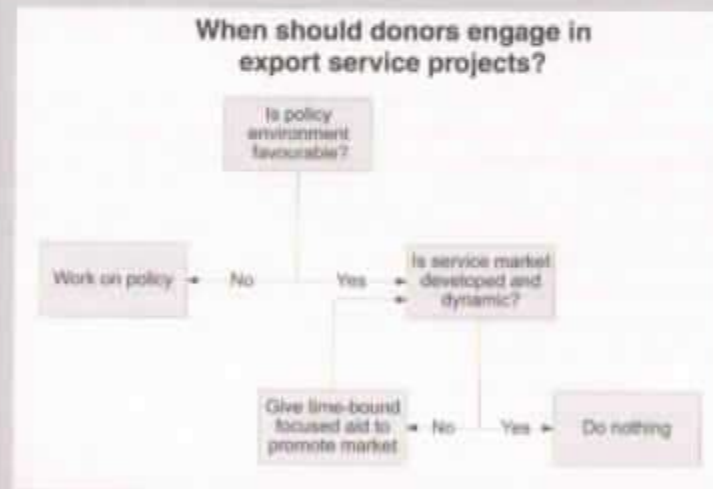
There are many challenges in sustaining effective business service programmes for small firms. Few export services programmes have been able to demonstrate their impact at a sectoral or national level. Examples already mentioned include Guatemala's exporter association AGEXPRONT, the targeted freestanding programme in Central America (PROEXAG /EXITOS), Thailand's DEP, and PROCHILE. Most other performing programmes are still at the pilot stage, yet to be scaled up. It will be difficult for governments and donors to justify the investment, unless the demonstration effect and wider application of the more effective business service programmes is better documented and disseminated.

A second challenge is sustainability of service provision. Innovative service providers, such as INSOTEC in Ecuador and AGEXPRONT in Guatemala, are actively and successfully adopting fee-based services and generating revenue through service provision. However, cost recovery is the exception, and by no means standard practice among providers of export development services. Most intermediaries reviewed for this study provided export services free of charge. As a result, they are either totally dependent on government aid or budgets, as is the case with TPOs, or are reliant on temporary infusions of funds from donors. What is needed is greater documentation and dissemination of the results of these

### Conceptual framework for export development service programmes

One outcome of this study has been the development of a decision tree for donors and governments to consider when embarking on export service programmes.

- Focus first on the policy environment: has trade been liberalized enough? Are macroeconomic and trade policies, and the business environment sufficiently favourable?
- If not, there is little justification for intervention with firm-level export services. If policies and the business environment are favorable, focus on the export support services market: are buyers, foreign investors, and private associations able and willing to respond to the demand for services?
- If the private business service market is too underdeveloped to respond, focus on identifying the 'gap' and the justification for intervention, which will facilitate access to private sector providers and develop the market for service provision.
- Once exports have taken off and a well-functioning service provider market has developed, there is less rationale for intervention except when special problems arise



experiments with fee-based services and cost recovery to increase the potential for more sustainable service provision.

Finally, governments and donors have a responsibility to reduce the significant bureaucratic, regulatory and infrastructure burdens facing small firms. Consistently in interviews, managers of export firms, importers, wholesalers, and machinery suppliers, complained about the ports, customs, telephones, labour, corruption, and land titling, as factors stifling export growth. 'Export know-how' does improve export firms' and other stakeholders' ability to cope with these difficulties, but that does not take away the fundamental need for improvement in the infrastructure to be more supportive of export growth.



## Notes

1. The fieldwork culminated in a published study, *Export and Investment Promotion: Sustainability and Effective Service Delivery*, USAID Programme and Operations Assessment Report No. 2.
2. Published country studies include: *Export and Investment in India*, A.I.D. Technical Report No. 16, *Export Promotion in Indonesia*, A.I.D. Technical Report No. 6, *Can Export Services Make a Difference? The Korea Experience*, A.I.D. Technical Report No. 7, and *Export and Investment Promotion in Thailand*, A.I.D. Technical Report.
3. McKean, C. and Fox, J. (1994), *Export and Investment Promotion Services: Do They Work?* USAID Programme and Operations Assessment Report No. 6.
4. Y. W. Rhee (1989), *The Role of Catalytic Agents in Entering International Markets: Preliminary Findings from a Review of Export Success Stories in Eleven Countries*, Industry and Energy Department Working Paper, Industry Series Paper, No. 5, Washington, DC, World Bank. Keesing, D. and Singer, A. (1990), *Development Assistance Gone Wrong: Why Support Services Have Failed to Expand Exports*, PRE/WP/WPS 543, Washington, DC, World Bank.
5. Keesing and Singer, op. cit.
6. McKean and Fox, op.cit., pp. 50-53, Tables 17 and 18.
7. See USAID's Technical Report No. 7, *Can Export Services Make a Difference? The Korea Experience* *Passim*.
8. Vernon-Wortzel, H., Wortzel, L.H. and Deng, S. 'Do Neophyte Exporters Understand Importers?' *Columbia Journal of World Business* 23 (4): p. 52.
9. In Chile, the study did not undertake a full survey, but relied on extensive interviews with key informants, such as importers, wholesalers, managers of export firms, government and non-profit providers, etc.
10. Keesing, D. and Singer, A. op. cit.
11. See, for example, 'Export Marketing for Nontraditional Products: Guatemala', Presentation by Fanny de Extrada at the IDB Conference, 'Building a Modern and Effective Business Development Services Industry', March 1999.
12. While the experience of INSOTEC in Ecuador was not part of this USAID assessment, the author has followed its development over 10 years. Also see paper describing INSOTEC's activities in Chapter 7 of this volume, which gives a fuller account of the introduction of technical services to microenterprises.
13. Goldmark L. and Londono, R. (1997), *Technology Access Services for Microenterprise*, Best Practices Series, Inter-American Development Bank, Washington DC p. 5.
14. Keesing and Singer, op. cit.

## 10. Swisscontact's business centre approach in Peru

JUAN H. HAGNAUER, CECILIA RIVERA and JOSÉ A. VALCÁRCEL

### The concept

#### Introduction

SINCE ITS FOUNDATION IN 1959, Swisscontact has been a Swiss NGO working with the Swiss Development Cooperation (SDC) convinced of the crucial role of the private sector in economic development. Accordingly, support from outside, through international donors should support institutions providing services for private businesses.

Swisscontact operates in around 25 countries in Latin America, Eastern Europe, Africa and Asia, prioritizing three strategic aspects: professional/vocational training, environmental protection, and small enterprise development.

During the 1990s, Swisscontact focused on the meso-level by supporting institutions supplying services to small enterprises. Lately the tendency has been to promote the market for business development services (BDS), improving the supply of such services and increasing the effective demand for BDS.

#### The importance of BDS

Discrimination of the agricultural sector in many developing countries and protection of industrial sectors has encouraged migration to the urban areas. People migrating from rural areas added to the fast-growing urban population have led to the expansion of the so-called informal sector, extensively written about by Hernando De Soto of Peru. As a consequence, the resulting industrial structure is characterized by few inefficient large state-owned enterprises, often with monopolistic positions and a vast number of informal micro- and small enterprises competing with each other at a rather low technical level.

Globalization has externally changed the environment for small-scale enterprises in most developing countries. Structural adjustment in reducing the public sector have increased the number of people seeking livelihoods from the informal sector. Lack of technological know-how, lack of access to finance, inadequate concepts on marketing, etc. are just a few problems of the steadily growing number of micro- and small entrepreneurs in the informal sector. Governments find it difficult to improve quickly the conditions for small-scale enterprises, which includes many actions in fields such as legislation, taxation and custom systems. As a consequence, most micro- and small-scale enterprises have difficulty facing the competition of imported products of higher quality and so little improvement in their quality of life.

In order to overcome this difficult situation various measures are needed. First, governments have to accelerate their reforms in order to improve conditions for the private sector (decentralization, acceleration of deregulation, better infrastructure, tax reforms, etc.). Private enterprises have to seek new forms of



collaboration with each other; especially, coalitions between large enterprises and organized groups of small enterprises have to be developed in order to attain economies of scale. Last, but not least, the supply of BDS, including the training for entrepreneurs, have to be developed further. In this process of improvement of BDS delivery, international co-operation can play an important role. Such BDS have to be demand-driven within a competitive environment, including financial, non-financial and technical services. The final aim must be to improve the competitiveness of small enterprises, even if it is clear that not all existing small – and especially microenterprises – will be able to grow or even survive. An effective supply of high quality BDS should help to empower the best of them with the necessary tools for their long-term development. However, BDS can be only a contributing factor to economic development – the success of an enterprise depends primarily on the entrepreneur's drive, skills and readiness to take risks.

### Swisscontact: the business centre approach

#### *Introduction and context*

In recent years, Swisscontact has tried to resolve one of the core problems concerned with promoting small enterprise development at the meso-level: how to develop institutions that can deliver a range of BDS to SME clients effectively and on a sustainable basis.

Sustainability of intervention is a fundamental issue for all development agencies. It is also one where the experience of industrialized nations is of limited relevance; here, the meso-level of business support is based on a scale of state aid beyond the limited resources of most developing economies; it is often distorted by a mixture of social, political and economic objectives and is based on institutional structures that historically have developed from different legal and cultural traditions. Moreover, conventional aid projects often appear to create aid-dependent institutions whose main orientation is towards donors rather than clients. However, existing research does clearly indicate the key characteristics that the most successful BDS organizations should possess, most important being:

- a businesslike approach to management, product development and delivery
- a transactional, demand-led relationship with clients

Swisscontact has developed a distinctive and innovative approach to financing and developing intermediary institutions. This is not a service-specific methodology per se but rather is concerned with creating a framework of rules and a set of support instruments with the objective of institution development ('business centres') capable of delivering a range of appropriate services in an effective and competitive manner. The approach is underpinned by a belief that:

- there exists a number of non-governmental BDS providers with potential for growth
- market relationships offer the best opportunity for sustainable and effective BDS delivery
- markets for BDS for SMEs are currently underdeveloped in many places, or virtually non-existent

- markets can be stimulated by the development of more facilitator BDS institutions (business centres) and by increasing effective demand for BDS (promotion, training vouchers, fellowships for entrepreneurs, demand-side intervention).

This business centre approach was first developed in Swisscontact's work in some Latin American countries. More recently it has been refined significantly in Indonesia and Peru, providing a comprehensive approach on how agencies can intervene to develop institutions, which are demand-led, businesslike, and which can offer effective services on a sustainable basis for their clients.

#### *The services*

The business centre approach to develop BDS institutions is not one that is based on specific types of services for SMEs. In Indonesia, for example, where six business centres have been supported, services include workshop diagnosis, specific technical skills training, technology advice and business administration services. These are usually sector-specific business centres – such as catering for metal, automotive products and tourism businesses. In Peru, where Swisscontact is currently supporting nine business development centres (BDCs), a non-sector-specific BDC offers marketing services to enterprises in sectors of garment manufacture, agro-industry, carpentry, etc. The BDCs have to reach a level of specialization in response to demand, be it by type of service or specific sub-sector.

More important than the specific services being offered by business centres is 'how' they are offered. The business centre approach encourages them to deliver services that:

- are carefully costed
- are responsive to the demand of clients, and are therefore focused and relevant
- evaluate BDS relevance and quality through pricing and income-generating capacity
- concentrate on services that are most profitable.
- optimize product mix for attracting and retaining clients.

#### *The client base*

Clients of business centres are usually small to medium-sized enterprises. In order to obtain cost recovery and to meet their financial targets, most, if not all, clients need to be from above the micro-level. (This, of course, will depend on the cut-off limits in the country's definition of micro-businesses.) As a guideline, clients of business centres are expected to have a yearly turnover of US\$50 000 to US\$1.5million, a workforce of between five and 200, and assets (excluding land and buildings) of below US\$0.5million. These criteria will not be used to exclude clients from being attended by the BDCs, but not all BDC clients receive incentives from Swisscontact's scheme. This focus on formal sector SMEs (rather than on those at a more micro- and informal level) is based on the view that these enterprises are a source of dynamism and employment growth in successful competitive economies. They represent the vital link in the economic tissue and are essential for growth of clusters.



Microenterprises at subsistence level can be helped by BDCs as long as a funding agency (government, donor) pays a major portion or all costs. In fact, this is an interesting client base for BDCs; however, it has some inherent problems:

- The BDC tends to focus attention on the demands of the funding agencies and not on the needs of the entrepreneurs
- This client segment is unpredictable and instable in the medium term.

Some business centres tend to work intensively with a relatively small number of clients. In Indonesia, client outreach targets are set for each business centre (20 to 50 new clients per year). However, these are less important than financial targets. In the Peru experience no such limitations on number of clients are set. However, a BDC involved in marketing and subcontracting will by nature tend to develop a small base of SMEs with reliable product quality, rather than searching for large outreach (although this might interest donors more!).

Swisscontact tries to give priority to business centres that work with SMEs where there is a relatively good opportunity to focus on gender and environmental aspects in client services. Overall, the logic of the approach however, is *not* to impose too tight restrictions on who business centres may work with, but to let a market self-selection take place.

#### The BDS providers and BDC operators

In Peru, as in most other countries, there are a wide variety of BDS providers. At the lower end of the client size scale these tend to be dominated by NGOs supported by donor agencies or state institutions. Larger SMEs may find that commercial BDS providers, such as individual consultants, are offering competitive services. In addition, there are a variety of informal learning mechanisms in many business sectors – sometimes through business associations – or even through linkages with larger companies or networking among SMEs themselves in a cluster in both formal and informal groups.

The selection of potential BDC operators is based on an assumption that they know their market best and the range of their capacity to deliver services. Therefore, Swisscontact has opted to offer its support to those interested in operating a BDC.

In selecting business centres to support, Swisscontact tries to find genuine gaps in the market, identified by the interested BDC operator. Indeed, as part of the tender process, prospective business centres are asked to set out who are their competition for each major service. In addition, the tender process for new business centres is open to any kind of organization – associations, private businesses, NGOs, higher education or research institutions, etc., and tries to build on existing BDS institutions rather than creating new ones.

#### Financial sustainability

*The importance of economic feasibility.* The entire process of institutional development of business centres is founded on transparency and accuracy in financial reporting. This allows detailed financial targets to be agreed for each business centre, which are laid out in the contract between it and Swisscontact. A

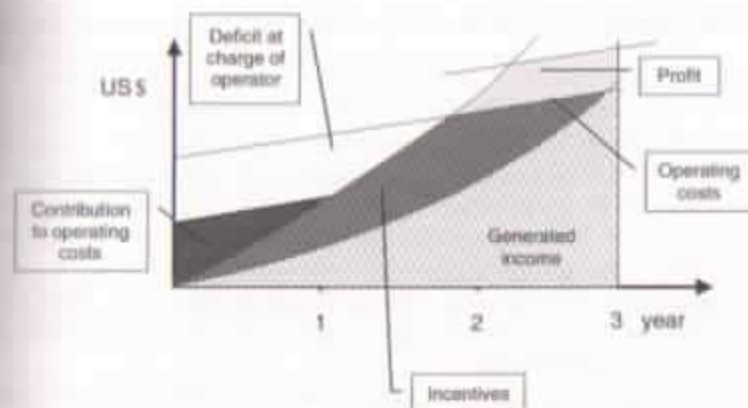


Figure 10.1 Swisscontact's financial support mechanism

number of key financial indicators are used to assess the performance of business centres, including:

- financial sustainability: this is the most important performance indicator; performance targets are set against it and it is the basis for Swisscontact financial support. Current targets require that business centres achieve 100 per cent self-financing within 2–3 years.
- the efficiency of delivering different business centre services (inputs per client)
- the efficiency of delivering different services (inputs against deliverable outputs)
- the gross margin contribution of different services.

Each service in a business centre portfolio is subject to cost breakdown (selling price, working hours, direct costs and gross margin) and provides a high level of detail for the analysis of services.

*The financial support mechanism.* Figure 10.1 illustrates the basic relationship between costs, income, deficits and Swisscontact's financial support mechanism. In practice, a number of different variations and refinements are developed in Indonesia and in Peru.

#### Institutional development

Swisscontact has developed a relatively sophisticated tool to implement this approach, which is based on a straightforward concept.

- The development of businesslike institutions is encouraged by an immediate funding environment which simulates 'real' market and business conditions.
- BDCs seek to stimulate the behaviour of small enterprises with growth potential, i.e. they start small and grow according to results. The financial support is closely linked to this evolution and is in strong contrast to other approaches, which start with strong front-end support and plan to reduce their input towards the end of the period of donor co-operation.



In practice, the approach has a number of key features.

- Selection through a competitive tendering process: prospective operators of business centres bid against each other for the contract to set up a business centre. The proposals must include detailed business plans and a financial commitment from the bidder, sharing investment costs and assuming start-up and potential medium-term deficits. This procedure assumes that there are sufficient institutions with the required level of organizational development and operational capacity. Swisscontact selects the ones considered to have the most potential to undertake the setting-up and operation of the centre. Thus, since it is assumed the bidder has the capacity to carry out the role, institutional development is of less importance.
- No restriction on legal status: business centres have to be formal organizations eligible to provide services to the private sector, but otherwise there is no restriction on their legal form. In practice, they may be NGOs or private businesses, technical or academic institutions, associations or public agencies capable of entering into legal contracts and issuing formal invoices.
- A contractual relationship: successful bidders enter into a detailed contractual relationship with Swisscontact specifying the responsibilities of each party.
- Based around financial incentives: Swisscontact's financial support for business centres is based on agreed financial performance targets. Meeting these targets produces rewards; not meeting them results in penalties. The amount of donor support has a realistic correlation with the potential of income generation in the specific market. In Peru, Swisscontact's total direct financial contribution per BDC for a five year period is approximately US\$100 000.
- A strong emphasis on monthly financial reporting: this is required both for the incentive system at the heart of the contract and to help business centres with their own internal planning, organization and information management.
- Non-financial support: in addition to the conditional financial support, Swisscontact offers non-financial support to business centres in the form of information, product development, staff training, market surveys and networking support. It is important to note that this support is based on the specific needs of each BDC and is to only a very limited extent an institutional development effort. Rather, it aims to be better informed to help the centre to perform the task. Therefore, it can hardly be described as training programmes for BDC operators and managers.
- Time-bound: financial support is limited, phased throughout the period – during the pre-operational, start-up and consolidation phases. In Peru, Swisscontact operates a 2-phase support system; during the first three years incentives are based on sales of services, and in the second phase (two years) incentives are based on sales per target group and service quality.

#### *Impact*

Impact can be measured by financial targets and clients' willingness to use and pay for services. Swisscontact also monitors the actual changes brought about by

services in client businesses and in their attitudes to business centres. The extent of client outreach is also a gauge of impact.

*Levels of intervention.* It is important to differentiate impact at three levels:

- Impact at the macro-level: can be measured through the effects of better performance of enterprises at the macro-level economic indicators (sales, exports, employment). Other indicators are based on the overall investment in SME promotion and income generation in taxes.
- Impact at the meso-level: If a programme has as its objective to improve the BDS market, we can assume that the presence of a new supplier, who responds to a certain demand, can be considered an impact. BDCs expect to intervene in the market, recruiting more entrepreneurs to become clients as they come under increased pressure to survive in the market, to be successful suppliers of products or services and to improve profits.
- Impact at the micro-level: This is obviously the most ambitious objective: to affirm with certainty that donor intervention supporting BDCs and BDS produces positive changes in the enterprise clients, manifested in financial results and employment figures. Impact may also be measured in other areas: for example, in services such as training. Some specialists affirm that the real impact is the change achieved in the outlook and attitude of the entrepreneur through new knowledge, information and better management. It is important to identify the changes produced in the enterprise, for example in cost control, greater productivity, better marketing, etc. These changes in the enterprise must result in increased income and profit, which will be the decisive impact at this level.

In all cases, it is important to analyse cost/benefit ratio of the monitoring. There must be a reasonable relationship between investment in the project and the amount spent on impact evaluation. It is also important to set out who is to finance the evaluation in order to avoid burdening BDCs with costs and efforts that might not be really relevant to their entrepreneurial objectives.

*Where/how do we intervene – Where/what do we measure?* It is important to consider the point of intervention, and the point of measurement for evaluation. The 'greater' the distance between these two points, the higher the risk that the result may be distorted by external factors. As Swisscontact promotes BDCs, the measurement is really of the effects of this intervention on the development and sustainability of a new player in the market: the centre. There may, however, be more difficulty in relating this intervention to, for example, a client's 20 per cent increase of sales. This is especially important because enterprises are dynamic entities, in permanent relation with many factors. This condition presents a challenge as to how to isolate the effects of the BDC intervention from other influences. An example from a BDC may be where a client has lost 10 per cent one month after taking the service. Impact may therefore look negative, but maybe without the service provided by the BDC the company might have lost 25 per cent, but this is very difficult to verify.

Before thinking about impact measurement we must first look for the services a BDC is providing (technical assistance, training, advising), and whether it is possible to collect the required data in a follow-up.



**Instruments.** At the macro-level, there is need for econometric models, which can help relate microenterprise productivity and macro-economic indicators.

At the meso-level, where Swisscontact has focused during the past few years, monitoring BDC performance can give us clear results in the principal indicators: income, costs, number of clients assisted, profitability, self-sustainability. This may give an indication if the trend is towards viable players in the BDS market.

The indicators at the meso-level may also show impact at the micro-level. Many assert that the entrepreneur's willingness to use and pay for services reflects the importance and benefits ascribed to these services. Entrepreneurs will not, it is agreed, pay market prices for services if they don't find them useful. Still, whether entrepreneurs' satisfaction is a decisive indicator of positive impact or not, Swisscontact carries out a limited number of surveys on clients, to find out whether they were satisfied with the services and found them useful.

Even though Swisscontact has an interest in keeping measurement at the meso-level, it is still regarded of interest to obtain information at the entrepreneur level. It is not considered worthwhile comparing behaviour of groups with and without services provided. There are too many external factors bearing on the results, so it is difficult to isolate causal effects of the BDC intervention. It is also considered too costly.

Swisscontact proposes to develop a questionnaire for the clients of BDCs to complete some months after the service. This survey will ask how the new knowledge, information or technology acquired has been applied in the company, and what benefits (if any) the company has derived. Can the client identify cost reduction, increase of sales, better financial management, increase of productivity after the service? What improvements have taken place? Finally, the managers of the BDCs themselves should be interested in collecting this information, as they can learn a great deal from the benefit their clients may consider they have derived from their services.

## How the approach works in practice in Peru

### Introduction

In 1994 the SDC started to prepare an SME promotion programme in Peru to stimulate and/or improve the BDS market in Peru. SDC intervention was mainly at the meso-level, with some support at the macro-level, to press for deregulation and to develop better policies for SME development. At the end of 1994 SDC contracted Swisscontact to implement the programme known in Peru under the name DESIDE (Desarrollo Eficiente del Mercado de Servicios Incentiva la Demanda Empresarial) which, in 1999, consisted of the elements shown in Table 10.1.

In the early stages of programme, efforts were made to combine elements from the standpoint of donor agencies and those from the private sector to be as much in tune as possible with the present Peruvian environment, which is strongly influenced by the concepts of liberalization and globalization.

Figure 10.2 shows the elements of this programme design.

Table 10.1 Elements of the DESIDE programme

Level	Strategic fields of intervention
Macro-level	<ul style="list-style-type: none"> <li>Support the improvement of environmental management capacity of the Ministry of Industry</li> <li>Develop pilot experiences in the field of local economic development and regional competitiveness</li> <li>Participate in inter-institutional coordination (donors, government, private sector)</li> </ul>
Upper meso-level	<ul style="list-style-type: none"> <li>Develop and introduce improved methodologies for SME training and consultancy</li> <li>Develop monitoring instruments for assessing performance of SME promotion programmes</li> <li>Conduct BDS market research and provide relevant information to market actors</li> </ul>
Lower meso-level	<ul style="list-style-type: none"> <li>Promote the establishment of sustainable BDCs</li> <li>Develop, test and replicate BDC model</li> </ul>

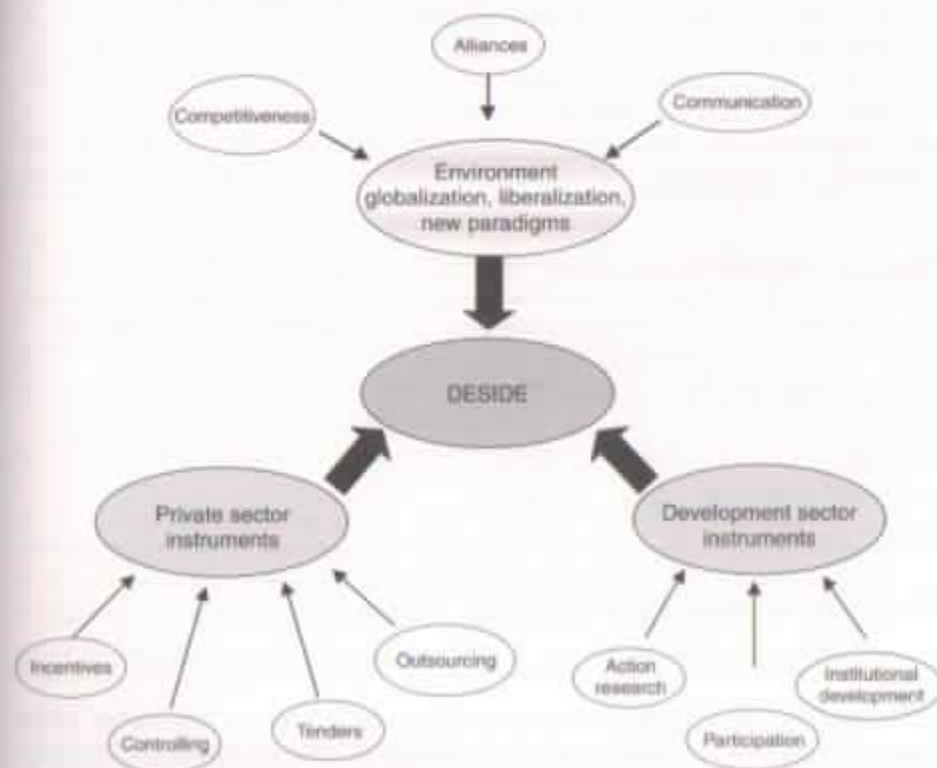


Figure 10.2 DESIDE programme design

### The selection process

As in any process of this sort, tender documents have to be elaborated together with evaluation instruments and selection criteria. Swisscontact then sets out the



tender procedures, deciding on the process of inviting bids and whether it is carried out in one step or by shortlisting and pre-qualification procedures.

In Peru, Swisscontact has so far conducted two tenders, in 1995 and in 1997, for which the steps were as shown in Table 10.2.

Only operators from outside Lima were invited to participate in these tenders.

The Table 10.3 shows the breakdown of the 44 participating institutions that applied, broken down by type of institution.

It is noteworthy that hardly any trade association nor chambers of trade and industry participated in the process, probably due to their knowledge of Swisscontact's strong views on income generation and self-financing.

**Table 10.2 The tender process**

Following public announcements in two newspapers with nationwide circulation	No.
Tender documents sold at @ US\$ 20 each	99
Documents received for pre-qualification	44
Pre-qualified institutions	18
Proposals selected for funding	4

**Table 10.3 Participating institutions in Peru**

Type of institution	Presented documents	Prequalified	Selected
NGOs	22	12	3
Consulting firms	14	4	1
Trade associations	3		
Universities	3		
Government programmes	2	2	
Total	44	18	4

#### *Contents of the tender – offered support*

The main characteristics of the last tender conducted in Peru are shown in Table 10.4.

The main criteria for evaluating the offers were centred on knowledge of the target market and proposed services, delivery capacity, economic performance and quality of human resources (staffing).

Arising from the tendering process, each BDC should have a full business plan, which is the basis for monitoring the financial performance. As the financial support system needs up-to-date information, monitoring is built around this key indicator. Peru has probably the most advanced monitoring system covering not only financial aspects, but also information on the sector and market involved.

**Table 10.4 Main characteristics of the last tender**

Location	Outside Lima metropolitan area
Ownership	Single owner as operator
Self-financing	Self-financing to be reached within three years, income generation is sought from the start, and Swisscontact's contribution is limited in time
Co-investment and incentives	Co-investment at all times, for initial investment as well as for operating costs (up to 50%)
Financial contributions	Up to US\$60 000 for three years, where from \$5000 for initial investment and up to \$10 000 as contribution to operating costs during the first 12 months
Non-financial support	Technical assistance and staff training for BDCs on a demand basis and outside the above amounts
Performance information	BDCs have to provide performance information, as per schedule and formats established by Swisscontact

*BDCs soon began to focus on specialized services, as will be seen from the examples.*

*BDC Mercadeando.* BDC Mercadeando specializes in marketing training and consultancy. They offer very general seminars for SME in marketing, and recruit SME clients to whom they offer their marketing consultancy services, usually through the seminars.

#### General characteristics:

- Clearly defined service package systematized.
- The participatory methodology used improves self-confidence of entrepreneurs and gives very good results with female entrepreneurs.
- The entrepreneur is involved in the improvement process.
- Operational tasks are transferred to the entrepreneur and his staff, reducing the investment of consultancy resources.
- During 1998, 500 hours of consultancy service was sold in Peru and 300 hours in Bolivia.
- The target for 1999 was to sell 1500 hours of consultancy services.
- The product is sold to entrepreneurs as well as to second-tier institutions.
- 10 per cent discount is given on large sales volumes.
- There is no product competition in other Latin American countries.

Staffing: manager, junior consultant, secretary, one associated consultant

*BDC Servicepi.* BDC Servicepi has developed a specialized subcontracting service, where the BDC participates in tenders from large companies and government institutions for office uniforms and working clothes. Once Servicepi wins a tender it organizes a number of SMEs to produce and fulfil the contract.

#### General characteristics:

- Systematized and well defined service package for the attention of local and foreign buyers.
- Sales as per demand.



**Table 10.5 Product: Bull sales**

<i>Clients need</i>	<i>Increase sales level</i>		
Description of the service	Internal and external diagnosis Explore solutions Work out proposals for improvements for short, medium and long term		
Final product	Custom-made marketing strategies, which are immediately applicable		
Benefits for the client	40% increase in sales within 30 days, (up to 600% increase in 90 days was obtained in one case)		
Human resources needed	<b>Activity</b>	<b>Level of staff</b>	<b>Time involved</b>
	Client training	Junior consultant	1 hour
	Analysis	Junior consultant	2 hours
	Exploration solutions	Junior and senior consultant	1 hour
	Proposal for changes	Junior consultant	1 hour
	Dialogue with client	Senior consultant	1 hour
Financial analysis of the service	Price: 5hrs @ US\$25,	US\$125	
	Costs 6hrs @ US\$13.45	US\$80.70	
	Gross margin, US\$	US\$44.30	
	Utility, %	54.9%	

**Table 10.6 Product: Market expansion**

<i>Clients (SME) need</i>	<i>Increase sales level</i>		
Description of the service	<ul style="list-style-type: none"> <li>• Identification of and preparation for participation in tenders from private enterprises and public institutions</li> <li>• Preparation of samples</li> <li>• Price negotiations with providers</li> <li>• Preparation and presentation of tender documents and other requirements (samples, bank guarantees, etc.)</li> <li>• Negotiation and signature on contract</li> <li>• Help in locating working capital</li> </ul>		
Final product	SME increases output and sales		
Benefits for the client	<ul style="list-style-type: none"> <li>• Increase of production levels</li> <li>• Increases in sales</li> <li>• Product improvement to purchasers' requirements</li> <li>• Access to working capital</li> <li>• Relationship with new clients</li> </ul>		
Human resources needed	1st phase: preparation of tender documents, including legal and financial requirements 2nd phase: production planning, quality control, consolidation of production and final delivery to purchaser		
Financial analysis of the service	97% of price is passed on to SME, 3% is retained as service fee		

The BDC Servicepi has four well defined products:

- Market articulation.
- Technical and managerial training.
- Technical assistance for SME in the garments sub-sector.
- Training for pre and young entrepreneurs.

**Staffing:** The manager is the main consultant and works with four associated consultants.

**BDC Micentro.** This BDC is located in Gamarra, Lima, where there are about 14 000 enterprises working in the textile and garments sub-sector. Micentro has therefore concentrated its services on technical assistance and training for this sub-sector.

Micentro has six developed products:

- Hands-on sewing training.
- Design and pattern making.
- Fashion trends.
- Development of fashion collections.
- Technical assistance in production improvement.
- Technical assistance in quality control and production costs analysis.

**Table 10.7 Product: Preparation of a fashion collection**

<i>Clients need</i>	<i>To improve garment designs to meet market demand</i>	
Description of the service	Together with the entrepreneurs following steps are completed: <ul style="list-style-type: none"> <li>• Analysis is made of the colour trends for collections for men, women and children</li> <li>• Proposals for combinations of colours and cloths are elaborated</li> <li>• Six final designs are prepared</li> <li>• Technical description is prepared</li> <li>• Patterns for each design and size</li> <li>• A finished sample is produced</li> </ul>	
Final product	<ul style="list-style-type: none"> <li>• Update on the trends in local and international markets</li> <li>• A collection consisting of six designs with corresponding patterns</li> </ul>	
Benefits for the client	<ul style="list-style-type: none"> <li>• Increase in sales</li> <li>• New/up-dated product line improves sales</li> </ul>	
Human resources needed	1st phase 2nd phase	Senior designer for trend analysis Senior and junior designer for collection development
	time requirement	40 hours
Financial analysis of the service	Total charge	US\$190.00
	Direct costs	US\$148.00
	Gross margin	US\$62.00
	Utility %	42.9%



Staffing: manager, secretary and five permanently associated consultants.

**BDC Idesi Huacho.** Idesi is a countrywide NGO network with 19 regional centres providing financial and non-financial services. In Huacho, a small town 140km north of Lima, this BDC offers mainly training and coaching programmes for three distinctive target groups, youth/pre-entrepreneurs, entrepreneurs, and employed professionals.

**Table 10.8 Product: Quality in service provision**

Clients need	Improve quality in attention to clients Improve employee efficiency to reach client satisfaction.
Description of the service	<ul style="list-style-type: none"> <li>• definition of target market</li> <li>• getting to know the client and his needs</li> <li>• evaluation/elaboration of product design according client need</li> <li>• presentation and discussion of proposals for improvement</li> <li>• implementation of in-house training (15 hours)</li> </ul>
Final product	<ul style="list-style-type: none"> <li>• higher service quality (measured according to pre-established indicators agreed with the SME client)</li> </ul>
Benefits for the client	<ul style="list-style-type: none"> <li>• increase in repeat clients</li> <li>• higher sales</li> <li>• clients identify themselves with the enterprise</li> </ul>
Human resources needed	1st phase Senior consultant, Junior consultant 2nd phase Senior consultant implementation of training
Financial analysis of the service	Price US\$320 Direct Costs US\$130 Fixed costs US\$65 Gross margin US\$125 % of gross margin on costs 64.1%

General characteristic: well defined product.

This BDC has four different products:

- Quality services.
- Technicians for marketing.
- Strategic planning.
- High level of secretarial support.

Staffing: manager and two associated consultants.

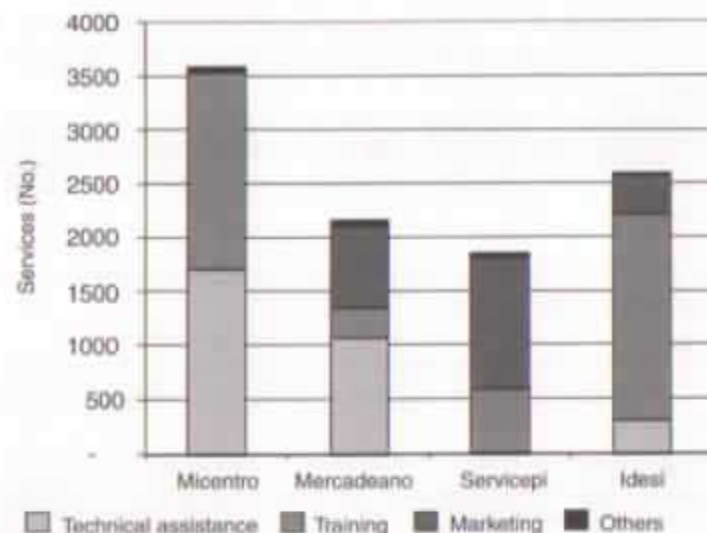
Figure 10.3 shows the importance of the different type of services for each of the four BDCs during the year 1998.

#### Evolution of supported BDCs

Table 10.9 shows the annual operating results for the BDCs, started in 1996.

#### Technical assistance and institutional development

**Staffing and internal organization.** Typically, BDCs have a manager, two associated consultants and one administrative staff. For specific contracts they may



**Figure 10.3 Number and type of service sold per BDC**

**Table 10.9 Annual operating results**

Name	Opening	1996			1997			1998		
		Income US\$	Costs US\$	%	Income US\$	Costs US\$	%	Income US\$	Costs US\$	%
First family										
Idesi Huacho	02/01/96	6349	19 103	33	42 735	58 474	73	34 298	53 079	65
Mercadeano	02/01/96	16 401	31 030	53	41 759	41 481	101	64 566	54 568	107
Micentro	02/01/96	14 515	29 675	49	37 310	71 706	52	12 453	25 943	43
Servicepi	02/01/96	19 025	39 905	46	484 177	332 908	138	914 196	650 132	119
Peritac*	02/01/96	2960	11 616	25						
Total first family		59 341	131 422	45	585 981	504 569	116	1 025 513	783 722	131

\*PEMTTEC finished activities in 1996

hire additional outside consultants. In this way the BDC keeps fixed costs low and enables rapid response to clients and market needs. This organizational form is typically for micro- and small enterprises and the experience shows that the BDCs in Peru start with an institutional behaviour similar to SMEs. Basic characteristics are: concentration of all main tasks with the manager, low level of delegation of tasks and responsibilities, lack of internal information management (on costs, clients, productivity indicators, etc), and an accounting system oriented to satisfy tax requirements only. As the BDC managers play a vital role in shaping the success of the centres, Swisscontact has taken great care and has participated in the replacement of poorly-performing managers and the selection of new ones.

In the first year of operation, strong emphasis has to be put on the BDC to introduce a minimum level of internal management information (accounting, cost calculation and consultant network).

The financial support mechanisms put pressure on the BDC to:



- generate income, because if there is no income there will be no financial incentives from Swisscontact. Incentives are paid monthly and upon presentation of accounting information.
- have up-to-date accounting information at hand.
- keep operational costs at a minimal level. Only in the first 12 months is a contribution towards operating costs (not exceeding 50 per cent) paid by Swisscontact.

To help the BDC to absorb all this pressure, Swisscontact offers non-financial technical assistance in these forms.

- Individual coaching by Swisscontact staff, depending on the specific need of the BDC. This also includes assistance in restructuring BDCs with poor performance.
- Training and assistance in elaborating general and/or annual business plans.
- Scholarships for human resource development (only on a cost-sharing basis).
- Networking with other BDCs, government institutions and other BDS providers.
- General promotion and publicity for BDCs and their services.
- External auditing services.
- On an individual basis, Swisscontact discusses quarterly performance of the BDC with the operators and managers. Benchmark information on performance is made available to each BDC, which enables them to judge their position within the competitive environment. BDCs that have a high rate of self-financing can apply for support to develop new or improve existing services. Again, Swisscontact covers only part of the cost of this support.

Inhibiting factors for the growth of BDCs are mainly related to staffing and the nature of the BDC products. Here again, managers and consultants are decisive for client satisfaction, as in small enterprises. In view of cost constraints the BDCs have to consider ways of fielding a mix of senior and junior consultants in the delivery of services.

*Relationship with operators.* The Swisscontact BDC concept is based on a contract between an operator and Swisscontact for the implementation of a BDC. Within the first two years of this contractual relationship, and strongly influenced by the support scheme (incentives/penalties and controls), the relationship between the BDC and the operator evolves in three different ways, as shown in Figure 10.4.

In the first case, the operator was conceived as a small unit and as the BDC started to be successful the other components of the group lost importance and the BDC absorbed the operator.

In the second case, the BDC developed enough strength to influence the operation of the operator. However, the operator still maintains a number of other activities not directly related to the BDC.

Key: ○ operator □ BDC ● Swisscontact (SC) — dependency = contract

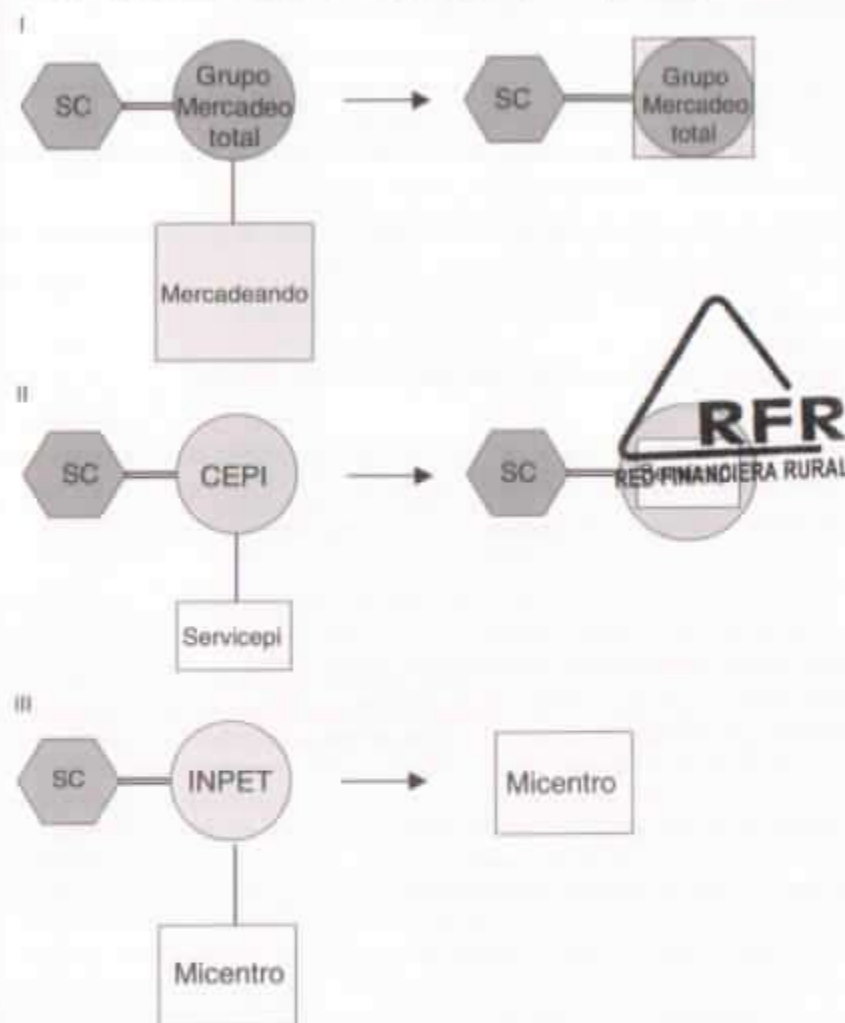


Figure 10.4 Relationships between Swisscontact and BDC operators

In the third case, the operator decided to found a legally independent company for the BDC.

In one case there was no evolution of the relationship between the operator and BDC. The first two cases are the most successful, possibly due to the very high personal commitment of the managers. Another common feature of both these cases is that the operator was in the first case a *small* company and in the second case a *small* local NGO.

#### Monitoring system

*The features of the system.* Monitoring was conceived as an important component of the BDC model – responsible for collecting important information – for



the different participants in the activity. There were two major objectives for sub-contracting the monitoring system outside Swisscontact.

- To develop a local capability in the design and use of these instruments, which may have value in a market where different groups are setting up BDCs.
- To isolate the monitoring roll (sometimes monitors may play the 'bad guys' role'), distant from the advisor and financing role played by Swisscontact.

The information collected in this sub-system, is used for paying incentives during the first phase of support. It covers the following:

- incomes
- expenses
- outreach/coverage (number and types of clients assisted)
- services provided.

The difficulty in the design of the monitoring system is that it is a multi-user system, which must be able to cater to the needs of:

- the BDC manager (information on performance)
- the programme (basis for incentive payments)
- the operator (owner) for supervision of the project.

*How does the monitoring system operate?* During the first five days of each month every BDC remits information about its results during the previous month. Three days later, the monitors transmit to Swisscontact a summary report called the 'pre-report', to enable the programme to pay the 'incentives' within the first 10 days of each month. Any irregularity will be corrected and reflected in the following period. The monitors put out three different kinds of reports: monthly, quarterly and semi-annual. These reports provide information based on data collected during the visits of the monitors to the centres, interviews with the clients, and the analysis and interpretation of the results reported by the centres, including gender analysis.

Table 10.10 summarizes the different reports and contents.

Monitoring software has been designed to facilitate the collecting and processing of information for the different users. With the system, managers can now develop a database of clients, register incomes, analyse costs per service, and also link with the accounting system included in the software.

#### *Gathering information from the micro-level*

During 1998 the monitors conducted 64 interviews with clients of the BDCs. From these interviews it was found that:

- the majority were contacted directly by the BDC
- 36 per cent were completely satisfied with the services, 16 per cent were only partly satisfied
- clients stated that services led to increased sales, although services to help in production and management had fewer positive results. Services take time to show effects.

**Table 10.10 Summary of Reports**

<i>Report</i>	<i>Contents</i>
Pre-report	Income Expense Percentage of self-financing Contribution of Swisscontact for operating expenses Contribution of Swisscontact for incentives Income and expense per kind of activity Indicators for quality and target group
Monthly report	Comments about results (based on pre-report) Graphics comparing results of centres Evolution of principal indicators Observations, recommendations
Quarterly report	Summary Evaluation of services, trends Quantitative and qualitative analysis Results from surveys to clients Gender Observations, recommendations
Semi-annual report	Additional to the quarterly report, it may include: Analysis of economic and political context Analysis of the organization: human resources, institutional image and internal organization Market level of penetration Operator's contribution

- 69 per cent of the clients fully paid for the services, the rest had access to some type of subsidies
- 75 per cent of those receiving subsidies say that they would not have accessed the services if they had not received financial support
- 38 per cent of the clients feel the prices are high; however, the majority consider the prices are fair
- the clients are satisfied with the attention from BDC staff, specially in contact and communication. Some negative comments were received on organizational matters.
- almost all the interviewed clients were willing to buy further services from the BDCs
- the main demand is in sales improvement, such as marketing techniques and handling clients
- a major problem is low sales; second are organizational aspects and employee management. During 1997 the first priority was production problems.
- 58 per cent of the people interviewed said they knew little of the services available on the BDS market.

Although the sample was small, the results of the survey gave important indicators on the centre's performance, and provides a first step towards the future monitoring at the micro-level.



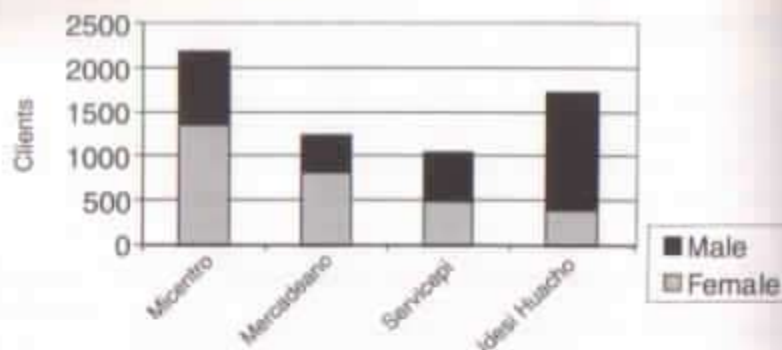


Figure 10.4 Number of clients differentiated by gender per BDC

Some information gathered via the monitoring system is shown in Figure 10.4 and Tables 10.11 and 10.12.

Table 10.11 Accumulated sales per sub-sector for 1996 to 1998

Sub-sector	Sales, US\$	%
Garments	1 172 204	70.2
Metalworking	85 971	5.1
Leather and shoes	103 165	6.2
Institutions	120 360	7.2
Handicrafts	17 194	1.0
Agro-industry	17 194	1.0
Commerce	34 388	2.1
Not identified	17 194	1.0
Others	103 165	6.2
<b>Total</b>	<b>1 670 635</b>	<b>100.0</b>

Table 10.12 Cost breakdown (1998)

Items/BDC	Micentro	Mercadeando	Serviceppi	Ideas Huacho	Total	%
General services	5 620	8 847	14 496		28 963	3.7
Interests		362	13 832		14 194	1.8
Materials	8	496 220		4	496 232	63.3
Other costs	5 526	14 544	9 620	16 139	45 829	5.9
Rents	1 963	2 586	6 251		10 800	1.3
Salaries	12 833	28 220	109 712	36 936	187 701	24.0
<b>Total</b>	<b>25 942</b>	<b>54 567</b>	<b>650 131</b>	<b>53 079</b>	<b>783 719</b>	<b>100.0</b>

## Discussion and conclusions

A number of lessons can be learnt from Swisscontact's experience:

- There is a market for BDS providers.

Traditional BDS providers and also donor agencies have to be convinced that the market oriented approach – as described – is viable. Swisscontact's approach puts major efforts into monitoring the economic results of BDCs, not only because it

is an integral part of the incentive system, but also to obtain first-hand data on the behaviour as a basis for further discussion.

- The management capacity of the owner/manager is crucial.

SMEs generally depend on the capacity of their owner/manager, and the same is true with BDCs. The motivation of the manager, his 'ownership' of the project is crucial to success. Like any small entrepreneur, there is a delicate balance between production and the owner's personal background. Over time, Swisscontact has gained more influence in the selection and appointment of new BDC managers. This needs to be pursued cautiously, as it could be interpreted as unwarranted interference in areas that are within the responsibility of the operator. In view of the still-limited income generated, there is virtually no possibility of basing BDC managers' remuneration on performance.

- Internal organization needs to be improved.

This should start with accurate and timely accounting information, in order to have a clear view on gross margins per service, direct costs per product, market segment, and identifying services with a high contribution towards self-financing. As the BDCs are small consulting enterprises, which sell mainly know-how and are closely linked to one manager, there is a major limitation to the prospects of the growth of a BDC. This presents a challenge and can create serious problems.

- Management of various different services (a BDS portfolio) at the same time is weak.

Income fluctuates greatly from month to month. The centres offers a limited (in many cases only one or two) number of services and they have a more sequential approach to selling and providing services, rather than a mix of products, which might smooth the income curve.

Under Peruvian conditions, and depending on the sub-sector, seasonal fluctuations do exist, but they have less impact if the centre is successful in establishing itself in the BDS market.

- So far, product improvement and development of new services is made by trial and error.

This is based more on perception than in-depth analysis. In Ecuador, Swisscontact defines, together with the BDC within the annual assistance programme, the proposals for product improvement and then offers a co-financing scheme. It is very difficult to develop new services based on market surveys. The recent Indonesian and Peruvian experiences of the BDC trying to survive in a time of economic crises indicates that product innovation takes place under economic pressure in struggling for survival; most supported BDCs should adjust their product portfolio after a re-orientation phase of two to three months.

Here the question of 'BDS development' needs to be discussed more from a macro-level point of view. In the medium term there is a need to invest in 'second-tier' institutions that respond to the need of BDCs for service develop-



ment. In Peru, Swisscontact is starting franchising the training of BDS and other providers based on experience from abroad.

- Differentiate BDC objectives as an enterprise from development objectives as a donor agency.

There exists a growing market for BDS so that competitive and specialized BDCs have good prospects of achieving sustainability. However, as already pointed out, a BDC might opt to work with a limited number of clients and seek greater quality and reliability in their contribution.

Development objectives seeking outreach and income distribution are not always compatible with BDC objectives as a business. The view is that in the long run the BDS market will contribute to the greater competitiveness of SME, which in turn fits in with development objectives.

- Donor agencies must be ready to react flexibly to institutional and product changes at BDC and operator level.

During the initial phase the supported BDCs changed rapidly at the institutional level, needing quick reactions and flexibility from the donor agency. BDCs with poor performance soon started experimenting with different products which were not in the original project proposals. If economic sustainability is taken seriously, changes have to be encouraged to some extent.

## Issues for further discussion

### *The rationale for investing in the private sector*

The availability of demand-oriented business development services is recognized worldwide as one element of a conducive environment for SME development. Swisscontact's BDC approach offers an efficient way to stimulate the BDS market by using an approach based on the market, and keeping market distortions to a minimum. Nevertheless, the justification for investing donor resources in 'private' service companies needs further clarification, and the assignment of donor resources may have to be more transparent.

Services closely related to production and marketing processes are highest in demand and, as shown, can be sold at prevailing market prices. Our support mechanism seeking economic viability of BDCs focuses attention on this type of service. However, the question has to be asked: Why is no private enterprise active in this market without incentives? Incentives certainly lower entry barriers. Are there only financial risks, or are there other barriers too? This subject needs to be studied further.

### *Reaching microenterprise customers*

The main customers of BDCs are small- to medium-sized enterprises with potential for growth, rather than microenterprises at subsistence level. Therefore the BDC approach cannot be considered an instrument for direct poverty alleviation. The challenge of how to deliver services to subsistence-level microenterprises in an efficient way remains unsolved. Further discussion on how to integrate the

smallest enterprises or clusters is needed. Experience in Indonesia shows that BDCs might be an effective channel to implement (donor or government) subsidized programmes for microenterprises, but there are serious risks that BDCs might lose their clear customer focus, if the implementation of subsidized programmes becomes their main business. This would inevitably lead to distortions.

Microenterprises as a target group will not be able to contribute significantly to the sustainability of the BDC. Donor agencies or governments will therefore have to finance the cost of reaching out to microenterprises. In which case the BDC would provide the services from the funds offered and would charge a management fee for delivering BDS to the target group or for administering programmes, e.g. a training voucher system. This income for the BDC will persist as long as government or a donor agency is ready to provide the financial support needed by the centre to continue its service.

### *Limitation of BDC activities*

The definition of the services to be provided by the BDC is an important entrepreneurial decision. BDCs offer the services that they feel 1) best fit within their core competency and 2) meet clients' demands. The entrepreneurial responsibility for the BDC product portfolio is an important precondition for future success, but is in contradiction to the desire of the donor to influence the type of services to be offered. Donors are therefore advised to be very careful with intervention in product selection and to make the restrictions clear from the beginning. Donors should limit their support to services such as training, consultancy, and information, and not venture into business-related services such as transport, storage, certification, etc., even if there is a demand. There is danger of market distortion in this type of activity. The drive for income and self-sustainability should not lead the BDC to be diverted from its major goal of raising the competitiveness of SME through support services.



## 11. The experience of *Corporación de Fomento* in Chile

GONZALO RIVAS G.

### **The framework of CORFO's business development action**

THE EVOLUTION OF *Corporación de Fomento de la Producción* (CORFO) work in business development has followed the course of development of the industrial policy of Latin America.

In 1939, when CORFO started, the work was aimed at the direct creation of enterprises, including both sectors that are fundamental to production (energy) and traditional areas of import substitution policy (iron and steel, oil refining, sugar, etc.). Later CORFO supported the creation of enterprises in partnership with the private sector, with a view to handing over their management and development to the private owners later, and began taking on a fundamental role in the setting up of institutions of innovation and technology transfer. Later, following political changes, it had the role of managing the so-called 'area of social ownership', and came to control the major companies in the country.

During the military regime, as well as operating as an organization whose task was to administer and privatize the companies under its control, it began to operate as a development bank, granting loans to the companies direct.

From 1990, efforts were made to reshape CORFO as a economic development institution. The first steps consisted in clearing the considerable portfolio of bad debts inherited from the direct loan operations and in consolidating access to the credit support scheme for SMEs, based on refinancing the financial institutions. Together with this major effort of reorganization, a new concept was taking shape on the role of CORFO, within an economy integrated with international trade, where the market allocates resources.

The diagnosis that guided the new development policies of Chile was based on the approach of 'market failures'. This focused on the impact of factors – such as the skills level of the workforce, technology, management and information – within the operation of the market and the effects that these factors might have on the SMEs' ability to compete. Other factors needing intervention included the rate of technological innovation and the capacity to increase and diversify exports.<sup>1</sup> The aim was to produce solutions applicable to any sector, and to favour market, rather than administrative, solutions.

It was within this conceptual framework that CORFO's new direction was formulated and the programmes and instruments developed by the institution to encourage competition were designed on this basis. It was, however, borne in



mind that just as there are 'market failures', there are also 'state failures'. In an eagerness to combat a problem – whether theoretically or practically justified – the costs of the public action may often exceed the benefits that might accrue.

As a result, CORFO has followed a prudent path in developing instruments of intervention. It has emphasized learning by experience and avoided implementing programmes that start off on too large a scale. This on-going learning process has helped to give the institution a sense of direction and has enabled it to act as an operational complement to its development activity.

The main bases of the new policy of CORFO are as follows.

- Company co-financing to reinforce the commitment of businesses to competitive improvement for which support is available from the government. Such co-financing is regarded as an indicator that the actions carried out are relevant: if companies agree to co-finance an activity, this implies that they value it.
- The temporary nature of the government support, based on the determination of the state not to develop paternalism in relation to companies, by making sure that they exit the programmes upon completion (when they have attained their defined objectives).
- Public-private co-operation to respond to the needs of companies more effectively, with each party involved contributing to the achievement of the objectives of the development policy.
- Decentralization, allowing the regions to make decisions about how resources can best be used and to match them better to local requirements.
- Assessable programmes that can be measured both in terms of the economic impact and the appropriateness and validity of the contribution.
- Stress on demand to direct the allocation of resources to projects that represent a real demand from companies. However, this will not prevent the supply of services to be regulated, to direct and promote improvements for companies.
- Proactive action by government, in promoting company demand for, and use of, the programmes available, particularly in regions that are most remote.

### The institutional design of CORFO's development action

The institutional design of the development action promoted by CORFO is based on a clear differentiation of the roles of the agencies involved. Efforts are also made to maximize networking, to make optimum use of the comparative advantages of each of the parties. The aim is to strengthen the links between central and regional government institutions and business associations, financial institutions, non-governmental organizations (NGOs), universities and research institutes, etc.

Thus, in general terms, four levels of action can be delineated:

- Those which directly implement the actions.
- Those which facilitate, administer and disburse the resources.
- Those which design the programmes and allocate the resources.
- Those which set policies and standards for assessing the impact of the action.

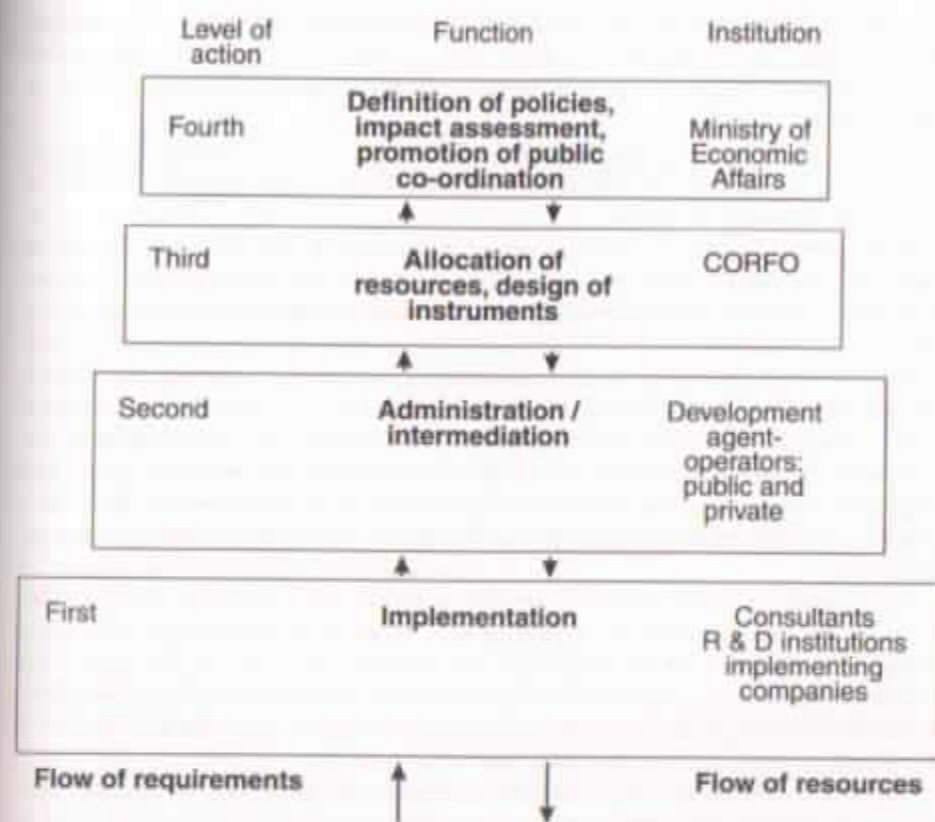


Figure 11.1 Institutional diagram of the SME support programme in Chile

Figure 11.1. summarizes the design in diagrammatic form.

In this system, CORFO has the role of designing the instruments, their implementation procedures and of allocating resources. Until 1997, that role was not clearly separated from that of the Ministry of Economic Affairs, since CORFO had the status of an independent ministry. This status not only gave it a political dimension that strengthened CORFO's action, but also became a hindrance in preventing it exercising its full executive capacity in sectoral areas that fell under a specific ministerial authority (as in the case of agriculture, for example). From 1998 onwards, CORFO ceased to have ministerial rank and its Board was expanded to include the Ministry of Agriculture and Foreign Relations, in view of the importance of CORFO's relation to those areas. Also, a new institution was created to administer the companies and assets belonging to CORFO (el Sistema Administrador de Empresas), which operates as a 'holding' company reporting to CORFO's board. In this way, CORFO's character as an institution specializing in development and with a capacity for cross-sectoral action was confirmed. It can now look after the requirements of practically all the economic sectors of the country, while avoiding the temptation to create sectoral or regional institutions.



In this system, it is the Ministries – particularly the Ministry of Economic Affairs – that are responsible for formulating policies and guidelines for development action, but they do not implement them, which is more suited to decentralized services.

For its part, in its development role CORFO has promoted a process of mediation for applying the instruments it has designed, by generating a network of intermediary agent-operators.

In the case of financial intermediation lines (refinancing of credit or leasing operations to SMEs, etc.) the client relationship is set up with the financial institutions, which are those that appraise the loan submissions and take on the risk.

In the case of the development instruments (promotion of partnership, technical assistance, etc.), agreements have been generated with national or regional entities linked to business organizations which, on proving that they have the necessary technical capacities, are given charge of working with the SMEs and supporting them in the preparation and presentation of their projects. They have also been delegated the task of administering the resources for projects already approved.

This arrangement has made it possible to utilize the knowledge and commitment of the private sector in preparing and evaluating the projects. This gives permanent feedback to the institution on the projects, while at the same time helping to increase the relevance and potential impact of its actions. It also makes it possible to incorporate the flexibility of private agents, who are not subject to the administrative restrictions of the public sector.

The operation of this network has increased the coverage of development action throughout the country, both in the number of enterprises assisted and in the amounts channelled through the different instruments. It has also acted to step up the decentralization process, since as the network has spread throughout the different regions of the territory it has initiated a process that stimulates the participation of local agents in the provision of development services and boosts the development of capabilities in each geographical region of Chile, a country that covers long distances.

Currently, the network comprises 13 private institutions and one public body, Servicio de Cooperación Técnica (SERCOTEC), which are identified in the following list:

- Asociación de Exportadores de Manufacturas (Asexma)
- Asociación de Exportadores de Manufacturas (Asexma Biobio)
- Asociación de Industriales de Malleco y Cautín (Asimca)
- Asociación de Industrias Metalúrgicas y Metalmecánicas (Asimet)
- Centro de Productividad Industrial (Cepri)
- Centro para el Desarrollo de La Araucanía (Trafsin)
- Cooperativa Agrícola Valle Central (Copeval)
- Corporación de Desarrollo de Arauco (Corparauco)
- Corporación de Desarrollo de la Región de Coquimbo (Corpadeco)
- Corporación de Desarrollo Social Sector Rural (Codesser)
- Corporación del Norte para el Desarrollo e Integración (Cordenor)

- Federación Gremial Nacional de Productores de Fruta (Fedefruta)
- Instituto Textil
- Servicio de Cooperación Técnica (Sercotec)

### CORFO's development programmes and instruments

In recent years CORFO has been evolving a set of development instruments, which seek to address the main difficulties faced by SMEs and improve their competitiveness. Institutionally, most of them are channelled through intermediaries, as in the case of the Technical Assistance Fund (FAT, Fondo de Asistencia Técnica), the Development Projects (Proyectos de Fomento) and the recently created Supplier Development Program (Programa de Desarrollo de Proveedores). Others are operated directly by CORFO, as in the case of the Technology and Productive Development Fund (FONTEC). This account covers only the non-financial assistance programmes, leaving aside other fields of CORFO's action, such as financial intermediation, the promotion of private investment for regions, support for research and development (R&D) activities, or production conversion programmes.

#### *Technical Assistance Fund (FAT)*

The FAT co-finances part of the cost of hiring accredited consultancy services, which are listed by speciality in a register kept by CORFO for that purpose. Although it admits services to groups of enterprises, over 75 per cent of the demand catered for by means of this instrument corresponds to help for firms, which stipulates a non-renewable fund of up to around US\$10 000 per company, payable in maximum modules of US\$2000 per consultancy, to be set against a co-financing by the company that will range between 30 per cent and 50 per cent of the cost of each project.

The aim of FAT is to help overcome the asymmetries of information which appear in the relationship between the SMEs and the consultancy providers, by establishing a contracting procedure that will make the market transparent (market regulation effect). It will also have the effect of making SMEs aware, through the experience of hiring external support, of the value of that support, so that later on they will continue to request it independently at their own expense.

Apart from this effect of 'market creation and regulation', FAT co-financing is also used by CORFO to promote actions that involve positive external impacts or are valued by the public authority as being of high social benefit. Such is the case with certain thematic FAT projects, such as those that provide support for the presentation of irrigation projects for small farmers, studies of the operation of areas of marine leasing for small-scale fishermen, or support for the introduction of improvements that have a positive impact on the environment.

These instances of technical assistance have the virtue of responding to clearly defined objectives where the achievement can be monitored, unlike operations where the company defines the terms of reference of the consultancy (within a general framework set by CORFO). The experience with these FATs, as well as



### **International safety certification: case study of the PROFO METALMEC II**

This PROFO consists of nine small- and medium-sized metal-mechanical enterprises in Antofagasta, which provide services to the large-scale copper mining industry. The aim of the group of companies in forming their alliance was to work together to expand their market, centralize the supply of services and increase sales. However, thanks to the experience of some of their members, and the consultancy of experts, they became convinced of the need first to deal with improving the quality of their products and services. To achieve this, they contacted South African professionals from the National Occupational Safety Association (NOSA) and are now working together with them on a programme implementing the safety rules currently in force in large-scale mining around the world (only two large Chilean mines have this certification). NOSA agreed to work with these SMEs because it realized that this was the agreed common aim of the group of companies and that there was the will to make the necessary changes and investments to achieve the required results.

The contact was made directly by the PROFO, as a result of the pressing demand from the large mining companies for services with adequate standards of safety and quality. One of the effects that the programme has already produced is an increase in the productivity of the member firms, as well as improvements in efficiency and response times, a critical aspect for companies trying to maintain their position in the demanding mining business. It is expected that cost savings of around 25 per cent will be achieved, due to improved safety in operations, fewer accidents and increased productivity. The group's initial aim is to attain the three-star certificate (the maximum number is five stars). Given the innovative character of the project, the companies submitted a draft to FONTEC, which enabled them to obtain financial support to implement the changes to obtain the certification.

The will to work together was consolidated in the setting up of a joint company Red de Ingeniería, Servicios y Representaciones (REDINSER S.A.), which centralizes the supply of the company's services. The intention is to continue working in partnership under the umbrella of this company after the PROFO project has come to an end.

of studies commissioned to assess the impact, have led to CORFO now developing a broader offer of FAT projects with defined objectives so long as the achievement can be monitored. Among these is the 'quality FAT', where the purpose is to promote specific actions to improve the quality of products in SMEs started during 1999.

Another way in which this approach is being improved is by refining the diagnostic stage prior to the hiring of a consultancy, through the standardization of diagnostic tools. These diagnoses are carried out by staff of the agencies that operate with CORFO, so that they can help the business owner to understand better the real needs of the firm when it comes to deciding what type of consultancy to hire. This can prevent the entrepreneur being unduly influenced by the consultant selected by the company as to the need for assistance.<sup>7</sup>

### *Partnership Development Projects (PROFOs)*

PROFO is an instrument designed to stimulate modernization and improve the competitiveness of SMEs, by encouraging the formation of partnership schemes between companies in similar or complementary lines of business, located in relative geographical proximity to each other. A PROFO involves the development of initiatives promoted by the group of participating companies, aimed at improving management, monitoring production and/or more effective marketing (see the box on the following page detailing a PROFO experience). Most of such actions would have been difficult for a firm to undertake individually.

In order to obtain CORFO co-financing, the group of companies (at least five) must present a joint project for implementing and hire a manager, chosen by the members of the PROFO themselves, to administer it. The approved activities are co-financed jointly by CORFO (70 per cent) and the companies. CORFO's contribution will go down to 50 per cent in the third and final year. Throughout, the PROFOs have to submit reports on their achievements during the project and present the activities planned for the coming year, within a framework set out by CORFO.

In spite of the challenge of forming a PROFO – in terms of getting a group of business owners to overcome their mistrust and agree to work together – this is now one of the most popular project types and most widely acclaimed of all those operated by CORFO. This is explained by the demonstration effect achieved by the successes of many PROFOs. Given the small scale of many production sectors – particularly in regions – the work of the PROFOs are soon spoken about by business owners, who can very quickly judge their successes or failures.

In 1996 the Ministry of Economic Affairs conducted an initial impact study carried out by researchers at the UN Economic Commission for Latin America (ECLA) and the Faculty of Economics of the University of Chile. From a representative sample of PROFOs that had been operating for more than two years, and control groups for each sector under consideration, the study found statistically significant differences in growth rates in the sales of those companies participating in PROFOs, compared with the average for companies in their sector. The differential as calculated was 11.6 per cent a significant variation.

In terms of net profits, in comparison with the control group for each line of production, by projecting these results over three years, 2.4 additional pesos of net profit were generated for each peso the PROFO company invested in these programmes. In tax terms, considering the differential in the VAT (Value Added Tax) receipts from the PROFO companies compared with their respective control groups, for each peso spent on the programme, the government receives 3.2 pesos per year.

Other results of the assessment indicate that in the long term PROFOs improve and strengthen the management of the businesses, the organization of work within the companies, and improvement in marketing strategies. There was also found to be a significant difference in investment in training in companies participating in PROFOs.

Although not evaluated in the research, a clear effect of the PROFOS is their contribution to the general social and economic development of the different



**Table 11.1 Companies assisted by CORFO's business modernization instruments, 1993-97 (number of enterprises)**

Instruments	1993	1994	1995	1996	1997
Technical Assistance funds (FATs)	1862	998*	1651	2015	4284
Development projects (PROFOs)	252	534	2091	4549	3404**
TOTAL	1914	1532	3742	6564	7688

Source: Development Department, CORFO

\*Does not take into account 3146 businesses in the transport sector.

\*\*Does not include microenterprises.

**Table 11.2 Funds placed through CORFO's business modernization instruments, 1993-97 (in thousands of dollars)**

Instruments	1993	1994	1995	1996	1997
Technical Assistance Funds (FATs)	1544	1658	2689	4021	8421
Development projects (PROFOs)	1118	2385	4355	11 179	9645
TOTAL	2662	4043	7024	15 200	18 066

Source: Development Department, CORFO

regions of the country. The PROFOs help to generate more and better relations between the regional and local authorities (with municipalities and local councils, for example), and in the launching of new initiatives by other members of the local community.<sup>3</sup> This strengthening of the SMEs' capacity for social dialogue and community development is an impact that is not explicitly an objective of the PROFOs, but is perhaps one of the most significant results achieved.

### Supplier Development Programme (PDP)

One of the most effective stimuli to the modernization of SMEs, particularly when domestic markets are small, is contact with international markets through exports. An equivalent effect is achieved when SMEs develop a stable, continuous relationship as suppliers of large companies. Indeed, the latter normally require high standards of quality, reliability in meeting delivery schedules and competitive cost levels. To achieve these, SMEs have to modernize their operations. However, smaller enterprises can be deterred from making the effort involved in improvement to reach the level of the purchasing companies, if they are not motivated by the prospect of achieving a stable commercial relationship as a result of their efforts.

This difficulty in building stable relationships adversely affects both the buying companies and the potential suppliers and can become an obstacle to improving the competitiveness of both the companies and the development of SMEs as suppliers.

For a long time CORFO tried to tackle this problem by approaching it from the viewpoint of the SMEs, but did not succeed in attracting the support of the companies. In 1998, a pilot supplier programme was initiated, but this time working together with the large companies. Starting from the large companies'

requirements, it aimed at tackling the problem areas of their SME suppliers. The actions were mainly directed by the larger companies receiving the supplies.

This plan achieved significant results. The supplier improvement programmes were based on a diagnosis carried out by the large company, or by consultants hired by them. After this diagnosis, an action programme was initiated, jointly financed by CORFO and the large company, within the framework of an agreement between the parties involved. Depending on the needs established in the diagnosis, the improvement programme could last up to four years (for example, in such cases as plantations of new varieties of fruit which require time to develop, or programmes involving ISO 9000 certification of participating SMEs).

During 1998, 1683 SMEs and microenterprises were involved in these programmes. Most actions were in the agricultural sector.

### Technological and Productive Development Fund (FONTEC)

FONTEC is a programme aimed at promoting technological innovation in private enterprises, by contributing to the financing of projects to introduce new technologies.

FONTEC has five lines of financing:

- *Technological innovation:* These are R&D projects for product, process or service technologies (management, organization, marketing, etc.). They include producing prototypes and pilot trials for new processes, and testing market reception of new products. The financing by FONTEC to the applicant companies, whether on an individual basis or as a group of independent companies, consists of a subsidy of up to a maximum of 50 per cent of the cost.

#### First technology centre for the production of fruit plants

The owners of four fruit tree nurseries – until recently competitors – formed the Consortium Viveros de Chile S.A. and initiated a project aimed at creating a technology transfer centre costing around US\$450 000, of which FONTEC financed 43 per cent. This centre, inaugurated in 1998, enables them to develop new product lines, placing the companies of the consortium in a leading position in multiplying and certifying new plants. Its fundamental objective is the introduction of certified plant material, of high quality in health terms. It will have a bank of traditional, genetically authentic and virus-free varieties, enabling the consortium to develop and produce plants that are certified both as to health impact and purity.

In addition, the group represents prestigious international hybridizers, which enables it to provide fruit growers with new varieties. These must be monitored for two years before they can be introduced on to the market.

This centre will make these nursery growers the first to be able to offer certified material, thus guaranteeing both variety and health, and benefiting not only the nursery growers themselves, but also the whole national fruit business. Finally, the project is looking into the possibility of exporting plant material to Latin America and Europe.



- *Technological infrastructure*: Investments in physical facilities, plant, scientific and production equipment, as well as technical training of personnel associated with the project to enable them to install, operate and maintain the machinery and support the technological development of the companies. This includes setting up industrial laboratories and quality certification and control units, technical information centres and other related services. FONTEC grants a maximum subsidy of 20–30 per cent of the total cost of the project, depending on whether it is submitted individually or by a group.
- *Technology transfer projects submitted in partnership* (technological missions and specialized consultancies): These involve five or more non-related enterprises producing goods or services, in the same or similar sectors, whose aim is to prospect, spread, transfer or adapt management, processes or production technologies to the associated companies, to help to modernize production. The activities eligible for financing may include: missions abroad to learn about technological advances, hiring of experts or consultants for highly specialized technologies. For missions of this type, FONTEC gives a maximum subsidy of 45 per cent of the total cost of the project, with an upper limit of US\$100 000.
- *Joint units of management and technology transfer centres*: Projects submitted by a group of five or more non-related enterprises, aimed at creating centres or joint units whose purpose is to develop, transfer and adapt technologies in the companies to advance their modernization. Operating costs for up to the first two years associated with the start-up and operation of the joint management units or technology transfer centres. FONTEC provides a maximum subsidy of 50 per cent of the total cost of the project, to a maximum amount of US\$400 000.
- *Pre-investment studies for innovation projects*: This is aimed at stimulating investment innovation in production, through the financing of pre-investment studies. The contribution provided by FONTEC allows for a subsidy of up to 50 per cent of the value of the pre-investment study, to a maximum of US\$15 000.

FONTEC is an open access fund, which operates at CORFO's offices throughout the regions. The process by which grants are awarded begins with an assessment of eligibility, ensuring that all the formal background information is provided (balance sheets, articles of association, certificates of current operation, indebtedness, etc.) and that the project is one of technological innovation and not just of investment, for example.

It is then subjected to an assessment, in which the main criteria by which the project is tested are: economic and financial viability of the venture, financial ability to match counterpart funds, assessment of the market, technological relevance, quality of the implementers, and amount of co-financing.

Finally, all projects are referred to the board, with a summary assessment sheet, a recommendation from the assessor and a presentation by the FONTEC project executive, who argues the case for the project at the meeting to which it is presented (the board meets once a fortnight). The board is constituted as an

expert panel, given the diversity of competencies that its members represent, as well as the experience accumulated in the assessment of this type of project. The board has a mixed public-private make-up, with four members appointed by the Ministries of Treasury, Economic Affairs and CORFO, and four by business associations in the private sector.

In the period 1991 to 1998, FONTEC co-financed over 1100 projects, with a co-financing level of less than 50 per cent in all cases. As a result, the cumulative company contribution raised through these FONTEC projects amounts to US\$95 million, against a state contribution of US\$67 million. Details are given in Table 11.3.

Table 11.3 Technological innovation projects co-financed by FONTEC, 1991–98

Year	Number of projects	Total cost	FONTEC financing (thousands of US\$)	Company financing (thousands of US\$)
1991	18	1367	675	692
1992	67	6329	3579	2750
1993	104	10 591	5978	4613
1994	106	17 891	7937	9954
1995	180	22 933	11 816	11 115
1996	188	29 014	11 784	17 230
1997	222	35 440	11 986	23 454
1998	304	38 533	13 330	25 202
TOTAL	1169	162 098	67 087	95 010

Source: FONTEC

The most recent evaluation, carried out in 1996 by a firm of consultants, concluded that the 15 most promising projects co-financed by FONTEC generated a surplus of US\$217 million, of which US\$55 million are attributable to the fund. Even without considering most of the remaining projects supported by FONTEC, this amount alone exceeds by far the US\$32 million cost of the programme, including grants and administration. From 1991 to 1995, the last year considered by the study.

#### High impact sectoral programmes

The way in which the development instruments described have evolved, both in terms of their coverage of SMEs and in terms of the experience gained, has enabled CORFO to co-ordinate more ambitious schemes for promoting the competitiveness of the sector. These programmes require a major effort of pre-investment, and agreements with other public institutions and with the companies participating in them, before the instruments can be deployed.

The experience of the Ovino de Magallanes development programme shows the type of initiative that can be promoted in this way. The aim of the programme is to develop the competitive potential of the chain of lamb production in the region of Magallanes (the most southern area of Chile), by taking an integral approach to the development requirements both of the market and of the technical development of the producers; diversification and expansion of markets;



development of more specialized intermediaries and strengthening the institutional support capabilities and techniques necessary for sustaining the effort required for the success of this initiative.

The Ministry of Agriculture takes part in the programme, through the Agricultural and Livestock Department, covering all matters relating to livestock and cold storage and to its support programmes for soil recovery and the development of grazing pastures; CORFO through its various mechanisms that support both livestock farmers and slaughterhouses (PROFOs, supplier development, technical assistance, FONTEC); the National Irrigation Commission, which offers special aid for irrigation and drainage schemes to support the improvement of the food base of cattle.

This programme, which covers all the elements of the food chain of production, reaches over 40 per cent of the region's sheep population. Its great merit is that it has been developed using existing programmes and in a schedule of activities in which the companies fully participate. This is without being offered any special incentives or being subject to the same conditions as those imposed on any project using public funds.

Similar initiatives are currently being promoted for the Pisco brandy sector in another region, tourism in a number of regions, the horticultural sector in the ninth region and agriculture in the Huasco Valley are being assisted in a similar way.

In these programmes, CORFO, as a public institution, has to conduct preliminary studies and co-ordinate with other public institutions. The problems and bottlenecks confronting the sector are discussed with potential participants. An essential part of the effort, therefore, lies not only in the efforts at co-ordination, but also in the generation of trust to enable the public and private sectors to work together.

### Some lessons

A number of lessons have been learned by CORFO during the course of this work over the past few years, and most of them are reflected in improved ways of operating the programmes, as well as in the development of new forms of intervention. Many of them have already been described. As CORFO's work through the intermediary agents is one of the more original aspects of institutional design in its action to help develop SMEs, the conclusions will focus on this aspect.

There are several advantages in working through intermediaries.

- The avoidance of the excessive bureaucracy of a public institution. When the operation is carried out exclusively by one institution, the only way to extend coverage is to take on additional staff. This ends by generating more bureaucracy, which makes organizing work efficiently more difficult and leads to an excessive number of staff working on administration. CORFO's solution has been to work with a limited number of high quality staff, who give priority to design, assessment, co-ordination and supervision related to the programmes. The direct implementation is contracted out without affecting the institutional learning process.

- They are closer to the end user. Inasmuch as the agencies are made up of groups with sectoral or local roots, the established links that such institutions have with the enterprises can be used to good effect. This facilitates the generation of levels of trust essential for companies to make effective use of the programmes at their disposal, but requires an investment and commitment from them, both in terms of money and time.
- They provide new sources for improving the action. Using their specialized knowledge and their experience in the field, intermediaries or agencies can contribute different ways of viewing the process, offering ideas that contribute to improving the development action.
- The possibility of generating a single 'window' for the development of assistance programmes. There are a number of business development tools that are not used by CORFO (skills improvement, promotion of exports, encouragement of irrigation, etc.), as these are carried out by other public institutions. Although these institutions can co-ordinate their action, there are always some problems, or simply institutional competition, that hinder the practical application of such co-ordination. Finally, companies have to go through a number of different institutions to gain access to these programmes and the possibility of achieving greater impact through the combined application of the tools is lost. A common agency option would enable companies to use the intermediary as a single window that could offer them all available forms of support and enable them to structure a programme with increased impact on those participating.

Of course, whether these advantages materialize or not depends on factors such as the abilities of the agencies, the existence of a readiness to delegate functions, etc. Experience tends to show that the institutional capacity is a process of learning. This means that at the beginning it is necessary to carry out some small-scale pilot experiences and, after these have been evaluated and adapted, steps can then be taken towards expanding the programme.

One relevant subject is for the public institution to define which functions will be contracted out to private agents and, more specifically, what financing mechanisms and incentives to use. These then have to be developed to achieve the desired results.

It seems clear that private agencies are better placed to identify opportunities for business development, bringing together and organizing groups of companies, preparing and presenting projects, financial administration and technical supervision.

There may be complications in the financing of these mechanisms and incentives. In Chile, the design conceived a first stage aimed at increasing the coverage of the development actions and safeguarding quality in the projects. This would then be followed by a second stage in which, based on the lessons learned from the variety of cases in the previous stage, the programme's aim would be re-evaluated to raise the effectiveness of the projects to be co-financed. At this stage one may expect some shortage of resources, arising out of increased demand.

From the experience gained, and from proposals and recommendations arising from the assessments carried out, changes to the cost levels have been introduced



(avoiding the implementation of programmes that would require too many resources, where the objective was more to raise the payment of 'overheads' to the agency). Clear budgetary structures have been set out by region and by the agency. The next step is to use external assessors to carry out a systematic sample evaluation of the projects to follow up the implementation. These initiatives, together with the changes that have been introduced over time to the programmes themselves, have consistently aimed at ensuring that the actions have greater impact.

Certain risks that should be avoided are:

- Not to generate over-dependence in the system on one particular agency, thereby some of the advantage of less-bureaucratization would be lost. It also gives the agency too much weight in negotiations with the public sector, which then gets transformed into a monopoly relationship. There is also the risk that the agency will generate its own vested interests, which then work counter to both the public interests and those of the clients.
- Exclusive dependency of the intermediary agencies on the financing that the system provides for them. This implies that it is preferable to have well established agencies, for whom the receipt of development resources is not essential to their operations, since this will enable the programmes to concentrate on the economic impact they produce, rather than as a way of protecting their own interests.
- The public institution must have the capacity to direct the work of the agencies. In order to avoid arbitrary selection it should be proactive in stimulating and helping to organize demand, without guaranteeing the award of resources. This should be made conditional on the quality of the project. Even so, it may be necessary for there to be an independent public intermediary who can work in those business segments that are not suitable for the private sector to implement.

## Notes

1. The main 'failures' included, among others:
  - insufficient depth of the markets, mainly determined by asymmetries between information and transaction costs
  - the existence of externalities and inappropriate strategies
  - lack of economies of scale.
2. Under the previous scheme, the consultants were the real 'sales force' for the FAT; they were the main people interested in the maximum number of consultancies being conducted. The problem is that the consultant sells his speciality (or general knowledge) and his aim is to convince the business owner that his proposal is the most suitable. Not all business owners are fully aware of the actual nature of their problem. Under the new scheme, the business owner still decides, but has a diagnosis made by the agency, which will give him a better idea of the real situation. The diagnosis also serves as a basis of comparison for measuring the effectiveness of the consultancy carried out.
3. In the case of tourism, the effect is practically direct, but this is not the only sector where it occurs.

## 12. Review of business services and local economic development

FRANCISCO ALBURQUERQUE

### Structural change, economic reforms and local development

THE COUNTRIES OF LATIN AMERICA and the Caribbean are confronting the inescapable demands of structural change in their economies. This affects not only the production framework and business management, but also the role of the state and the degree of regulation of society and its public and private institutions. Based on techno-economic and organizational restructuring, major innovations are being introduced, which are opening up new horizons as regards optimal production outputs and competitive operations. These developments have resulted in the emergence of new economic activities, and the decline of others. This has taken place through the restructuring of the existing production frameworks and enterprises and calls for a process that demands an imaginative design of policies to face these challenges, taking into account the specific nature of each country and region. To these structural changes have to be added the effects of increasing globalization impacting on various sectors. This imposes demands for higher competitiveness, increased efficiency and the introduction of new technologies.

The structural reform policies have improved the operation of markets, by removing the constraints of past centralized, state-controlled regulations. These new policies have given priority to macroeconomic stability and have tried to guide the economies increasingly towards competition in international markets. Macroeconomic stabilization has thus made it possible to dispel the negative effects of inflation, which in turn has helped to reduce financial instability. The new situation favours the application of policies at the micro- and mesoeconomic level, and the introduction of technological innovations in the countries of Latin America and the Caribbean. Many of the economic activities are carried out in these countries by microenterprises and small enterprises, that are unable on their own to access production support services, restricting the process of productive and management innovation.

As can be seen from Table 12.1, in 11 Latin American countries – Argentina, Bolivia, Brazil, Colombia, Costa Rica, Chile, Mexico, Nicaragua, Panama, Peru and Uruguay – microenterprises and small enterprises represent over 96 per cent of existing enterprises, and over 56 per cent of employment. Within the formal establishments, microenterprises make up 77 per cent of the total, and account for over 27 per cent of jobs, while small enterprises represent approximately 20 per cent of the establishments and give employment to almost 30 per cent of the working population. These figures indicate the enormous effort that has to be made, in terms of innovation, to modernize these enterprises. Policies dictated by the state are ineffective to achieve this.

Microenterprises and small enterprises are most important in providing employment and income for broad layers of the population, as well as in creating



**Table 12.1 Importance of microenterprise and small enterprise in Latin America**

Countries	Enterprises by number of employees	Number of enterprises (% of total)	Share of employment (% of total)
Argentina	1 to 50	96.5	47.0
Bolivia	1 to 49	99.5	80.5
Brazil	1 to 49	94.0	37.4
Chile	MISMEs up to 200	97.2	79.8
Colombia	1 to 49	95.9	66.4
Costa Rica	1 to 49	96.0	43.3
México	1 to 50	94.7	50.8
Nicaragua	1 to 30	99.6	73.9
Panamá	1 to 49	91.5	37.6
Perú	1 to 50	95.8	40.2
Uruguay	1 to 49	97.9	64.4
Average of 11 countries	Micro- and small enterprises (MISES)	96.2	56.3

Source: Official data on business establishments, with the exception of Argentina, Nicaragua, Panama and Peru, which refer to manufacturing establishments.

a balanced spread of technical progress and economic growth. There is need to change the current approach prevailing in Latin America, which considers this group of enterprises as marginal and generally 'not really viable', and as recipients of assistance funds, rather than as an important part of the national economy. There needs to be a broad approach of productive and enterprise development for microenterprises introduced nationally, while strengthening the role of local authorities in this field.

Enterprises do not operate in a vacuum, but are interrelated in linkages with one another, as suppliers and customers in successive phases of productive activities. Listing enterprises by size is not very helpful. We need to know the productive linkages and the economic groupings in which these enterprises operate. The lack of economic information impedes effective actions to improve these linkages and serves as a barrier to modernization in those enterprises.

Moreover, there is a lack of appropriate criteria for gathering substantive information on economic development, since the classical differentiation of economic activities (primary, secondary, tertiary) is of little use when intervening in the real business world which, in practice, mixes different linkages ('backwards' and 'forwards') from various sectors.

Economic activities are not, therefore, exclusively agricultural, industrial or service-related, but a set of elements of transformation that incorporates inputs from all these sectors. Thus, the old sectoral classification is becoming obsolete, since what is really important is whether or not the activities incorporate more advanced components of information and of technologies.

Microenterprises and small enterprises do not constitute a marginal or insignificant segment within the enterprise structure of Latin America. They form a substantive part of the economic base in each country or region. They need to be dealt with appropriately on the microeconomic level and incorporated in the

structural changes proposed. Support for innovation in the microenterprises and small enterprises sector must be given greater emphasis in Latin America, and be considered as part of the role of local council officers (regional and municipal). Otherwise one runs the risk of moving forward macroeconomic adjustment, while leaving behind large sections of the economy.

Small and medium-sized enterprises are also important in developed countries, where SMEs also comprise a significant total number of enterprises and of sales, jobs and exports. According to data from the European Observatory for the Small Enterprise (European Union, 1994), in 1993 there were 17 million SMEs in the European Union (EU), providing 67 million jobs, of which around 30 million were in enterprises with fewer than 10 employees. As stated by Bianchi (1996), SMEs therefore have a crucial role to play, not only in promoting employment, but in guaranteeing the dynamism of the markets, the success of regional trade agreements and the strengthening of social stability in the countries of the EU.

Indeed, a strategy aimed at developing the specialization and complementarity of SMEs, within clusters, can be decisive. There is abundant literature showing how the success of small enterprises in Europe is often related to the characteristics of these clusters of different firms, which are individually specialized but which work in a network of complementarity. 'Clusters' can play a leading role in the struggle for the competitiveness of SMEs.

The demand for modernization among all these smaller enterprises cannot be adequately met through a centralist approach. One of the main lessons of international 'best practice' is of the important place of local and regional economic development in the development of SMEs. The proximity of these agencies to the enterprise makes it possible to identify the real demand for business development services. This applies both to the introduction of technological and management changes and to skills development in line with the needs of local businesses. The institutional strengthening of local authorities, and the encouragement of decentralization which stimulates the democratic participation of citizens, become basic tools in local economic development by fostering concerted action by both public and private players to help support the development of local businesses.

Enterprises depend upon the quality of their urban environment to enable them to progress in terms of productivity and competitiveness. It is necessary to improve the quality of infrastructure and basic services, as well as of public transport systems, as principal components of the environment in each city or local area.

### The importance of the local environment in globalization

The focus on productive efficiency and better business management calls for appropriate public and private actions in relation to two aspects of economic development: 1) technological and management innovations in production and marketing of goods; and 2) skills development. This calls for responses at a microeconomic level, since it affects production and management of both enterprises and organizations, both private and public. Responses are also needed at a mesoeconomic level, and effective steps have to be taken to obtain a suitable



match between training and the requirements of the businesses in each local area.

Within the microeconomic level there is need for improvement in the efficacy of business networks of suppliers and customers, the quality of industrial relations that involve the employees, the matching of training to the requirements of the local economy and type of enterprises, and the linking up of firms with the providers of business development services. None of these aspects is usually covered in the general agenda of macroeconomic adjustment, which aims to create stable conditions for the basic macroeconomic environment. Although these are fundamental, they are merely preconditions for development – not its sole agenda.

International 'best practice' shows that, since the mid-1980s, a significant change has been taking place in the developed countries in the design of business development policies. It has been increasingly found that local or regional approaches are highly effective in dealing with demands for technological change and skills development. The importance of the local environment might seem to be in conflict with the increasing globalization of economic activities and sectors. However, in spite of this strong trend towards economic 'globalization' of sectors, the overwhelming preponderance of production on a worldwide level continues to take place essentially in local, regional or national structures.

According to data from the World Bank's *World Development Indicators 1998*, the world trade in goods and services in 1996, measured by the sum total of exports and imports of goods valued in current US dollars and divided by the gross domestic product (GDP) in terms of purchasing power parity, was only 29.1 per cent of world production. In other words, in spite of the significant growth in external trade that has taken place over the past ten years (see Table 12.2), over 70 per cent of world production as included in national accounts for 1996 was not marketed internationally; it was fully within the local, regional or national economies.

This calculation of world production does not include the activities of consumption by the producer, barter or business activities of an informal character, which are significant in the developing world. If we assume that these forms of productive activities equal around 25 or 30 per cent of total production measured in monetary terms by national accounts (which is a modest estimate), we can affirm that, in 1996, over 75 per cent of world production was still produced in a local, regional or national context.

In fact, a considerable share of countries' exports is aimed at neighbouring countries rather than the whole world, as some views of 'globalization' might suggest. There is, therefore, some exaggeration in the widely used expression 'we are in a global market', since the truth is that that market continues to be quite heterogeneous and the role of the different local production systems continues to be decisive.

In the case of Latin America, as can be seen from Table 12.3, for an average of 18 countries the total extent of exports and imports represents only around 20 per cent of GDP. That is to say, if we take only the production measured in monetary terms, 80 per cent of Latin American production is within local, regional or national economies. If we add to this an estimate of consumption by the producer, barter, informal, etc. assuming that these are equal in Latin America to around

**Table 12.2 Trade in goods and services as a percentage of GDP (measured in terms of purchasing power parity)**

Countries	1986	1996
France	33.7	45.4
Germany	—	55.1
Greece	21.2	27.9
Italy	28.0	39.6
Japan	21.5	26.1
Spain	18.4	36.8
United Kingdom	33.3	46.3
United States	14.0	19.4
World total	20.7	29.1

Source: *World Development Indicators 1998*, World Bank, Washington DC.

**Table 12.3 Trade in goods and services in Latin America as a percentage of GDP (measured in terms of purchasing power parity)**

Countries	1986	1996
Argentina	5.9	14.0
Bolivia	11.7	12.0
Brazil	5.8	10.2
Chile	11.6	18.9
Colombia	7.1	9.5
Costa Rica	20.2	34.4
Dominican Republic	12.3	28.3
Ecuador	11.8	16.3
El Salvador	20.7	22.5
Guatemala	9.7	12.2
Haiti	6.9	12.6
Honduras	21.7	42.5
Mexico	6.8	26.1
Nicaragua	15.5	19.4
Paraguay	8.2	29.3
Peru	6.6	13.0
Uruguay	14.7	22.8
Venezuela	15.3	19.0
Average 18 countries	11.8	20.1

Source: *World Development Indicators 1998*, World Bank, Washington DC.

**Table 12.4 Gross direct foreign investment as a percentage of GDP (measured in terms of purchasing power parity)**

Countries	1986	1996
France	1.1	3.7
Germany	—	2.0
Greece	0.6	0.8
Italy	0.4	0.8
Japan	0.9	0.9
Spain	1.1	1.9
United Kingdom	3.6	6.6
United States	1.4	2.6
World total	1.1	2.2

Source: *World Development Indicators 1998*, World Bank, Washington DC.



40 or 50 per cent of formal production, we can infer that in reality over 86 per cent of production is produced and marketed within the domestic economy.

The figures of gross direct foreign investment, i.e. the sum of the flows of incoming and outgoing direct foreign investments contained in the balance of payments (including capital stock, reinvestment of profits as well as other types of long-term and short-term capital), are another indication of the degree of 'globalization'. Here, the data show that, on average, these gross direct foreign investments represent only 2.2 per cent of world GDP (see Table 12.4).

For the 18 countries of Latin America mentioned above, these investments are equivalent to only 1.1 per cent of the total GDP of the region. This shows the extent to which the production decisions are primarily taken by national, regional or local decision makers. One should not, therefore, confuse the growing trend of globalization of certain sectors of the world economy, and the liberalization of markets, with the assumption that 'there is only a global market' or that foreign investments are the most important source of capital. This exaggeration is not helpful when it comes to designing strategies for innovation in the different specific situations in each country.

### **Progress in the processes of democratization and decentralization in Latin America**

Local and regional authorities have significant advantages over central governments, both because of their greater capacity for representation and legitimacy before their constituencies, which enables them to serve as institutional agents of social and cultural integration of communities; and because of their greater flexibility and adaptability within changing contexts (Borja and Castells, 1997). Hence, the strengthening of institutions at a local or regional level can help the creation of networks of co-operation between enterprises and institutions through greater transparency in information and swift action against bureaucracy and corruption. Faced with the challenges of the technological revolution and economic globalization, the strengthening of the institutions that manage and represent society at a local level combines participatory democracy, administrative decentralization, and social and cultural integration with innovation and business development.

The progress in democratization in Latin America and the Caribbean has also strengthened municipal governments, after decades of local authorities being the appointees of central government. Cities, villages and districts in Latin America now exercise the right to elect their own local representatives and to make them accountable for their actions. This change, which implies turning local councils into new centres of power and decision making, is part of a process of decentralization of authority accompanying the political and economic reforms adopted by more governments in Latin America over the last decade.

As a result, there has been an affirmation of the right of citizens at local level to help decide on the allocation of public resources to tackle local and regional problems. Under pressure from the electorate, central governments have begun to decentralize tax and tariff mechanisms, which has placed unprecedented monetary resources in the hands of municipal and local governments, involving them

in new roles and responsibilities for the provision of basic social services and the deployment of a wide range of local development projects (Hausmann, 1997).

But the progress of the decentralization processes in Latin America and the Caribbean cannot be reduced to fiscal matters alone. Provisional governments have been increasing their political autonomy and, in turn, have been taking responsibilities for services such as education, health and other fields for social and economic development. The process of decentralization should not be restricted merely to an improvement in the management of the increased financial resources transferred to local governments, or the more efficient provision of municipal public services by transferring to the private sector those that can be managed by the latter more efficiently, but should also include the promotion of business development and strengthening of local economic structures.

### **Lessons from the experiences of local economic development internationally**

In the developed countries a variety of local development initiatives have taken place over the past two decades, to promote new enterprises, and generate new jobs, by encouraging innovation. These initiatives have also fostered networking between small firms, greater product diversification, and group efforts to identify new markets.

The purpose of this set of local development initiatives is to focus on the need to support macroeconomic adjustment with flexible microadjustments in the different regions of the country. In each locality there must be a parallel effort to promote innovation in technology and in modern management, as well as skills development to fit the specific industries in each area. This implies emphasizing innovation according to each locality's capacity for development, rather than channelling uniform programmes from central government. This is why decentralization is indispensable in these processes, as it transfers competencies, resources and responsibilities to the different local administrations.

This also implies mobilizing the active members of the community in each area to become involved in local economic development and to launch business information systems relevant to the region. Efforts should be made to encourage innovation in local enterprises; to improve basic infrastructures; to strengthen co-ordination of services supporting microenterprises and small enterprises; to facilitate access to financing facilities for small borrowers – in short, to create the appropriate institutional instruments for regional development, through joint public-private action in the community. The problem faced by cities, towns and local districts is how to restructure the business community and improve the urban environment, so that agricultural, industrial and service enterprises can raise productivity and strengthen competitiveness in all markets.

Local development experience shows that the proper way forward is a strategy of enterprise development, implemented through actions at a local level. Local development initiatives require new attitudes, far removed from offering subsidies and waiting for the public authorities to provide solutions. On the contrary, this approach stresses the importance of people acting for themselves in each locality, by mobilizing the different players and organizations, both public and



private. Local authorities have to be strengthened for this new role. There is a need to look at them from the perspective of economic development and try to integrate them with the structural reforms that have been put in place nationally to complement reforms towards a more efficient economy.

Structural changes test the ability of economies, institutions and social players to adapt to new opportunities to deploy their resources and capabilities. Public policies try to reinforce these processes by initiating actions aimed at increasing productivity and the competitiveness of enterprises. This is done partly by improving the operation of the capital market and development of the skills and human resources. It also requires raising the efficiency of the public sector by reforming national and local government. Microenterprises and small enterprises must be given suitable treatment to help them compete 'on a level playing field' with large enterprises and also to ensure that economic growth, job and wealth creation are equitably spread throughout the country and to all strata of society.

Economic growth does not necessarily have to be concentrated in big cities. It can also be spread more evenly through the country if the potential for development is fostered throughout the whole country. The new strategy of regional development, the technological and institutional characteristics of the local environment, and the local physical and business resources can help to determine the process of economic growth. For that reason, in order to develop a region one has to use, apart from external imports, *all* the internal resources of the area.

Programmes for enterprise development must encourage innovation, raising entrepreneurial capacity, improving indigenous skills and a new more flexible attitude to marshalling all local resources effectively to meet the current challenges. Achieving local development is therefore not only based on the implementation of large industrial projects with external capital, but also in supporting initiatives that use the local human potential available in the area and fostering entrepreneurial initiatives.

The assessments that have been made of local development initiatives in the OECD countries show that the countries with the best indicators in terms of employment, income, social justice and quality of life are not those that strive to reduce production costs, lower salaries and offer tax subsidies to enterprises, but those that have stimulated enterprises by encouraging their development capabilities, such as the quality of human resources, technological innovation, basic infrastructures, appropriate financing facilities, etc. To a large extent, these are the result of dynamic regional or local policies, initiated by local administrations in collaboration with the private sector. Thus, the strategies that reinforce intangible factors of development (such as the creation of a climate of enterprise, innovating environment and management abilities) seem to be much more effective than others that aim merely to reduce costs.

### Local economic development initiatives in Latin America

Over the past few years, a number of local initiatives have been springing up in different parts of Latin America. They seek to make better use of indigenous

resources by improving the networking of different local businesses towards greater efficiency and better business management. Unfortunately, these incipient local economic development initiatives in Latin America have generally tended to remain as isolated cases, having little effect on the types of economic intervention. They have not yet managed to create the regional innovating environments as observed in the 'best practice' in the developed countries, but they do clearly point to the need for a combined policy of strengthening local government and promotion of enterprise development as a fundamental basis of development initiatives. There is a need to rethink the roles and functions of the public administrations, to enable them to achieve maximum efficiency at their different levels.

To date, in Latin America and the Caribbean, the region's national governments and multilateral organizations have not sufficiently promoted or financed local economic development initiatives. The sectoral approach to economic problems has prevailed and there has been little adaptation to local situations in supporting small enterprise development. The centralized approach to economic development fails to recognize the potential of human resources and small enterprises available locally. The pursuit of short-term results by governments is counter-productive; local development generally requires longer timescales to produce the real results from investments.

The pressure of the specific demands for technological and industrial change in each region must recognize the importance of micro- and small enterprises in the creation of employment and income. It has begun to be recognized that there is a need to promote indigenous development of each locality, helped by increased decentralization and transfer of resources to regional and municipal authorities. There is a slow, but increasing awareness of the importance of the localized character of economic and social development, and the need to design decentralized support programmes for training, innovation and entrepreneurial development. All this means that greater decentralization is needed in the organization of public institutions.

### Conclusions

The process of decentralization helps bring public services into line with the requirements of the population. It can facilitate greater citizen participation and increase the degree of accountability for the actions of those in power. To achieve this, local administrations must have the institutional capacity to manage the new responsibilities assigned to them for there to be an effective local democracy, with sufficient political participation, to avoid the risks of nepotism and other forms of corruption. The relations between the different administrations, including the manner of transfers from the centre and the rules on borrowing must be subject to *strict budgetary controls*. There must be strict supervision of expenditure and of the right to generate revenue at the local level, in order to minimize fiscal problems and corruption.

For decentralization to offer its full advantages in Latin America and the Caribbean – as demonstrated by best practices on an international level – it cannot be limited to taxation. Regional governments have to take on increasing political autonomy and more important public services, such as education, health



and other services for socio-economic development. The process should not be limited merely to improving the management of the increased financial resources transferred to local government, nor to the more efficient provision of local public services by transferring to the private sector those services that can be managed more efficiently by the latter, but should also include the function of promoting productive development and entrepreneurial initiatives in each locality.

Enterprises are not alone in the competitive struggle in the markets. The grouping of enterprises (or clusters) also compete within themselves, and the institutional environment in which these enterprises operate also plays its part. The availability of qualified human resources, the linking of the system of education and training with the productive profile of each area, proper municipal management and the efficient provision of services with the aid of the private sector, access for microenterprises and small enterprises to financing facilities, the availability of business services for enterprises to access information on markets and technologies, marketing, co-operation between enterprises, etc. are all aspects of the strategic factors that have to be built into each region, through a joint public-private effort to create innovating environments in the different areas.

While this is valid for all types of enterprise, it is even more so for microenterprises and small enterprises, who are unable on their own to access the support services required for business innovation. These enterprises must be able to find in their own districts the inputs for productive and management innovation. Only in this way will small enterprises be able to set up local networks with suppliers and customers, as well as with business services, training or support agencies. The local environment becomes the place where innovations are stimulated and information is disseminated, supplying positive support for raising productivity and increasing competitiveness of enterprises.

As can be seen, the new demands of structural adjustment, together with the impacts arising from economic globalization may give rise to complex and differing situations on a local level. It is not always possible to respond effectively, in terms of development policies, to those diverse economic situations from a centralist or even from a sectoral perspective. What is required instead are policies in which local authorities intervene as decisive players in joint public-private action to tackle the different situations as they arise.

Local governments have a major responsibility in the creation and management of the fundamental 'capital stock' as the basis for the productivity and competitiveness of local enterprises. But, as has been pointed out, this requires the type of action that will support the structural reforms on the local level and ensure technological and management innovation of the local production systems, in order to generate higher quality employment and new sources of wealth for the communities.

Local governments must extend the action into the new field of interest by becoming promoters and strategic catalysts of initiatives launched together with the private sector, to create a local innovating institutional framework to stimulate the development of enterprises, municipal modernization and the generation of employment. The financing of local development initiatives and of the moni-

toring of the progress of these actions in Latin America are tasks that could be supported by the multilateral and bilateral donors.

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## 13. The role of private partnership and public agencies in the Sinos Valley, Brazil

HUBERT SCHMITZ

### Introduction

It is now well established that clustering and networking help small and medium enterprises to grow and compete in distant markets. The evidence comes from case studies carried out in many countries and covering the 1970s and 1980s. It is less clear how local clusters cope with the global competitive pressures typical of the 1990s. This chapter sums up the experience of a Brazilian cluster which one would expect to do well: the shoe-producing Sinos Valley in Rio Grande do Sul.<sup>1</sup> By the end of the 1980s, the cluster had become a major exporter of leather shoes to the USA and Europe. Recent research has shown both success and failure in responding to the global competition of the 1990s. Drawing lessons from this case is particularly interesting. It shows that co-operation among local enterprises strengthens their ability to compete globally and that business associations can play an important role in identifying the key problems and in proposing solutions. However, it also shows that the state is not redundant. Even where local industry and business associations are already well developed, public agencies are needed to mediate conflicts between business associations and entrepreneurial alliances and help forge a local innovation consensus.

### The challenge

'The Dragon Advances'. This was the headline of a special report by a Brazilian journalist on the Chinese shoe industry. He had gone to China to see for himself how and why China was able to out-compete the Sinos Valley. The low wages, long working hours and low taxes in China were the main themes in his report, which was published in three instalments in the main local newspaper (13, 14 and 15 April, 1995). Coinciding with the news of several local factory closures it sent ripples of fear through the Sinos Valley. It seemed that the whole cluster had finally internalized a threat that had been known for several years.

Before summarizing the cluster's response, it should be stressed that equating the challenge with China's entry into the international footwear market is simplistic. There were multiple challenges: 1) Taiwanese manufacturers relocating to mainland China and using their production expertise and trade networks to export at unprecedented low prices; 2) the rapid growth of US imports slowing down; and 3) buyer behaviour – in external and internal markets – changing from just-in-case to just-in-time. These three changes began to make themselves felt in the late 1980s but a clear perception of these new challenges emerged only in the early 1990s. In a way, this is not surprising: few entrepreneurs had direct knowledge of the international market, inflation rates fluctuated wildly, as did exchange rates. As a consequence there were time lags, first in perception and then in responses.

In order to understand the response to the challenge it helps to recall the advantages that enterprises derive from clustering. Compared with dispersed enterprises, clustering enterprises have two competitive advantages: 1) economies of agglomeration and synergies tend to arise spontaneously with sectoral and geographical concentration; and 2) co-operation between firms tends to be easier. The former advantage is incidental and the latter is consciously pursued. The hypothesis that arises from earlier research on clusters is that responding to major opportunities and crises requires more and better co-operation between the clustering firms. In other words, economies of agglomeration are important to growth but are not sufficient to ride out major changes in product or factor markets: that requires joint action.

As stressed above, the Sinos Valley has been confronted with such a major change. Competition in the global shoe market has intensified over recent years. Other producer countries with even lower wages are squeezing into the market and buyers in the USA and Europe are imposing standards of quality that would have been thought unattainable a few years ago – at the prices they are prepared to pay. Since beating competitors like China on labour costs is hardly possible, the challenge has been to raise quality, speed and flexibility and to open up new markets and marketing channels.

This chapter shows how local producers have responded to the challenge. Have they – in line with the above hypothesis – stepped up co-operation? Have enterprises that increased co-operation performed better than those that did not? What was the role of public agencies in the failures and in the successes?

The information comes from a number of sources, and was collected using a combination of methods: a survey of 65 enterprises; in-depth interviews with selected manufacturers and their suppliers; interviews with the officials of business associations and public agencies; participant observation at meetings of industrialists; screening of the local press, and the usual secondary sources.

### Local co-operation

The focus on inter-firm co-operation in this chapter does not imply that individual excellence does not matter; far from it. Performance within clusters varies, and the excellence of one firm tends to have incidental positive effects on others. Proximity ensures that such external effects do not 'evaporate'. The proposition is that relying merely on such spontaneous effects is not sufficient to cope with crisis, hence the focus on joint action.

One of the main discoveries of the survey is the positive and significant relationship between co-operation and performance. Enterprises that increased co-operation tended to perform better than those that did not. The survey, combined with other fieldwork methods, showed, however, that changes in co-operation over the period 1992–97 varied with the type of co-operation considered. The findings are summarized in Table 13.1.

What stands out is the strong increase in bi-lateral vertical co-operation, notably between shoemakers on the one hand and their input suppliers and subcontractors on the other. The results of the survey are very clear in this respect, but so is the limitation of the research instrument. How real is the



**Table 13.1 Summary of changes in types of co-operation (1992–97)**

	<i>Bilateral</i>	<i>Multilateral</i>
<b>Horizontal</b>	No change	Varies with association
<b>Vertical</b>	Substantial increase	First an increase, then decline

reported 'increase in co-operation'? The detailed case studies of shoe manufacturers and related firms confirmed the increase, but also provided important qualifications. For example, in subcontracting relationships, the co-operation was selective in that it was limited to core subcontractors.

As shown in the Table 13.1, horizontal co-operation changed little. This is clearest in bilateral horizontal relations, but less so in multilateral co-operation. The latter is more difficult to summarize because there are several business associations in the Sinos Valley that have developed in different directions. More interesting than discussing them individually is their joint initiative, the 'Shoes from Brazil' programme. The mere existence of this programme commands attention because it encompassed associations representing the entire local value chain, because it was based on the explicit recognition of interdependence, and because raising competitiveness was its mission. This included a number of upgrading proposals, which ranged from the targeting of new markets to raising the image of 'Made in Brazil', eradicating child labour, joint participation in fairs, and creating a local design capacity. While a lot of the groundwork was carried out by local consultants and association officials, the entrepreneurs themselves were involved in the analysis and formulation of proposals.

Based on a combination of in-depth interviews and participant observation, the rise and fall of this programme was traced. The reason for its decline was that some of the leading enterprises were not interested in the programme succeeding; they put their alliance with a powerful foreign buyer above local co-operation. Producing for this buyer served them well for many years but it kept their strategies firmly limited to intra-firm upgrading, whereas the 'Shoes from Brazil' programme was aimed at upgrading along the entire local supply chain and moving into marketing and design.

Presumably such conflicts of interest – whether carried out openly or not – are not unique to the Sinos Valley. The question is whether their resolution follows a global or a local rationale. The research suggests that the decline of the programme was not a necessary consequence. The local rationale might have prevailed had there been a knowledgeable public mediator – an issue discussed later.

In summary, the research shows that bilateral vertical co-operation increased and that multilateral co-operation across the entire local value chain collapsed. So what? Why should these findings be of wider concern? They are of concern because they have direct implications for the ability of the cluster to compete globally and create jobs and income locally.

The increasing co-operation in bilateral vertical relationships (between shoe manufacturers and suppliers) was essential for achieving increases in quality, speed and flexibility. The survey findings show very clearly this improvement in performance. This improvement is confirmed by European and US buyers, who

suggest that – on the above parameters – their Brazilian suppliers are close to the Italian competitors. In this sense, stepping up co-operation has helped the Sinos Valley to live up to the global competitive pressure.

The problem is that these improvements in production have merely enabled the cluster to stand still. Exports in 1997 were at the level of 1990 – with some fluctuations in between. More problematic still, profits declined. The survey shows this very clearly, particularly for exporting firms. Detailed interviews suggest that this is not just the usual tendency of entrepreneurs to understate their profits, but that profits fell by more than half. As a result there is a downward pressure on wages.

Thus, this case study confirms recent writings on globalization, warning that a focus on manufacturing alone may not lead to sustainable income growth and that a shift to other stages of the value chain – such as design or marketing – may be a more rewarding target. Upgrading outside production has, however, been very limited in the Sinos Valley. While the cluster is a world-class producer, it has not been able to establish a positive and recognizable image in the European and US market, it has not exhibited in a substantial and regular way at the world's key trade fairs, it has very few own brands in its main export markets and very little capacity for innovative design. Progress in these non-production areas was one of the main objectives of the 'Shoes from Brazil' programme. Its failure means that the chances of the Sinos Valley differentiating itself in the international market are a more distant prospect. The final section of the chapter deepens the anatomy of collective failure, focusing on the role of public agencies.

### The absent mediator

Even though some of the largest enterprises were not committed to promoting the cluster as a whole, the collapse of the 'Shoes from Brazil' programme was not a necessary or predictable outcome. There were instances in the evolution of the programme that could have triggered an upward rather than a downward spiral in co-operation. In other words, there were moments when the programme could have gone either way. Informed political mediation was required for the alliance of private sector institutions to work. But government agencies did not recognize their opportunity of industrial policy by mediation.

One of the conflicts that required public mediation concerned the export of semi-processed leather (wet blue). In the course of 1996, leather exports were increasing fast, infuriating tanneries specializing in final processing, and also shoe manufacturers. Their concerns were that 1) local raw material prices rose, 2) the best leather was exported, especially in the specification needed for high quality shoes, and 3) most of this leather went to the countries that were Brazil's main competitors in the international footwear market – especially Italy and Hong Kong (for re-export to other Asian countries).

The proposal that they put forward was that a 7 per cent export tax should be levied on semi-processed leather. The reasoning came from a differential in EU tariffs of zero import tariff on semi-processed leather and 7 per cent import tariff on finished leather. This EU regulation clearly benefited the Italian (and other



European) tanners, so the proposal that the Brazilian government should counterbalance the differential seemed modest and reasonable. Yet the issue remained unresolved, harming the 'Shoes from Brazil' programme far beyond the immediate issue at stake.

Another conflict concerned the frequency and timing of trade fairs for footwear machinery and components. The local trade fair organization tried to impose timings that suited its international partner (an Italian trade fair organization) more than the local machinery and component industry. A negotiated settlement was reached only after several years of fierce conflict, from which both sides emerged weakened.

These are two examples of conflicts in which public mediation was required and openly requested. The positions of the various parties have been set out in more detail elsewhere (Schmitz, 1998). The main message here is that there is no capacity within government to consider different claims and assess their validity and likely impact. Nor is there much interest in building up such a capacity. Neither at the federal nor the state level does a serious attempt exist to conduct industrial policy. Neo-liberalism might be on its way out in Washington, but it continues to dominate in Brazil, a country that used to practice an active industrial policy. The actors involved in the 'Shoes from Brazil' programme were not hoping for a return to the old-style top-down industrial policy. On the contrary, they had taken the initiative, they had done the institutional groundwork, they had explicitly recognized their interdependence in the value chain, they had created a forum for discussing their differences. But there were cases where they could not overcome these differences. What they were hoping for was intelligent mediation by a public actor. This did not materialize.

Instead, government adopted the position that, since the private sector could not agree, it would take no action – which was conveniently in line with the dominant neo-liberal sentiment 'the free market with its potentially perverse effects – is better for the private sector than a situation of state intervention' (*Exclusivo*, 3–9 June, 1996). It is impossible to know whether private multilateral co-operation would have succeeded with public mediation. It is, however, clear that with public mediation there would have been a much greater chance of resolving conflicts in the private sector.

There is a potentially important policy conclusion, not just for the debate on clusters but for the debate on business development services. One of its main tenets is that such services can be provided by the private sector itself – either through specialized enterprises or collective organizations such as business associations, consortia and the like. The 'Shoes from Brazil' programme both underlines this view but also shows its limits. The private sector did all the preparatory work for what could be called a programme of local sectoral governance, but it could not – on its own – resolve the emerging conflicts. What is striking is that even in Brazil, where inefficiency and corruption have discredited the state, it is still seen as the most legitimate mediator. But in addition to legitimacy, mediation requires knowledge of two types: knowledge of the industrial sector in question, and expertise in techniques of conflict resolution. In summary, conflict mediation is an important role even, or especially, for the lean state which relies on the self-help of the private sector.

This policy conclusion is also important for the recent debates on regional development and innovation systems. Both have stressed the importance of institutions, especially the relevance of collective institutions. The Sinos Valley has this kind of 'institutional thickness' in its professional associations, business associations and technology centres. Clearly, this is not sufficient because fragmentation occurs and conflicts arise. Even in an institutionally well endowed region, government is needed to mediate conflicts and help foster an upgrading consensus.

Such a conclusion is inevitably controversial, given the dangers of incompetence and corruption in the public agencies. The development literature of the past decade has given a great deal of attention to the failures of public agencies. The conclusion to be drawn from this debate is not, however, to minimize public intervention but a shift towards different kinds of intervention. The contention of this chapter is that conflict resolution is one of those interventions that deserve more attention in future. Experiences from other countries and fields lend support to this proposition. For example, Sabel (1992) has stressed the importance of mediation and arbitration in the studies of European industrial districts: 'whenever the parties to these conflicts regulate their disputes through arbitration boards or councils ... the districts flourish; when not, then not' (p. 228). Further support comes from Rodrik's (1998) recent study *Making Openness Work: The New Global Economy and the Developing Countries*. He concludes that societies with weak institutions of conflict management experience lower growth. 'Conflict management institutions play a far more important role in generating the capacity to handle external turbulence than conventional economic analysis has generally allowed' (p. 88).

## Notes

1. Readers interested in a more detailed account of the cluster's recent experience are referred to Schmitz, 1998.

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## 14. Public-private partnerships in local development in Argentina

OMAR A. PEROTTI

### Introduction

LOCAL ECONOMIC POLICIES should respond to the need to foster partnership between businesses and institutions to establish a network of relationships that help to create conditions for increasing the competitive advantages of local firms.<sup>1</sup>

This is part of the attempt to cope with globalization and to integrate the regional economy into the world system. It is about working on the productive system, from the infrastructures to all the other aspects that increase the competitiveness of enterprises.

Rafaela, a city in the Province of Santa Fe, Argentina, is one of the examples of this type of action. This city, situated in the central-western region of the province of Santa Fe, is the third most important city after Rosario and Santa Fe; with over 80 000 inhabitants. It is the centre of an extensive cattle-raising agricultural region and provides the base for intensive industrial operations, mainly in agribusiness and the metal-mechanical industry, and of commercial activity.

Rafaela's community lives in a culture derived from the pioneering colonists who migrated to this region from different parts of Europe and based their lives on hard work and saving.

Although there is no single factor that explains this, there are a series of historical, cultural, political and economic factors that have helped create a positive environment not only for the growth of the productive sector, but for the society as a whole.

This environment enabled it to grow within the pattern predominant in Argentina before the 1990s. It also provided it with a basis for responding to the new challenges in a highly competitive market.

One of the principal reasons behind this experience is the fundamental role of the local institutions, both public and private, that Rafaela has produced, and their interrelationships. Among these has been a municipal government that is no longer concerned only with the provision of services and the basic infrastructure. It now takes a leading role in providing broader services and in co-operating with initiatives arising from within the community itself.

### Socio-economic description of Rafaela

The Province has 19 departments, one of them is the department of Castellanos - Rafaela is its centre - which provides around 5 per cent of the industrial output of the Province of Santa Fe, with a rather higher share in the two main sectors of specialization - agribusiness and the metal-mechanical industry. The industrial sector of the city represents around 50 per cent of the total industrial output of the department and comprises 449 enterprises employing 8300 people, accounting for 87 per cent of employment.

Rafaela's manufacturing industry has adapted better to the increases in competitive pressure resulting from the liberalization process, following the convertibility plan and the setting up of Mercosur,<sup>2</sup> in particular when compared with the industrial evolution of the Province of Santa Fe as a whole, and with the national average. This is shown by its very successful performance between the mid-1980s and the mid-1990s:

- industrial employment went up by almost 20 per cent, while at the provincial level it fell by a similar proportion; and
- the number of industrial establishments in Rafaela increased by 13 per cent, and fell by 11 per cent at the provincial level, reflecting a very significant rate of business creation.<sup>3</sup>

There are also a number of other indicators on the performance of Rafaela's enterprises which make them stand out above the rest of the province.<sup>4</sup>

Table 14.1 Performance of Rafaela Enterprises

	Rafaela	Province
Exporting industries	13.5%	6.9%
Enterprises that train their staff	37.5%	16.8%
Membership of chambers of commerce	62.0%	39.5%
Enterprises with a modern profile(*)	16.1%	3.9%

(\*) Enterprises were considered as having a 'modern profile' if they could simultaneously meet 10 requirements linked with an innovative attitude.

Its socio-economic position compared with other cities in the country, or with the average of certain national indicators, reveals a remarkably high performance.

The unemployment rate is lower, around 8 per cent in 1998 against a national average of 14 per cent; health coverage for its population is 81 per cent against an average of 70 per cent in the province as a whole; and the number of people unable to meet their basic needs, which in Rafaela is 13 per cent, in other cities in Santa Fe province is 18 per cent.<sup>5</sup>

### The relationship between the public sector and the private sector

By studying the evolution of the institutional system we can gain a clearer understanding of how Rafaela has achieved its growth. The historical progress has been as follows:

- 1906 Rural Society
- 1912 School of Technical Education
- 1926 Rafaela INTA
- 1932 Centre of Commerce and Industry for the Department of Castellanos - CCIDC
- 1966 Chamber of Metal Manufacturers
- 1967 CITIL - Centre for Technological Research of the Milk Industry
- 1972 UTN - National Technological University - Rafaela Regional Faculty
- 1978 CCE - Chamber of Foreign Trade
- 1991 SPE - Municipal Office of Economic Planning
- 1992 Foundation for Regional Development



- 1994 CAPIR – Regional Chamber of Small Industries
- 1995 CITRA – Rafaela Technological Research Centre
- 1996 CDE – Enterprise Development Centre
- 1997 ICEDEL – Institute of Training and Research for Local Development

As we see, public-private co-operation became a general feature of institution development only in the 1990s.

It is instructive to review more fully the institutional development in three particular years: 1912, the creation of the Technical School (School of Agricultural Engineers), 1932, Centre of Commerce and Industry for the Department of Castellanos (CCIDC) and 1978, Chamber of Foreign Trade of the CCE.

*1912: School of Agricultural Engineers.* This is now the School of Technical Education No. 460. Its graduates were the first trained people who went into industry in Rafaela. Many of the later small business owners were also taught in its classrooms and workshops, particularly in the metalworking section.

*1932: Centre of Commerce and Industry for the Department of Castellanos.* This was the parent organization of 24 chambers of commerce and industry in Rafaela, with influence throughout the province.

*1978: Chamber of Foreign Trade.* It began its search for foreign markets in an approach that significantly anticipated the process which was later followed in the whole of Argentina. A group of companies received significant training and partnership, along with some capital. This organization is the one that works in other chambers in the province and throughout the country, together with the Office of Foreign Trade, the Banco Provincial and the municipal council, with the aim of helping new exporters.

If the 1980s were, as many have said, the lost decade in Argentina, there is no doubt that the one that followed has been the decade of the greatest structural changes. When the macroeconomic changes came in the 1990s, Rafaela already had the experience that gave it a basis from which react vigorously and positively to the new economic developments.

In 1991 the municipal council of Rafaela took over the role of spearheading economic development which, until then, had been carried out by private institutions and businesses. The municipal council needed to show that a public administration could assist growth. Its main executive arm for this was the Office of Economic Planning (SPE), one of the first such municipal institutions of the sort<sup>6</sup> in Argentina, which started visiting businesses, collecting information, generating statistical data for decision making, and identifying priority areas and the medium-term needs of Rafaela and its Region.

At the same time, and in view of the need for the State itself to be restructured, work was started on the municipal accounts so that, within a few years, the budget could be put on a sound footing and the city recapitalized. The municipality then had a high level of borrowing, a significant deficit, obsolete equipment, overstaffing, inflexible regulations governing civil service personnel, poor training and low morale.

A training programme in new management techniques was initiated. This was done on the assumption that good services are not exclusive to private enterprise, that the future of the city depends, at least in part, on the success of public services, and municipal councils, moreover, are not merely bodies that regulate and order activities, but must also strengthen local development, meeting growing requirements.

The aim was to put Rafaela in a role of regional leadership with national influence, based on the excellence of its public and private resources, in order to achieve an impact on economic, political, social and educational issues.

The achievements of the first years of this activity led to the receipt, in 1995, of the National Award for Quality (Premio Nacional a la Calidad).

It was necessary to rebuild the confidence of residents in their municipal council through good administration.

Reaction from the private sector was rapid in several areas, such as creating a foundation for dealing with management and quality issues on a regional basis. Co-ordination and mutual trust have helped build, with the political will of all sectors, a network of co-operation that today characterizes Rafaela and is one of its greatest strengths.

Another distinctive element created, to quote Patrizio Bianchi, was a breed of 'executive agents whose role was to design and administer local or sectoral actions in order to define the institutional framework at a national level and to negotiate the process of convergence at an international level'. He continues: '... executive agents must operate from local and national government offices, but also in business associations, universities, research centres and international organizations. The formation of such a body is a crucial factor in the success of industrial policy'.<sup>7</sup>

In addition to the knowledge accumulated previously at the beginning of the 1990s, a group of new leaders – most of them younger – came from different parts of the civil society to move this change forward. This group of Rafaelians had the right contacts to pass from the public to the private sector and vice versa, which improved the necessary links between the sectors.

### **Policies implemented in the 1990s<sup>8</sup>**

One of the most tangible results of the positive role played by the institutions is the implementation of an industrial policy that 'wherever it comes from, is implemented by everyone'. There is now a serious attempt not to duplicate efforts, while there has also developed better controls over policy design. This has helped to reduce the uncertainties arising from globalization and has, in some cases, improved the situation of businesses in market terms.

#### *Partnership policies for small businesses*

The municipal council's Office of Economic Planning is starting to work in the field of SME by bringing together a sector that did not belong to any sectoral chamber. It was highly vulnerable to the impending changes, due to a low investment in resources, lack of information and inadequate management capacity.



In the new framework, it was the State's responsibility to initiate active policies to deal with this. The limited scope of CCIDC held back enterprises with dynamic potential for growth, increasing the gap between small and large businesses.

For two years, programmes combining collective and individual actions were carried out in the fields of training and business development services. Following training courses, the preparation of investment projects, the creation of groups for joint purchases, trade missions and, above all, firms networking with one another, some 20 entrepreneurs founded CAPIR.

Today CAPIR operates with over 100 businesses under the umbrella of the CCIDC and, together with the Municipal Council, promotes actions in such fields as training, product quality improvement and financing.

Raising awareness, and the strengthening of public-private co-operation, were carried out by a team from the Office of Planning, helped by students from the Technological University through work experience placements.

In 1996, at the request of the municipal council, the UN Economic Commission for Latin America's (CEPAL) office in Buenos Aires carried out an evaluation of the policies, which provided feedback on this work.<sup>3</sup>

#### *The internationalization of the regional economy*

In addition to promoting exports and to the search for new markets, products were adapted to international requirements to connect the region, at all levels, with other parts of the world, and so create a network that would facilitate the transfer of knowledge and technologies to the whole business community.

Today there is a strong connection with foreign countries; the links with the regions from which the first settlers came have been revitalized, and a high percentage of the population speaks foreign languages or is beginning to learn them.

#### *Multiplier programme*

The Foundation for Regional Development works in the areas of management and quality and is starting a programme similar to one in Japan. After a pilot programme with medium-sized enterprises in the region, the foundation will try to adapt the programme to make it suitable for small and microenterprises.

The foundation provides the knowledge, the Office of Economic Planning, along with CAPIR, does the fieldwork and together they implement a pilot programme of order, safety and cleanliness, for a six-month period. The financing is shared.

The role of the facilitators is to follow up programmes by providing training for trainers. These are employees of medium-sized enterprises who have received additional training and then transmit their knowledge to the small and microenterprises.

#### *Enterprise Development Centre (CDE) IADB-UJA Agreement*

The need to provide businesses in the region with more non-financial support services in addition, which would help them to improve their competitiveness to

cope successfully with world markets, led the municipal council to look for different forms of financing and co-operation to design an alternative to meet the current need.

The project began to take shape with contributions from CEPAL and from the Inter-American Development Bank (IADB), who provided technical and professional advice and assistance.

These first steps, along with others, such as the involvement of the CCIDC, resulted in the creation of CDEs financed by IADB's Multilateral Investment Fund. One of these CDEs was set up in Rafaela with the involvement of several local and regional business institutions, such as the CCIDC, the Chamber of Foreign Trade, the Chamber of Metallurgists, the Foundation for Regional Development, the Centre of Industry and Commerce and residents of the Department of Las Colonias and the Association of Metallurgical Manufacturers of San Francisco.

The main aims of the CDE, which is a technical co-operation project, are: to increase SME demand for professional assistance, to improve the quality of the local business services, to promote collective actions and to strengthen the regional and local organizations.

#### *The plan for Rafaela*

The plan was first launched in 1996 based on the concept of participatory management. Most representative organizations on the executive council appointed members.

One of the PER projects was the ICEDEL Institute of Training and Research for Local Development, a new institution that aims to help in the changes taking place in the community by working on the development of human resources and strengthening the interaction between government and the community.

#### **Strengthening of public-private partnership**

In 1998, in collaboration with the Centre of Commerce and Industry, ICEDEL requested CEPAL's Buenos Aires office to carry out a study in institutional relations, within the community of Rafaela.

The resulting report: *Interaction between institutions providing support to the production sector*<sup>10</sup> offers valuable feedback on this process. The study analysed training, leadership and the circulation of information on public-private partnerships. The following were some of its most important conclusions:

- The areas seen as most feasible for joint activities between Rafaela's private and public institutions were those relating to the training and development of human resources: almost 75 per cent of all the institutions interviewed had worked in conjunction with another regional institution in these fields. There was also co-operation, though to a lesser extent, in research, in the support of new ventures and in the area of work experience.
- Successful co-operation in the local context depend on continuous co-ordination of work; and a high degree of professionalism in the institutions.





Figure 14.1 *Main lines of action*

- Leadership attributes should be characterized by:
  - generation of initiatives and proposals
  - ability to co-ordinate and generate consensus
  - capacity for external negotiation
  - strategic vision of the future.
- Within the institutions there was a general opinion on the characteristics of good leadership, in which all concerned advocated an approach of initiatives open to participation and the generation of consensus.
- The transmission of information is effective, although contacts with some of the more isolated firms need to be strengthened. This may mean that the radius of action should be extended.

This highly dynamic process requires constant monitoring of such actions of co-operation and training as: a continuous development of industrial networks, policies of promoting specialization and sub-contracting, innovation, financial assistance, incentives for new enterprises and the search for new markets.

### Application of the concepts of the 'Rafaela Experience' to a wider territorial area

In this final part, a programme of work is described which was designed by government at provincial level to generate the conditions that would enable all the municipal councils in the Province of Santa Fe to implement successful policies of the type in Rafaela (see Figure 14.1).

This time the initial challenge was to convince the political authorities, the business organizations and the businesses in each of the towns concerned, that

the municipal council, which in the vast majority of cases did no more than provide the usual public services, should become involved in the generation and implementation of policies to help productive ventures.

A strategic element in the Rafaela case was the political decision of the local authorities to become involved in economic development, through the creation of the Office of Economic Planning. This was the act that epitomized the development of the new role for local government, which led to the creation of similar departments in all towns of the province.

With the aim of strengthening and integrating the Province's economy, the local and regional action of the municipal councils and communes then led to the design and implementation of programmes that transformed the role of the municipalities.

In order to manage this project, a provincial management unit – UGP – was created within the Ministry, to complement the institutional relationship between the Government of the Province of Santa Fe and the municipalities and communes.

Its main objectives are: to support, train and make the UGP work as an activator in some cases, a catalyst in others, and to provide the framework to increase activities in areas where the municipalities and communes were not yet in a position to act.

In 1996 the aim was first to increase awareness among municipal authorities of the importance of taking the lead in decision making as it affected the local economy.

To accelerate changes, and to increase the capabilities of those responsible, an intensive training programme was introduced covering the following fields:

- Data analysis and decision making techniques.
- The process of change, and the role of municipal agents.
- Introduction to total quality.

At the same time, a survey of the industrial sector of Santa Fe Province was carried out. In addition to providing the quantitative and qualitative data needed to set local policies, it was the first field study on the road to making decentralization a reality. It also enabled those responsible for the various fields to come into contact with the sectoral organizations and the educational system.

In 1997, the training of managers was further developed, extending to small and medium entrepreneurs. In less developed areas where there was private initiative, the 'Associations for Development' were strengthened. These comprised municipalities and communes of the region and were helped by funds to finance small economic ventures, which they monitored and evaluated themselves.

Clear progress was soon evident in the interaction between firms in different towns. Regional meetings were held which reviewed strengths and weaknesses.

In 1998, new fields of work were added, to promote further the incorporation of the communes and the municipalities in the work. Heads of departments developed their own programmes and regular communication within the province increased. Programmes were developed jointly, with greater commitment from all concerned. There are no longer mayors who do not speak of the importance of economic development.



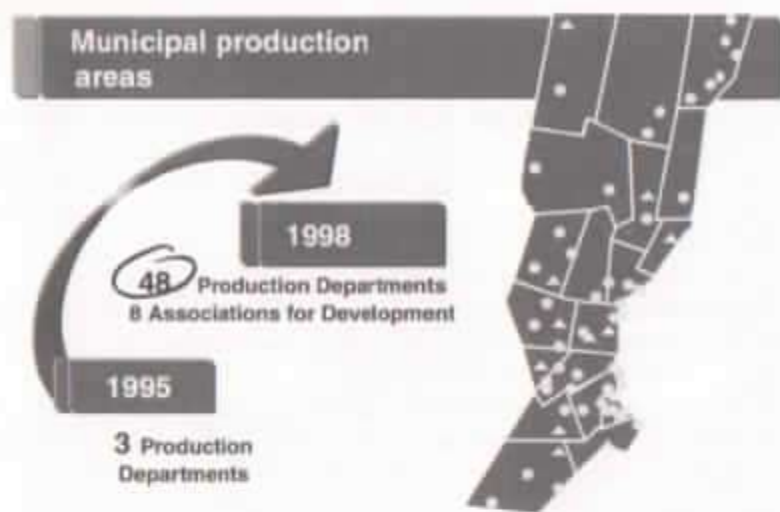


Figure 14.2 Municipal production areas in Santa Fe

Municipalities promoted the participation of local firms and agencies at international fairs, not only from their own town and region but also representatives of many other firms with which contacts had been made at business meetings. Missions are organized after fairs to help conclude agreements made through contacts.

During 1997 and 1998 more training activities were held, following requests arising from the surveys conducted in each region. In all, 12 474 people were trained. The following subjects were dealt with:

- costs
- human resources
- marketing
- foreign trade
- quality technology
- information technology
- preparation and evaluation of investment projects
- industrial health and safety
- technological innovation.

After three years of the programme, there is now an improved level of management ability in the agencies promoting business development. They are generating a variety of new initiatives, promoting local activities, regional interaction and joint planning.

The preparation and evaluation of investment projects, the organization of trade missions, business meetings, fairs and exhibitions have all resulted from training and decentralization programmes.

An external assessment of the programme was recently carried out by CEPAL. As a result, it was possible to quantify the achievements, and to identify the objectives that had not yet been achieved.

The managers of these activities in the municipalities have become agents of change, promoters of economic growth both in their own towns and in the region. They help enterprises to come together to develop joint actions to increase competitiveness.

These municipalities have become one more link in the process of uniting the businesses of Santa Fe Province.

## Conclusions

Co-operation between the public sector – at its different levels – and the private sector, is an appropriate way of achieving progress in competitiveness. To play a leading part in the on-going effort to achieve business competitiveness, it is important for the state to be seen by the community to be an efficient operator.

In Rafaela, increased public-private co-operation and a purposeful regional leadership, on the basis of an optimization of available resources, has resulted in improved economic, social and educational development.

The work of the municipal councils aimed at supporting productive sectors has proved to be effective in decentralizing the implementation of policies, both nationally and at the provincial level. Local administrations have demonstrated the benefits and greater effectiveness of being close to the people.

The experience of Rafaela, and the policy of replication from the provincial level to a large number of municipalities and communes in Santa Fe, has now been going for three years. During this time, favourable indicators have demonstrated both the validity of the policies described and the advisability of applying them in other regions and countries.

## Notes

1. Porter, Michael, 'Clusters and the new Economies of Competitions', *Harvard Business Review*.
2. The regional common market comprising Brazil, Argentina, Paraguay and Uruguay.
3. The difference in behaviour between Rafaela's SMEs during the closed stage of the economy and most of the businesses in the country explains why the new scenario did not take them by surprise. Unlike other firms they were not operating in an obsolete manner, nor did they have high idle capacity. In spite of Rafaela's small economy, its industry was very diversified and was therefore little affected by any sectoral crisis.
4. Survey of the Production Sector 1996, MAGIC, Province of Santa Fe.
5. Office of Economic Planning, Municipality of Rafaela.
6. Office of Planning, Production Division or Municipal Development Services. These are different names given to the same function.
7. Bianchi, Patrizio, 'Construir el Mercado' (Building the Market), Universidad Nacional de Quilmes, 1997.
8. Working Document of the Office of Economic Planning, Boscherini, Costamagna, Op.cit.
9. Industrial Policy at Local Level. Assessment of the Municipality's policy for the promotion of business partnership in small industrial enterprises in Rafaela. CEPAL (UN Economic Commission of Latin America), Aída Quintar and Fabio Boscherini, Second semester, 1996.
10. Ferrato, Carlo et al. November 1998.



*Micro- and Small Enterprises in Latin America* sets out approaches to the provision of business development services based on experience in the region. These approaches aim at creating cost-effective support services that are sustainable, with wide outreach and optimum impact on the beneficiary enterprises and the business environment.

Case studies examine the role of business development services and the principles of best practice in the field. Individual chapters deal with voucher programmes for training in Paraguay, the use of matching grants and a review of the consultancy market in Argentina.

The book also reviews marketing and technology services for craft industries in Nicaragua and Ecuador, the setting up of a business information service in Bolivia and the establishment and operation of business centres in Peru. There is also an account of networking through the clustering of small enterprises.

The final section deals specifically with the role of the public sector in the establishment and operation of business development services. A contribution from Chile reviews the appropriate role for the State and covers experiences in the role of business services in local economic development.

*Micro- and Small Enterprises in Latin America* will be important to all those working on programmes for small enterprise development, including research organizations, donors, development agencies, NGOs and private consultants. It forms a companion volume to *Business Development Services: A Review of International Experience*.

Jacob Levitsky is a UK consultant, working with the Donor Agencies Committee for Small Enterprise Development. He was formerly Small Enterprise Advisor to the World Bank in Washington DC.

Lene Hojmark Mikkelsen is a consultant with the Microenterprise Unit of the Inter-American Development Bank in Washington DC.

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