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Strategies for Small and Medium Enterprise Development in Central and Eastern Europe

Volume I
Strategies and Future Directions

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Preface

This report was prepared by Management Systems International (MSI) for the Office of Enterprise Development, ENI Bureau, A.I.D. Washington. The content is based upon five month's of field research and reviews in Washington, D.C. conducted between March and July, 1994. The MSI team was staffed by: Larry Cooley, Tom Gray, Steve Silcox, Cathy Silverstein, and Russ Webster. All of the comments and recommendations in this report are those of the team, and do not necessarily reflect USAID policy or program directives.

The team would like to thank all of those individuals who committed their time, energy, and knowledge to this exercise. Their experiences and insights were invaluable to us in helping to articulate what USAID's priorities should be for promoting small and medium enterprise (SME) development in Central and Eastern Europe. Most of all, we would like to thank Melissa Brinkerhoff of AID/W for her participation, and her dedication to this project.

Russ Webster, Team Leader

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ACRONYMS & ABBREVIATIONS

ABA	American Bar Association
ABS	American Breeders Service
ACDI	Agricultural Cooperative Development International
ACE	American Cooperative Enterprise Center
BAEF	Bulgarian American Enterprise Fund
CARESBAC	CARE Small Business Assistance Corporation
CBI	Cooperative Business International
CCET	Center for Cooperation with the Economies in Transition (of the OECD)
CDC	Citizens Democracy Corps
CEE	Central and Eastern Europe
CIPE	Center for International Private Enterprise (of the U.S. Chamber of Commerce)
DSTI	Directorate of Science, Technology & Industry (of the OECD)
EC	European Community (now known as the European Union)
ECU	European Currency Unit
FSVC	Financial Services Voluntary Corps
GEMINI	Growth and equity through Microenterprise Investments and Institutions
IDA	International Development Association
IDLI	International Development Law Institute
IESC	International Executive Service Corps
IFC	International Finance Corporation

F

IFDC	International Fertilizer Development Center
ILE	Local Initiatives and Employment Creation Program (of the OECD)
KHF	Know How Fund
LOL	Land-O-Lakes Cooperative
LOP	Life of Project
MSI	Managments Systems International
NCBA	National Cooperative Business Association
NGO	Non-Gevernmental Organization
NIS	Newly Independent States (former Soviet Union)
OIC	Opportunities Industrialization Centers
PIET	Partners for International Educational Training
PIT	Partners in Transition
PVO	Private Voluntary Organization
SEED	Support for Eastern European Democracy Program
SME	Small and Medium-scale Enterprise
TA	Technical Assistance
USAID	United States Agency for International Development
USDA	United States Department of Agriculture
VOCA	Volunteers in Overseas Cooperative Assistance

Executive Summary

Lessons Learned

• A significant portion of the 1800023 resources to date has funded the provision of short-term technical assistance to privatizing and newly-emerging private sector SMEs in Central and Eastern Europe. This strategy proved to be a good entry point for working in the sector. Besides giving SMEs needed technical and managerial training, firm-level assistance quickly provided A.I.D. with an understanding of SME constraints, both at the enterprise level, and the macro-level of policies and regulations affecting the private sector. The lessons learned and information gained over the past several years have shown that there is a need now to focus more intently on problems that can't be adequately addressed through firm-level assistance alone.

• The need for basic business advisory services and training is still being addressed largely through donor-led programs, such as the small business development centers (SBDCs) being supported by the ECPHARE, A.I.D., UNDP and a few others. An indigenous, nascent services sector is beginning to emerge in a few countries and provide support to SMEs. This sector will be critical for long-term development of the SME sector. Of the SBDC programs, the more successful operations are those that identified a clear market for their services, and specialized their program accordingly.

• The needs of the larger, more complex enterprises have evolved since A.I.D.'s work first began. Whereas in the early stages, general management consulting services and basic training in "how to operate profitably in a free-market system" was appropriate, these firms now need better targeted, often highly technical, assistance. Also, many problems they face would be better addressed through longer-term technical assistance arrangements.

• In some countries, a significant portion of A.I.D.'s firm level assistance has gone to medium- and large-scale privatizing enterprises. In the early stages, the service providers, and probably the firms themselves, expected privatization to go more quickly than it has. The reasons for the slow pace are attributable to many factors, some within the companies themselves, and some external to them. Whatever the case might be in any given country, private enterprises, typically of a small- to medium-scale, have been emerging either (a) through municipal-level privatizations, or (b) the creation of start-up businesses with individual capital. It is the team's opinion that A.I.D. should favor a program that focuses on these businesses, and provide assistance to privatizing firms only on a special case basis.

• Difficulty in accessing SME credit continues to be a bottleneck in most Central and Eastern European countries to enterprise growth. Experts working with SMEs have been quick to point out, however, that there is also a significant lack of well-presented, bankable projects. Through training, A.I.D. can help to improve the lender-borrower relationship. However, major structural issues continue to constrain the banking sectors in CEE. (See below.)

• Several donors are introducing special lines of credit into selected commercial banks in an attempt to encourage these institutions to develop SME clients. However, until the systemic

issues that adversely effect CEE national and central banks are solved -- namely the problems of national debt, and continuing public sector support of inefficient state-owned enterprises -- little can be expected to happen that will sufficiently meet SME financial needs. Through the assistance of major multilateral donors and financial institutions this situation should improve, but at an unpredictable pace. Meanwhile, there is an obvious need to take a broader look at SME financial services, and begin exploring other schemes that operate outside the national banking system.

• Policy and regulatory reform are areas where A.I.D. services continue to be needed. Experience to date has shown that the more successful efforts are ones that (a) have a well-defined set of problems, legal, or policy issues to work on, (b) have connections with stable public sector agencies, and (c) can engage a broader set of private sector reform advocates into the process of policy debate and formulation.

• There is a significant lack of information about SMEs and the role they are playing in the transitioning economies of CEE. This adversely affects the ability of governments to make the appropriate decisions about reform measures. It also makes it difficult for advocacy groups and business associations to argue credibly on behalf of SMEs. In a few countries, A.I.D. has supported specific programs to address this problem of information shortage and public dialogue with good success.

• Indigenous organizations and business associations are yet at a nascent stage in Central and Eastern Europe, although businesses are beginning to realize that they can benefit by joinging together in certain spheres. Most governments are moving toward a chamber of commerce model which would mandate membership for all businesses. It does not appear that the chambers have either the support of private business, or the ability to provide the kinds of services that will be needed by SMEs to become more competitive in the transitioning economies. A.I.D. has worked successfully with some independent groups, and should build on this experience in the future to promote viable intermediary organizations and associations of private entrepreneurs.

• In most CEE countries, the size of the internal markets is not sufficient to support an SME sector of any significant proportion. Strengthening trade linkages within the region, and where appropriate internationally, must be a component of any SME development program.

Recommended Goals and Strategies

SME Development Goals

The team formulated two statements to characterize the goals of A.I.D.'s SME program in Central and Eastern Europe. The intermediate goal statement is to strengthen the SME sector to be a positive force for development in Central and Eastern Europe. This goal statement provides a framework within which to define A.I.D.'s SME programs. The long-term goal statement is to secure a full transition to an open-market economic system.

From our experience so far in CEE, we know that the transition process is uneven, subject to many political and economic variables affecting individual countries. However uneven this

process might be, our eventual aim is that the establishment of open market principles and practices is far enough along so that it is irreversible. The second goal statement therefore distinguishes the transition process from indicators that the transition is complete.

SME Development Goal Statements for CEE

Intermediate Goal: *The creation of an SME sector capable of contributing to and competing effectively in both the economic and political marketplaces that characterize a modern open market economy.*

Long-Term Goal: *To assist countries of Central and Eastern Europe in undertaking the transition from an economic system based on the socialist principles of centralized planning and management, to the capitalist system of open markets, competition, and free enterprise.*

The team feels it also is important for the strategy to signal a point at which U.S. assistance becomes less critical to securing the goal of SME development in a given country. In the discussion of strategies and objectives below, we have identified several strategic areas for A.I.D. assistance resources to be programmed. As a country progresses in each of these areas -- which are all aimed at helping the transition and its establishment as a viable basis for long-term development of the economy -- A.I.D. should consider scaling back in certain areas and focussing on others.

Strategic Framework

There are many factors that influence the ability of SMEs to make the kind of progress described in the goal statements above. The team identified six principal strategies as an approach to addressing these various factors. In turn, these strategies, and their related objectives, provide a framework within which A.I.D. can identify priorities and design specific project interventions.

The strategies we identified relate to both (a) strengthening the ability of entrepreneurs to manage their businesses, and (b) improving the broader environment (of laws, policies, regulations) and the relationship between government and business.

Strategic Areas for SME Development in CEE

Strategies that will improve the ability of entrepreneurs to run their businesses.

1. Strengthen the capabilities of indigenous entrepreneurs to manage their SMEs in a world characterized by increasingly rapid change and by intense competition in both domestic and international markets.

2. Strengthen the marketplace capability to deliver support services to SMEs

3. Improve the flow of financial services to the SME sector by introducing alternate, competitive services to the current banking system, and by strengthening the capabilities of financial institutions to make viable loans or investments.

Strategies that will improve the relationship between gov't and business.

4. Support the establishment of a "rule of law," with particular emphasis on the establishment and implementation of those laws that constitute an "enabling environment" promoting the growth and development of SMEs in the economy.

5. Support the development of a public sector with positive attitudes toward SMEs, and with the administrative capability to support the private SME sector.

6. Create information flows between government and SMEs that represent and support business needs, and help guide government in SME policy formulation.

For each of the six strategies, the report discusses a set of objectives and program activities which A.I.D. should consider in designing SME projects for CEE. These are presented with specific examples of work presently going on that can be expanded, as well as recommendations for new approaches to providing assistance.

An important component of the team's terms of reference was to investigate how this strategy can build on the U.S. experience in small business development, and our comparative advantage in understanding the requirements for a healthy SME sector. CEE government officials and other donors recognized that the U.S. had a great deal to offer in helping to guide (a) the policy reform process, (b) the development of intermediary institutions that serve the sector, and (c) the strengthening of small and medium scale business managers so that they can operate in a competitive environment. The report highlights and discusses those areas of comparative advantage, and suggests ways in which they can be applied to achieving the objectives of the SME development program.

The amount of time needed to make progress in any of these six areas will depend on factors that are unique to a given country. Although this is a regional strategy, its application is intended to be country specific. For each of the six strategic areas, the report outlines an analytical approach that will identify where a given country is at and what kind of progress it is making in creating both better entrepreneurs and a better environment for SMEs. Based on the team's field work, the report also draws some preliminary comparison between countries, their SME development priorities, and how the strategy applies to meeting those needs.

Introduction

This document reports on the findings, conclusions and recommendations for A.I.D.'s small and medium enterprise (SME) development strategy in Central and Eastern Europe. Field research and analysis were carried out from March through July 1994 by a team of SME specialists provided by Management Systems International (MSI). [1] One week visits were made to ten countries where A.I.D. is active (in order): Poland, Hungary, Czech Republic, Slovakia, Romania, Bulgaria, Latvia and Estonia (together one week), Albania, and Macedonia. Support from the A.I.D. field offices for this exercise was very high, and the team benefited from the active participation of A.I.D. staff, grantees, contractors, other local professionals, and other donor representatives. In all, more than 260 individuals participated in individual interviews or roundtable discussions facilitated by the team.

The purpose of the SME strategy exercise was to assist A.I.D. in identifying future programmatic directions for SME development in Central and Eastern Europe (CEE). The scope of work required the team to:

- Review lessons learned in the CEE by the various organizations implementing activities under project number 180-0023 (Technical Assistance to Enterprises), as well as those of other non-U.S. funded organizations.

- Survey mission and host country perceived future small business development needs.

- Advise A.I.D. on possible new directions for a second phase of activity utilizing a more cohesive and synergistic strategy of SME development assistance.

- Recommend a specific small business development strategy which would include an overall goal and specific objectives, benchmarks, indicators, measures of impact, and measures of cost-effectiveness.

The exercise was undertaken as a *regional* strategy, however the team strove to identify an approach which could be tailored to country-specific conditions. The report contains a strategy-by-strategy guideline for refining country programs based on (a) local economic and institutional conditions that impact on SMEs, (b) current reform efforts supported by the national government, (c) technology and managerial skill levels of enterprises, and (d) other donor-led programs for SMEs. Based on the limited information which could be put together during each of the one-week stays, the team made preliminary recommendations about strategic priorities for each country. (See Chapter V.) This is presented with the caveat that a more thorough analysis is needed before making specific project design decisions.

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[1] The team: Russell Webster (Team Leader), Tom Gray, Cathy Silverstein, Larry Cooley, Steve Silcox. Melissa Brinkerhoff, Manager of the Technical Assistance to Enterprises portfolio of projects, also travelled with the team on each of the field assignments. Other A.I.D. team members included Maria Rendon (Romania) and Robert Navin (Macedonia).

The team folowed an approach in carrying out its work which would help ensure that the resultant strategy would be (a) built upon lessons learned to date, and (b) developed with participation from organizations who would be involved in eventual implementation of activities under the new strategy. To accomplish this:

- The combined expertise of the team, which included background in SME programs in CEE as well as the U.S. and other countries around the world, made it possible to draw upon a wide variety of experiences and lessons learned, and assess how they could be applied in the CEE context.

- As work progressed, the team developed a set of preliminary strategy statements, and ideas for future SME programming. These provided the basis for discussions with individuals and groups of practicioners, and allowed the team's meetings to become opportunities for strategizing with a range of stakeholders. This approach was a useful complement to the other objectives of our meetings, which were assembling information about past experiences, lessons learned, and recommendations about future needs and priorities.

- The team was asked to give entry and exit debriefings in each CEE country visited, almost without exception. This helped the team to base each field visit upon an understanding of A.I.D. priorities and interests in specific countries. At the end of each visit, the team provided A.I.D. missions with an overview of work completed, and suggestions for applying the strategy to future programming decisions.

An overview of the report content appears below.

Chapter	*Description*
Volume I: Strategies and Future Directions	
I. Current Characteristics of the SME Sector	- Discusses issues that impact on the ability of SMEs to grow in a post-socialist environment (economic, legal, political, institutional, human resource, financial). - Lays the foundation for understanding constraints during the transition, and priorities for econmic reform.
II. Lessons Learned to Date and Future Development Needs	- Summarizes lessons learned based on interviews with A.I.D., grantees, contractors, government officials, entrepreneurs and other donors. A more detailed report appears in Volume II. - Based on interview results and document reviews, sumarizes priorities for future SME development. Key topics are introduced, with more detail provided in later sections.
III. Strategic Approaches to SME Development in CEE	- Presents goals and objectives of the strategy. Describes a framework having six strategic areas designed to strengthen entrepreneurs and the "enabling environment" which allows them to compete in an open market economy. - For each strategy, suggests a range of objectives and activities that should advance economic reforms, and create a class of independent business owners and managers.
IV. The Importance of SMEs and the Role for U.S. Foreign Assistance	- Discusses the importance of small businesses to economic growth, employment, technology innovation and income. Provides an economic as well as democratic perspective on why SMEs are critical for development of CEE. - Analyzes the U.S.' comparative advantage in promoting SMEs, and suggests ways in which the A.I.D. assistance effort can build on this comparative advantage in CEE.
V. Guidelines for Applying the Strategy to Future SME Development Programming	- Based on lessons learned and interviews in the field, presents principles and priorities in designing successful SME programs. - Suggests output and purpose level indicators for six strategic areas. - Outlilnes a methodology for applying the strategic framework to making programming and project design decisions.

Chapter	*Description*
Volume II: Background and Lessons Learned	
I. Overview of A.I.D. Development Programs in Central and Eastern Europe	- Outlines purpose, objectives, funding levels for all programs under the SEED Act. - Breaks out activities by country, program focus.
II. Elements of Current A.I.D. SME Development Programs in CEE	- Description of activities, targets, funding for 1800023 (Technical Assistance to Enterprises) grantees and contractors. - Report on lessons learned in several areas: effectiveness of various forms of assistance, targetting of assistance efforts, ensuring sustainability of benefits, program management issues, and examples of how lessons learned have been applied to SME activities. - Overview of other A.I.D. activities in SME sector in CEE.
III. Other Donor Activities in SME Development	- Summary of SME development work being done by OECD, ECPhare, EBRD, and World Bank in CEE.
Attachments	A. Summaries of 1800023 Grants and Contracts (an overview of objectives, activities, lessons learned, etc. for each project) B. Contacts List (also available in Lotus 1-2-3 spreadsheet/database format) C. Bibliography of Reference Materials (also available in Lotus 1-2-3 spreadsheet/database format) D. Scope of Work

Chapter I. Current Characteristics of the SME Sector

A. Recent Economic Conditions

1. Problems Affecting Statistical Comparisons

Comparing statistical and social indicators for the Central and Eastern European countries with other countries is difficult at this time. During the period before 1989-1990, statistical data for most of these countries were specified using definitions developed by the USSR, and appropriate to a socialist environment. While some measures, such as gross domestic product, were used for comparisons with Western numbers, the definitional bases differed by enough to make some comparisons difficult. Western economists also placed little faith in the actual measurements made by the Soviet bloc statisticians. As an example, prior to the fall of the Berlin Wall in 1989, some observers, including the CIA, believed that East German per capita Gross Domestic Product (GDP) was higher than West German per capita GDP. Similar statistics could be quoted for Hungary, Czechoslovakia, Poland, and the Baltic states.

The comparison problem is made even more difficult by the on-going transition to market economies. New constitutions, new laws, new taxes and regulations, and falling GDP and tax revenue have made data collection difficult and relatively more expensive. Major international institutions, such as the World Bank, the International Monetary Fund, the Organization for European Cooperation and Development, and the European Bank for Reconstruction and Development, have offered technical assistance to improve data collection techniques. Several donor countries have also provided similar technical assistance. Despite this assistance, the output of economic and social information is lagging in most of the CEE countries. The World Bank is attempting to integrate CEE data into its data banks, but most of the information for 1990, 1991, 1992, and 1993 is missing or unusuable.[2]

Because so little reliable information is available, the comparisons of social and economic data made here will be limited. Occasional comparisons will be made with U.S. data, but there will be no attempt to make broader comparisons with other developed countries in Europe.

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[2]The government of Macedonia has made a valiant attempt to maintain a statistical system, while shifting status from a region within a country to an independent entity. Because the country of Macedonia has not been recognized by most major countries or international organizations at this time, there is little external assistance to help with statistical measurement, nor is there any external statistical system attempting to incorporate measurements about Macedonia into an international framework of data.

The orderly breakup of Czechoslovakia into the Czech Republic and Slovakia has also hindered data output, as the two new republics initiate new reporting systems. Backward comparisons are much more difficult, however, since earlier measurements will have to be broken systematically to reflect new boundaries. This will probably not be a high priority task for either of the new Republics.

Backward comparisons among the Baltic states of Estonia, Latvia, and Lithuania are also difficult, because the USSR did not break out many statistics according to the former boundaries of these countries. New boundaries were established by agreement between the countries when they became independent of the USSR.

Countries will be discussed in clusters, where possible, with comparisons and contrasts made in terms of broad trends. Cardinal rankings will be avoided as much as possible.

2. Basic Comparisons

The CEE countries all face the challenge of moving to a new legal and regulatory structure that will support the operation of a modern open market economy. Many of the physical, social, economic and other demographic factors affecting the potential success of the transition lie within relatively narrow ranges. Simply said, most of the CEE countries are similar in a number of ways. Poland and Romania stand out as the largest countries, in both geographic area and in population. All of the other countries are significantly smaller. Albania is roughly the size of the state of New Hampshire, for example, while Bulgaria is about the size of the state of Maine. (See Figure 1)

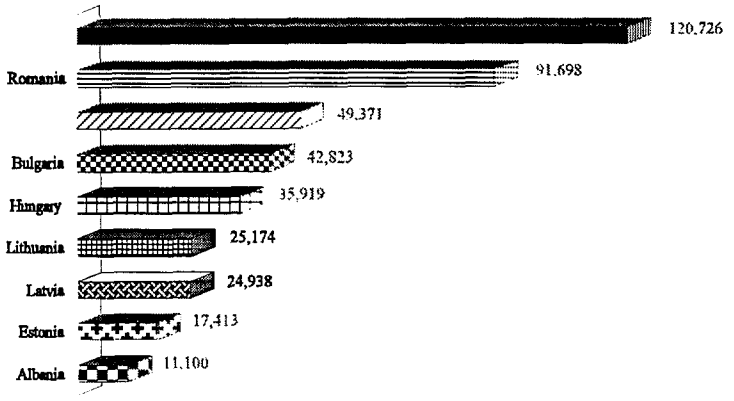

Figure 1

In terms of population, none of the CEE countries rank as large, or high population, countries. Poland has a population large enough to represent a strong internal market. (See Figure 2). This provides Poland with a degree of freedom probably not available to any of the other CEE countries, since their internal populations are not large enough to generate scale economies when producing for internal consumption only.[3] For all of the remaining CEE countries, open markets and production for the world market may be the best long-term approach to development. For this development to occur, the CEE countries must learn to compete with Western quality standards and Western marketing (including distribution and followup support) techniques.

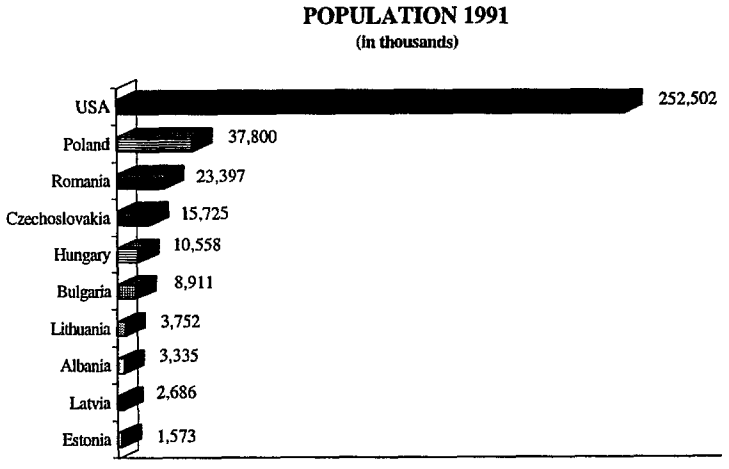

Figure 2

[3] Romania may be an exception to this in some industries, but the number of industries is probably quite limited.

3. Agricultural and Rural Issues

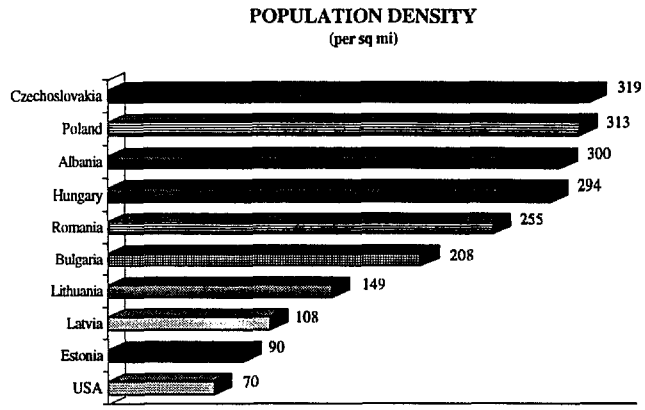

Figure 3

All of the CEE countries are densely populated, relative to the United States. The Baltic countries of Estonia, Latvia, and Lithuania are less densely populated (90 to 149 inhabitants per square mile) than the Czech and Slovak Republics, Poland, Albania, and Hungary, (all in the 300 inhabitants per square mile range). Romania and Bulgaria lie in the middle range (255 and 208 inhabitants per square mile). None of the countries are so densely populated that population threatens the availability of land. (See Figure 3.)[4] Nonetheless, several countries have maintained or returned to land tenure schemes where ownership of rural agricultural land is widely disbursed. Average holdings in these countries range from as little as one hectare (approximately two and one/half acres) to 10 hectares. Many of the landholdings are disbursed into several even smaller parcels.[5] These parcels may be too small to ever be farmed in a competitive manner leading to increased output or the ability to compete in world agricultural markets.

Many of the CEE countries have their agricultural potential limited by geographic factors such as mountainous topography.[6] Lack of fertilizer has also limited output in recent years. U.S. aid in Albania helped raise agricultural output significantly in 1993, by introducing and financing an effective fertilizer market. This market functioned by itself in 1994, hopefully supporting another good crop year for Albanian farmers.

With the exception of Albania, all of the CEE countries could be characterized as highly urbanized. (See Figure 4) This is important for small business development, since small businesses tend to be even more heavily clustered than population.[7] From a programming

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[4] When no date is given for a figure, the assumption is that the data is for 1988. In most cases, the data would not change significantly over one or two years. Exceptions to this generalization will be noted as they occur.

[5] This description fits both Poland and Bulgaria. The Bulgarian situation is made more difficult because many of the lands "restituted" were originally owned by families which have moved to urban areas. In 1993 and 1994, many hectares are unworked, because neither land rental or land sale markets have developed effectively. Most countries are attempting to return rural lands to former owners. Hungary may be an exception to this rule, since it appears that most farming is still being done using large communal farms.

[6] This statement doesn't apply to the Baltic states, to large parts of Poland, and to most of Hungary. It does apply to all of the other CEE countries.

[7] In the United States, for example, 91 percent of small businesses are found in urban areas which account for 74 percent of population. This is a good example of the statement made by Adam Smith in the Wealth of Nations that "the extent of specialization is limited by the size of the market." Smaller businesses tend to identify and service "niche"

standpoint, it is easier to deliver services to smaller businesses or to entrepreneurs in large urban areas, and, generally, more difficult to deliver services in rural areas.

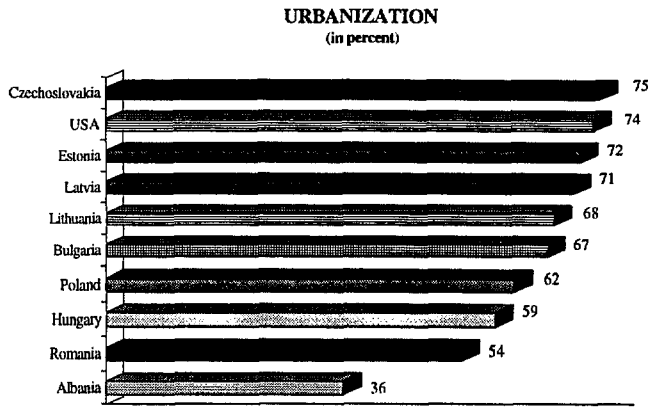

Figure 4

Despite the high levels of urbanization in the CEE countries, most of the countries have significant rural populations. Business support services may be delivered to these rural populations through activities in smaller cities or regional centers. The cost of reaching existing or potential rural small businesses may be prohibitive, if services are being delivered on a one-on-one basis. Since small business development will occur relatively more frequently in population centers, service delivery should probably be focused on these centers. For the very largest population centers (Warsaw, Prague, Budapest, for example) the markets for business services are already developing quickly, as market density generates many opportunities for specialized consultants and business service companies. Programming for SME support services are more crucial for regional cities, where the service base is developing less rapidly.

4. Are the CEE Countries Developing Countries?

In economics, it is almost impossible to provide a simple definition of a developing country. Pick a variable, and establish the range of values to be found for this variable in developing countries, and someone will almost immediately identify a case which lies outside the range. Most economists hold that they can identify a developing country when they see one, and they can define enough development characteristics to ensure that the definition is reasonable when considered by other development specialists.

On the basis of social, educational and health characteristics, most of the CEE countries would be considered as developed countries. On the basis of per capita GDP, however, they would not be considered among the highly developed countries, but would be found, with two exceptions, in the lower half of the middle income countries. Before examining a range of social indicators presented below, consider the issue of GDP, and recent changes in GDP.

The best numbers available for GDP per capita are for 1992, and come from World Bank papers prepared for internal use in early 1994. Using these per capita GDP figures, the CEE countries can be broken into four groups. The high income group of three countries includes Hungary, Estonia, and the Czech Republic, with per capita GDP (in U.S. dollars) ranging from

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markets, markets which are often too small to warrant attention from a larger company. Niche markets are more likely to be found in larger population centers.

$2,980 for Hungary to $2,460 for the Czech Republic. (See Table 1)[8] Latvia, Slovakia, and Poland are closely clustered, with per capita GDP in the $1,900 area. Bulgaria and Lithuania are clustered around $1,300 per capita GDP and Romania is slightly lower at $1,090 per person per year. The last cluster is made up of two countries, Macedonia at $680 per person, and Albania with only $290 per capita GDP in 1992.

[8] According to the World Bank, World Development Report, 1994, Hungary and Estonia are considered upper middle-income countries, with all other CEE countries in the lower middle-income category.

Table 1: Population and Per Capita GDP

Country	Mid-'92 Pop (millions)[5]	Per Capita GDP (US $)					GDP (US$ Millions)[3]	
		1988[6]	1989[6]	1990[6]	1991[6]	1992[6]	1990	1991
Hungary	10.3	2,490	2,630	2,780	2,720	2,970	32,920	30,795
Estonia	1.6				3,830	2,760		
Czech Republic[1]	10.3	3,360[4]	3,470[4]	3,190[4]	2,470[4]	2,450	44,450[4]	33,172[4]
Latvia	2.7				3,410	1,930		
Slovakia[1]	5.3				1,930[4]	1,930	44,450[4]	33,172[4]
Poland	38.4	1,860	1,890	1,680	1,790	1,910	63,590	78,031
Bulgaria	9.0	2,910	2,780	2,280	1,840	1,330	19,910	7,909
Lithuania	3.8				2,710	1,310		
Romania	22.9		1,730	1,670	1,390	1,130	34,730	27,619
Macedonia[2]	2.1	2,860[7]	3,000[7]	2,940[7]		683	82,310[7]	82,317[7]
Albania	3.3					290		

Notes:

1 The national accounts data for the Czech Republic and Slovakia are limited and preliminary. Prior to 1993 national accounts data for the two countries were not maintained separately.

2 The figures for Macedonia are 1993 statistics. Source: Consultative Group Meeting Documents prepared for the Paris meeting, June 27-28, 1994.

3 Source: 1993 World Development Report, World Bank.

4 Figures are for the combined Czech and Slovak Republics (Czechoslovakia).

5 Source: World Bank "Country Briefs," January 7, 1994.

6 Source: "World Tables, 1993", World Bank.

7 Numbers are for Yugoslavia.

From the difference between the top and bottom groups, the differences in per capita GDP would appear significant. However, it should be remembered that GDP, and GDP per capita, has been declining relatively rapidly, but at differing rates, for the past several years. Current per capita GDP, used here as a proxy for income per capita, does not reflect the income level enjoyed one or two years ago, nor is it necessarily a good indicator of what income levels will be in the near future. The change in per capita GDP can be seen in Table 1, in dollar terms, or in Table 2, in percentage terms. Table 2 gives a better idea, perhaps of the magnitude of wealth and income lost in reevaluating assets of state-owned enterprises (SOEs), and in shifting resources to private enterprises.

Table 2: Annual Change in Gross Domestic Product (Percent)

	1990	1991	1992	1993
Hungary		-10.5	-5.1	
Estonia	-8.1	-11.0	-25.8	
Czech Republic		-14.2	-7.1	
Latvia	2.9	-8.3	-33.8	-13.0[1]
Slovakia		-15.8	-6.0	-8 to 9[2]
Poland		-7.4	1.5	4.0
Bulgaria	-9.0	-13.5	-6.1	
Lithuania	-3.3	-13.1	-37.7	-16 to 17[2]
Romania		-13.4	-14.9	
Macedonia		----	----	
Albania	-10.0	-27.7	-9.7	

Notes:
[1] For first three quarters.
[2] Projected
Source: World Bank "Country Briefs," Jan. 7, 1994.

The Baltic states appear to have been most heavily affected by declining GDP, but recent information indicates that they may have bottomed out in 1993, and may resume positive growth in 1994. Albania, certainly the least developed of the CEE countries by most measures (see below) was also heavily affected by declining GDP. None of the CEE countries was able to maintain constant per capita GDP levels over the 1991-1992 period, but it is difficult to say what this means in welfare terms, without adjusting for price changes over the period.[9]

Current GDP per capita is a poor predictor of the wealth in a given CEE country, and is also a poor indicator of growth possibilities or of real welfare. More precise measurement, using consistent definitions across countries will improve the usefulness of the data. The use of purchasing power parity numbers (adjusted to reflect price differences for domestic and foreign goods) will give a much better estimate of the real purchasing power of per capita GDP. It will take some time to develop the measurement systems to collect this data.

[9] This statement probably holds for 1990, also, but there are no systematic figures available from which to confirm this judgment.

Table 3: Distribution and Changes in GDP Over Time

Country	Agriculture				Industry				Services			
	1980	1990	1991	1992	1980	1990	1991	1992	1980	1990	1991	1992
Hungary	17	13	10	7	41	32	33	30	42	55	57	63
Estonia	14	16	15	17	49	47	44	49	37	38	41	34
Czech Republic[1]	7	7	6		63	62	62		30	32	32	
Latvia		19	20	17		47	49	37		35	32	47
Slovakia[1]	7	7	7	6	63	59	58	54	30	34	36	40
Poland		8	7	7		54	50	51		37	43	42
Bulgaria	14	18	15	14	54	51	48	45	32	31	37	41
Lithuania	19	28	21	17	53	53	53	48	29	29	26	35
Romania	13	18	19	23	60	54	49	45	27	28	33	32
Macedonia												
Albania	28	28	31	40	37	29	29	13	35	39	41	47

Notes:

[1] The national accounts data for the Czech Republic and Slovakia are limited and preliminary. Prior to 1993 national accounts data for the two countries were not maintained separately.

Source: World Bank "Country Briefs," Jan 7, 1994.

The decline in GDP over the 1990-1992 period was not proportional across industries in most countries in CEE. In Table 3, for example, Hungary shows a severe drop in agricultural output as a percent of GDP from 1990 to 1992, while Estonia shows an increase in agriculture as a proportion of GDP for the same period. The pattern for the two countries is reversed in the industry sector,[10] and reversed again in the services sector. While both countries had to make extensive adjustments as GDP declined, they appear to have made the adjustments in differing ways. The more general pattern is similar to the Hungarian pattern, with manufacturing declining and services rising significantly. Agricultural output remained more steady across the countries as a proportion of GDP, but it should be remembered that this means that agricultural output declined at roughly the same rate that national GDP declined in most countries.

5. Business Startups

No table is presented for business startups, since the numbers available are primarily anecdotal. Nevertheless, if there is a uniform change which can be traced across all of the CEE countries, it is the increase in the number of businesses which has occurred since the CEE countries declared their new status. Some of the changes actually predate the change in legal status of the country. Estonia, for example, was given broad powers to experiment with privitizing small SOEs in 1988. Almost all small and medium-sized businesses in the country were in private hands by early 1994. Other countries such as Poland have shown an increase of almost a million businesses registered with the government in the last five years. In Hungary, 700,000 new businesses have been registered since 1989. Other countries in the CEE show similar patterns, although it is difficult to get complete counts or even estimates from government officials not used to dealing with open markets.

Registering a business is not the same as actually running a business. In Estonia, there is no tax on profits made during the first business transaction. Many businesses are registered, therefore, but go out of business after making one business transaction, such as importing an automobile or another piece of equipment. Estonian officials estimate that about one third of businesses exist for only this single transaction. In other countries, businesses may be registered with the government at one time, but may go underground to avoid taxes on the business or on employees. In Poland, for example, there are some indicators that the tax burden imposed on businesses by the state is sufficiently onerous that the "underground" or "gray" economy may actually still be growing. This underground economy is made up of businesses that pay no taxes, and often deal in smuggled goods or in stolen property. Many of the businesses are street vendors, making only enough to stay in business or to grow slowly. Other countries with high taxes may also be driving businesses into the underground or informal sector, although it is almost impossible to get data to confirm such activity.

The number of businesses starting may be slowing down, even though many of the CEE countries appear to finally be generating positive growth in 1994. This slowdown may be related to high taxes, improved government registration and collection methods, better tax policy, or some other change in government policy. Business startups may also be slowing because illegal activity is still increasing in some CEE countries. Organized gangs are extorting

[10] In this table, industry means manufacturing output.

protection money from merchants in most of the CEE countries, although the severity of the problem does vary from country to country, and within country according to urban or rural location.

Government officials in several countries also appear to be extorting companies by requesting payments for approval of routine but necessary documents, licenses, etc. In some countries this is considered to be a normal practice, with extensive historical precedent, but there is evidence that the fees charged have been growing in recent years. Police activity in support of the business community is notable primarily by its absence in most CEE countries. In some cases, the police may not be acting due to the absence of specific statutes describing observed extortion as a crime. Several parliaments may be acting to pass appropriate laws in these situations, but there is little evidence of concerted activity by the business community to get such changes made.

The inflow of foreign funds has been and continues to be a source of help for both business startups and business expansions in some of the CEE countries. Hungary has been the leader in receiving such external funds. Other countries receiving relatively large external funding from private sources include Poland and the Czech Republic. Recently, there is evidence of strong inflows of funds into Latvia. Bulgaria appears to be discouraging inflows of foreign funds, which dwindled considerably in 1993, and show no signs of accelerating in 1994. Most of the CEE countries are eager to obtain foreign capital and to work in joint ventures with foreign business owners. Problems with the legal framework for business, and with bureaucratic inefficiency appear to have frustrated some of these flows over the past two years.

6. Social Indicators

Literacy Rate

Some American observers might be surprised by the relative rank of the United States on the literacy scale, when compared to the CEE countries. (Figure 5) The United States actually ranks seventh, with six CEE countries above it. Czechoslovakia and Hungary have 99 percent literacy, with the Baltic states and Poland, only one percentage point behind. On this scale, only Albania would rank as a developing country, and it would rank in the higher levels of the developing countries with 72 percent literacy.

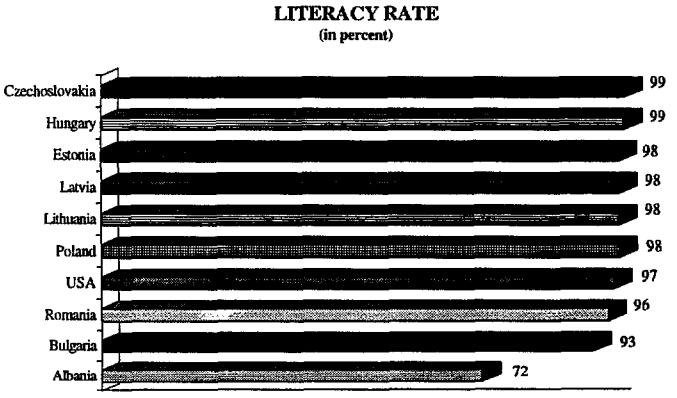


Figure 5

Birth and Death Rates and Infant Mortality

Population birth and death rates for all of the CEE countries except Albania look very much like U.S. rates, with relatively low birth rates and death rates. (See Figures 6 and 7) Albania shows a demographic picture that is more representative of a developing country. The birth rate is 50 percent higher in Albania than in Latvia or Romania, the next highest birth rate

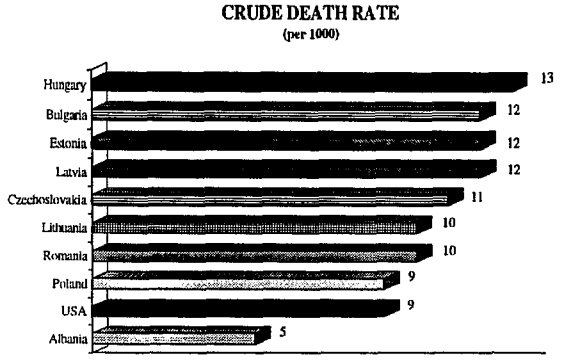


Figure 6

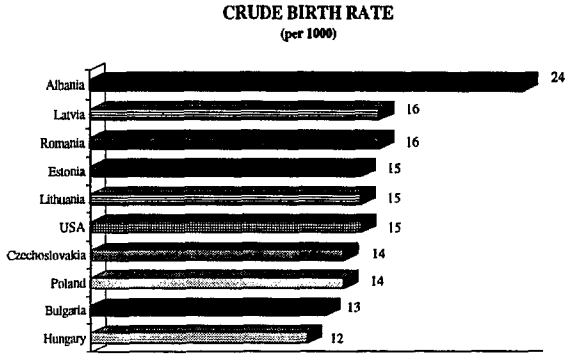


Figure 7

countries, and the death rate is only five per thousand, compared to nine per thousand in Poland or in the United States. These numbers are consistent with an Albanian population that is younger than the populations in the rest of the CEE countries, with more women in the child-bearing age group, and fewer older people, proportionally, than in the rest of the CEE countries. The very high infant mortality rate in Albania is also more suggestive of a developing country when compared to the relatively low rates in the remaining CEE countries. (Figure 8)

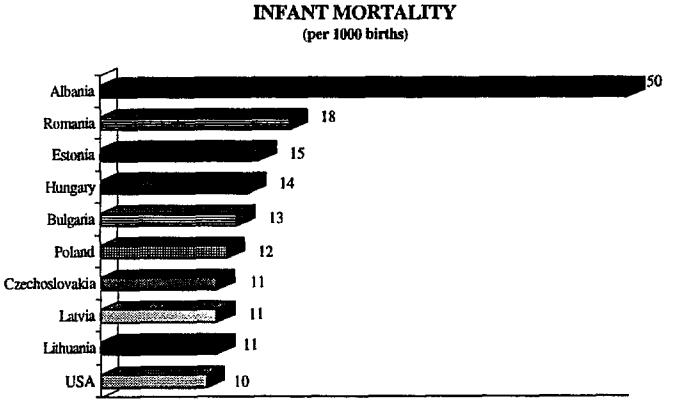


Figure 8

Population per Physician

As might be expected from the infant mortality chart, Albania and Romania have the fewest doctors per capita (or highest number of people per physician) of the CEE countries. Six countries show fewer people per physician than the United States. The Baltic states show particularly large numbers of physicians in relative terms, probably reflecting the more extensive Russian dominance of these countries compared to the other CEE countries. The Russian model calls for large numbers of doctors, although numbers are not associated with quality of training nor with use of modern medical methods and technology. In general, with the exception of Albania, the medical delivery system does seem to be providing necessary care with respect to the categories examined here.

Tourist Arrivals

One last social indicator is tourist arrivals for 1989. Although this is not an important economic indicator for some purposes, it does indicate the openness of a CEE country just prior to the shift towards a market orientation. Note that Hungary and Czechoslovakia had the most visitors (including probably the most visitors from the Western countries) and the largest inflows of foreign capital from 1990 onward. (Figure 9) Although Bulgaria shows a large number of tourists, many of its visitors were from the USSR. This source of visitors has declined considerably since 1989. Bulgaria has also been reluctant to admit foreign capital that was intended for hotel and resort building necessary to bring tourist facilities up to Western standards.

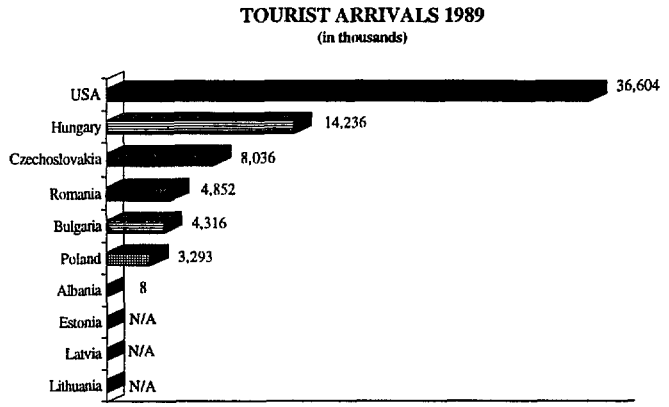


Figure 9

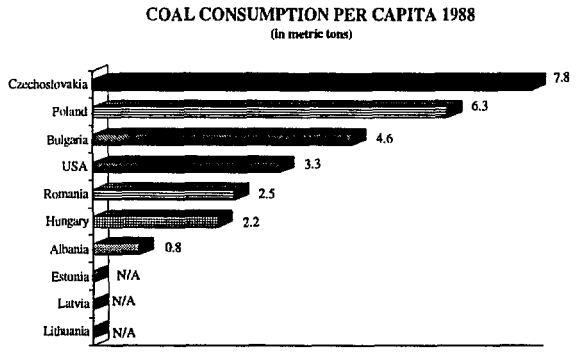
Albania is perhaps a special case with respect to tourists, since it was for many years the most closed of all CEE countries. Albania now welcomes tourists, but still lacks almost all facilities needed to attract Western visitors. Albania is perhaps the only case in all of Eastern Europe where the infrastructure needs are so great that they will clearly inhibit foreign visitors (in large numbers) for a while. Although tourist numbers are not available for the Baltic countries, Estonia and Latvia appear to be attracting large numbers of tourists. Estonian tourists appear to be drawn primarily from Finland and Sweden, while Latvia is attracting large numbers of Russians eager to trade with the West through use of Latvian port and banking facilities.

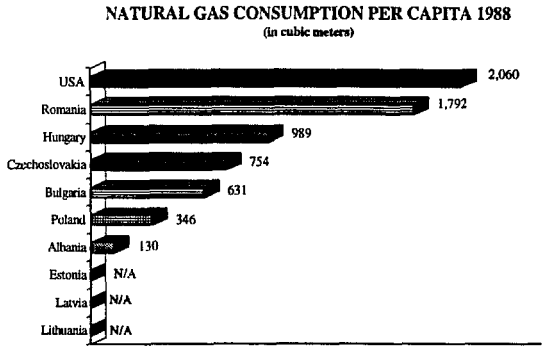
7. Energy Consumption as an Economic Indicator

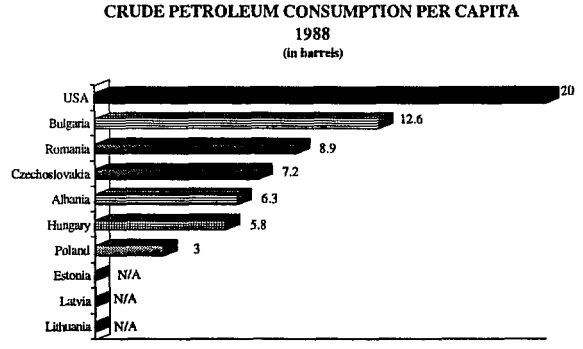
Fuel or energy use can be useful economic indicators, but they must be interpreted carefully, since use of a particular fuel or energy source may be ideosyncratic, determined as much by chance endowment or by political happenstance as by rational economics. Coal consumption per capita is high in Czechoslovakia, Poland, and Bulgaria, for example, because they have endowments of coal, and find it more difficult to import fuel oil or natural gas. (Figures 10 - 13) Czechoslovakia is a large user of coal and, to a lesser extent, of oil and natural gas, to support a high per capita consumption of electricity. Much of this electricity goes to industrial production. Bulgaria uses slightly less coal, but significantly more oil and natural gas per capita than Czechoslovakia, for essentially the same reasons.

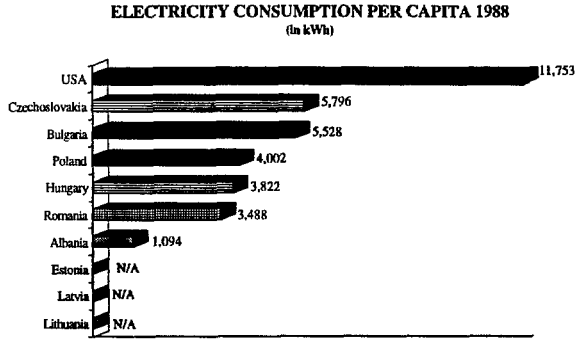
Poland consumes much domestically produced coal (although local coal production costs are relatively high compared to world coal prices) but less oil and natural gas. Albania uses very low amounts of electricity and of other fuels, reflecting low industrial output. Albania actually is an exporter of electricity made with hydroelectric generating capacity. In Albania electric use is low because of poor infrastructure, including wiring systems that are breaking down frequently from lack of maintenance.

Figures 10 - 13









Note that the energy and fuel consumption numbers come from 1988, before the shift of CEE countries from Socialism. Trading patterns in 1988 differ significantly from today. In 1988 trade with the USSR and with other CEE countries dominated most trade flows. Today many of the CEE countries, most notably larger countries such as Poland, the Czech Republic and Hungary, and smaller countries such as Estonia look to the West for trade possibilities. Other CEE countries such as Latvia and Lithuania maintain more extensive trading relationships with Russia and the other republics. The nature of the trade flows may have significant affects on current energy usage. More data is necessary to fully analyze current energy use. Better information should be available within each CEE country.

B. Characteristics of the Legal and Regulatory Environment

A main feature of the open market transition taking place in CEE is the changing sets of laws and regulations which impact private businesses. Under the former system of central planning, investment in production was largely decided by the State. There was little need for laws governing private sector ownership and business transactions. Some variation existed among countries, but the net effect was that efficiencies were lost because of the State's inability to make decisions which responded to market forces.

During the transitions now taking place, legal constraints vary from country to country. Policy discussions and debates are taking place in many close and open forums, but an underlying constraint is the inexperience current leaders have with implementing policy changes in an open

and democratic way. Whereas reforms have been instituted rapidly, for example, in Poland and Hungary, this process is progressing much slower in other countries such as Romania and Bulgaria. Yet, even where new laws have been introduced, the existing legal system has often been ill-equipped to facilitate commercial transactions, or to adjudicate contract disputes brought before the courts. There is not only a need for new law, but a serious need to improve the administration of law. In addition, CEE governments have been receiving multiple advisors from various countries, and are adopting laws based on different models of private sector support and regulation. There is a need for CEE ministries to exchange information and better coordinate efforts regarding the changes in law which have been adopted.

1. Structural and Regulatory Problems

Several legal problems continue to constrain open markets:

- Lack of commercial codes.
- Inefficient and untimely systems for obtaining licenses.
- Lack of collateral law and a system of registering securities against loans.
- Outdated or in some cases non-existent property surveys and registries.
- Restrictions on the sale of real estate until needed systems and regulations can be agreed upon and developed.
- Lack of systems and procedures for declaring and filing bankruptcy.
- An outdated and ineffective court system, operated by grossly underpaid lawyers and judges.
- Lack of laws on intellectual property, copyrights, and patents.
- Lack of real estate law, i.e.. allowing foreign venture partners to own land.
- Lack of other laws which enable development of new institutions such as credit unions, foundations, and non-profit organizations.

The severity of these constraints varies among countries, but in general these systems need to be either overhauled or built anew from the ground up. More detailed discussions appear later in this report.

2. Historical, Administrative and Institutional Problems

Several variables which weigh heavily on the process of legal change in Central and Eastern European countries:

- Historical precedent: The extent of changes which must be made during the current post-communist transition is partly based on the pre-existence of laws, traditions, and institutions which pre-date the communist era. Historical precedents, such as existence of commercial codes, bankruptcy laws, land and ownership records, and entrepreneurial traditions are important factors which impact the current transition process.

- Government Capacity and Commitment: The pace of economic reforms in CEE countries ranges from cautious, as in Romania, to the progressive "shock therapy" of Poland. Governments in all CEE countries are trying to balance the need for reforms with the need to provide a social safety net, as reform efforts have created high levels of unemployment and inflation, price increases, loss of eastern-block markets and other hardships. In Poland and recently in Hungary, voters have elected new governments which have promised to slow the pace of reform. However, in countries with strong leadership, such as the Czech Republic, government has been able to undergo rapid reforms with relatively little political upheaval. In most CEE countries, privatization of former state-owned enterprises (SOEs) has consumed most government attention, often to the exclusion of policy and regulatory reforms needed to improve the enabling environment for private sector, primarily small and medium, businesses.

- Quality of Information About Issues and Constraints: There is a general lack of information about SMEs, their contribution to the overall economy, and how they are managing during the transition period. CEE governments generally know little about the employment patterns of SMEs, their sectors of operation, the constraints they face, and many other issues that are important for rationalizing policy and regulatory reform. Since many small businesses are unregistered mainly to avoid taxes and operate "informally," the ability to collect good information on the SME sector is further complicated. This makes it difficult to engage in meaningful debates about priorities and future policy directions.

- Strength of Non-Governmental Organizations: Indigenous, private voluntary organizations are a key force in influencing governments to adopt laws that are favorable to the private sector. Yet, in most CEE countries, such organizations are new and inexperienced. Some that have emerged are opportunistic efforts, or platforms for individuals seeking political clout or foreign aid capital. Yet, other organizations are emerging which are intent on serving the business community. Well-organized NGOs, backed by voluntary members, are important to encourage the development of an open market system.

C. The Situation With Financial Services

SMEs in Central and Eastern Europe have very limited options for financing their ventures. The variety and availability of financial services found in the U.S. or in Western Europe does not yet exist in the CEE. For example, the banking system in many CEE countries still lacks the legal, institutional, or technological base for providing normal bank services such as checking accounts, long-term loans, or letters of credit. Some debt financing is available from newly commercialized banks generally through credit lines provided by foreign donor organizations.

Yet, most SME needs for financial services are still not being met due to continued deficiencies in the banking system. Despite some improvements, many former state-owned banks are technically insolvent as they still carry the burden of bad loans made to SOEs during the communist era. Banks and their loan officers have limited experience evaluating business plans or making credit decisions. Businesses have even less experience in preparing business plans, although this is improving with the assistance of foreign aid programs. In the effort to exercise financial prudence, banks are often too cautious in their lending policies, and often lend only on highly restrictive terms. These constraints to the delivery of financial services will improve in the long-term through government initiatives such as adoption of new bank supervisory rules, non-inflationary monetary policy, and privatization of large SOEs.

Meanwhile bank reform is a priority for major multi-lateral institutions like the IMF, the World Bank and the EBRD. Until large-scale bank reforms are complete, some donors are encouraging CEE countries to serve the financial needs of SMEs through preferential lines of credit, loan guarantees, and small venture capital funds. In addition, there are some local venture capital initiatives which local entrepreneurs have established on a small scale to meet the need for investment capital.

Chapter III contains a detailed discussion of problems and recommendations in the financial arena.

D. Public Sector Agencies and Non-Governmental Organizations (NGOs)

In the U.S. and other developed countries, the public and private sectors have a tradition of dialogue and debate on the issues that affect the operating environment of private business. To strengthen their voice in this dialogue, entrepreneurs often belong to organizations which seek to represent their individual interests. There are many approaches to bring pressure on government to take note of private sector interests. Yet, in a democracy, this open dialogue between the public sector and business organizations is the best method of adopting policies which ultimately benefit individual consumers and society at large. [11]

1. Business Associations and the Chamber of Commerce System

Intermediary organizations are vital to this process of public dialogue. In Central and Eastern Europe, such organizations, where they exist, are in a nascent stage. Some business owners realize the vital role that business associations can play in helping the business community over the long term. As a result, new organizations have emerged but are inexperienced. They are struggling with issues of fundraising, constituency building, and offering appropriate services to members. Membership itself is problematic, since many individuals are resistant to joining groups given the legacy of the communist era.

In many CEE countries, local chambers of commerce have been fashioned out of former socialist institutions. Due to their socialist roots, these organizations still often function as state-run entities. There is a movement in several CEE countries to make chamber membership mandatory for all business owners, based on the chamber model active in Germany. Yet, field research shows that (a) chambers are ill-equipped to provide services which meet business needs and (b) as a result, businesses are now organizing their own associations and advocacy groups based on voluntary membership. These local efforts to promote independent business can benefit the SME sector by working from the "bottom up."

2. Public Sector Agencies

Effecting lasting improvements in the legal and regulatory environment also depends on the ability of public agencies and their staff to (a) understand the needs and contribution of business to the economy, (b) analyze the constraints facing businesses which the government is able to overcome, (c) make decisions which are supported by the business community and the general public, and (d) systematically track the impact of their decisions and make changes accordingly. All of these steps must be done with minimal intervention, a difficult concept for many public officials to grasp given the recent legacy of the communist system.

Many governments in Central and Eastern Europe tend to over-manage the private sector -- much like trying to compartmentalize diverse private sector activities into a socialist planning model. This tendency is understandable given the current social and political pressures to protect

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[11] See sections on "Building on the U.S. Comparative" and "What We Have Learned from the U.S. Experience with Small Business Development" in Chapter IV.

those hurt by reforms, such as pensioners on declining incomes and the unemployed. However, production and productivity levels in most CEE countries are still too low to generate the capital necessary to sustain a welfare state. Thus, governments are struggling to balance the need for continued economic reforms with the cost of social programs. This struggle creates an environment of uncertainty for private entrepreneurs, and can add to skepticism about the role of government in economic development.

Public sector agencies and legislative bodies continue to need technical assistance and support in managing this transition. At the same time, the general public needs to be educated about the importance of SMEs in order to build the political support necessary for governments to move ahead with economic reform.

E. Private Enterprises and Entrepreneurship

Enterprises in Central and Eastern Europe are generally experienced at production techniques, are well educated, and have strong technical skills. However, they lack the necessary tools for effectively competing in a free-market economy such as financial management, pricing, and marketing strategies. Another problem is the reliance on old technologies that can't compete with Western standards. Many firms are seeking foreign investors and joint-venture partners to help upgrade production methods and find new markets overseas. Yet many producers realize they cannot rely solely on outside sources and must obtain additional skills.

Technical assistance and training continue to be important needs for SMEs of all sizes in CEE. Because of increasing complexity requirements, this assistance must be tailored to fit the firm's size, stage of growth, and capability. Smaller, emerging businesses can benefit from basic business management tools, whereas established firms and larger, privatizing enterprises have more sophisticated needs, both technical and managerial.

Entrepreneurship is growing in this post-communist period. The strategy team met many small- to medium-sized entrepreneurs who managed several small or micro businesses. Typically, these operations began through trading activities financed with private capital, then expanded into small service operations such as transportation and light manufacturing. This shows that some enterprising individuals have gained access to sufficient start-up capital, and created viable small businesses. These are the individuals who, given the right skills and good business planning, could use additional financing to expand productive capacity and create jobs.

Information about the private sector is underdeveloped in most CEE countries. This makes it difficult for local entrepreneurs as well as foreign investors to make investment decisions. This problem increases dramatically outside of the capital cities. In addition to encumbering the businesses themselves, this lack of information makes it difficult to conduct meaningful analysis about policy reforms, and to target regulatory changes which create incentives for the SME sector.

Indigenous business advisory services for SMEs are beginning to emerge. Some of this movement has been stimulated through the efforts of foreign donors, like A.I.D., to establish and operate business advisory centers, train management consultants, and improve the curricula of

university and training centers. Most firms are inexperienced with technical and management assistance, and are still learning the value of such services to their operations.

F. Political Change and Stabilization

Political stability is important for continued growth and development of businesses of all sizes. Some firms are able to take quick advantage of the chaotic political environment in the CEE, but they alone are not able to bring about the kind of economic overhaul necessary for long-term growth.

During the transition period, many new firms are looking for a quick return on their investment. This is not necessarily a bad approach. In fact it makes good business sense from a strategic point of view, and it generates capital and creates some employment. Stabilization in the political and regulatory environment must come, however, in order to provide the incentives for these profits to be re-invested in more productive enterprises that create more stable jobs and increased incomes.

Like privatization, policy reform, or regulatory reform, political reform efforts that help secure democracy in the CEE directly benefit the ability of SMEs to move freely within an open market economy.

Chapter II. Summary of Lessons Learned and Future Development Needs

Chapter III of Volume Two (Background Information) contains a detailed discussion of the lessons learned to date by A.I.D. and its grantees operating under the 1800023 portfolio, as well as insights gained through the team's meetings with other donor agencies, governments, private sector associations and entrepreneurs in Central and Eastern Europe. Presented here is a summary of the main points, which have been important in guiding the team's development of goals, strategies and objectives for future SME program directions in the region.

A. Firm-Level Assistance Must be Tailored to Needs, and Established in the Local Marketplace for Long-Term Viability

• Entrepreneurs generally have technical skills, are well educated, and are experienced producers. However, they lack experience as managers and innovators.

• As market reforms take place, firms in different growth stages have different technical assistance needs. Start-ups require basic business management tools, while established firms need more advanced tools in organizational development, marketing, distribution, and industry-specific technology.

• Entrepreneurs who are managing small or micro start-up business benefit greatly from basic skills training. There sometimes to be a lack, however, of standard marterials for this purpose.

• There is a lack of readily accessible indigenous technical and management consulting services to support expanding small businesses, and the larger more complex enterprises. The enterprises themselves, as well as the indigenous service providers, need support in better understanding the consultant-client relationship.

• Whereas SMEs may sometimes perceive credit as their main problem, frequently they are missing opportunities to decrease costs and improve profit margins through management interventions. This needs to be a high priority for firm-level training and technical assistance.

• Trading has been a good short-term strategy for entrepreneurs to quickly mobilize savings for future business ventures. However, firms must now move from trading into productive activities to ensure long-term viability of the private sector.

• SMEs are beginning to play an important role in the transition to an open market economy as alternative sources of income and employment for former employees of SOEs.

B. Policy and Regulatory Reforms are Proceeding, but Need Continuing Pressure

• Necessary reforms in the legal, policy, and regulatory areas have proceeded more slowly than was originally anticipated. Political pressures and unpredictable public support, coupled with the strains of structural adjustment, have made the decision-making processes among government leadership less clear.

• Information on the SME sector and its contribution to the overall economy is lacking throughout the region, making it difficult to formulate policy and regulatory reforms that cater to the needs of the sector.

• The slow pace of large-scale privatization in most countries is contributing to an uncertain operating environment for SMEs.

• CEE countries need to build a stronger base of support for privatization and SME policy reforms within the private sector, non-governmental organizations, and the public at large.

• Lasting policy reform can best be achieved through (a) a strong grassroots base for SME advocacy, (b) good information and analysis on the role and value of SMEs in the economy, and (c) effective dialogue between SME advocates and policy makers at all levels of government.

• There is a need to improve government officials' understanding of the importance of SMEs, and their ability to formulate and implement the necessary policies and regulations which support an 'enabling environment'.

C. The Emergence and Development of Local Intermediary Institutions are Important for Long-Term Sustainability of Reforms

• Future programs must support indigenous institutions to the extent possible, rather than create new, temporary structures. Many local groups are emerging and need assistance to strengthen organizational and membership development, leadership, financing, and public relations.

• Improvements in local service delivery capacity can be achieved by promoting the growth of business support services for SMEs. This should be a focus for future assistance.

• Institutional structures for analyzing and disseminating much-needed information about SMEs, markets, and policy reform issues are lacking. Some efforts are beginning, and need support to become credible in the business community and public sector over the long-term.

D. Financial Services for SMEs Still Largely Unavailable

• Given the enormous task of reforming the financial sector and limited A.I.D. resources, the 1800023 portfolio of programs can have limited impact on the basic structures which impede this area. Implementors can, however, help to articulate issues, improve demand for financial

services among SMEs, train lenders and borrowers in better practices, and introduce alternative financing schemes where appropriate.

• Since most SMEs needs for financial services are not being met, there is a need for increased non-bank sources of financing via credit unions, leasing companies, factoring arrangements, and equity capital financing. Greater savings mobilization must also be encouraged throughout the region.

• Both lenders and borrowers need further education about their respective roles and responsibilities in supplying and receiving financial services. Training programs are needed to prepare both groups as capital markets improve over time.

E. Training and Creating Local Training Capacity for Entrepreneurs are Key

• Firms need continued training in business management, marketing, and strategic planning. Also, experienced entrepreneurs need more specialized training to improve production methods, quality control, and market competitiveness.

• Future programs need to encourage training of trainers in government, banks, universities, business advisory centers, and other institutions where training resources can be leveraged.

• Given scarce A.I.D. resources, participant training programs in the U.S. are a lessor priority than in-country training of trainers, business managers, bank personnel, and policy makers.

• Universities and schools at all levels should be supported in upgrading curriculum on the workings of a free market economy. This will help prepare youth in the principles of open-market economics and skills and techniques of business management, marketing, finance and banking.

F. Targeting SME Development Resources can Achieve Greater Impact

• To the extent possible, A.I.D. should locate programs outside capital cities in selected municipalities, secondary cities, and other areas where fewer assistance resources are available. In most CEE countries, development of business is happening rapidly in major municipalities.

• Priority should be placed on (a) fully private, rather than privatizing firms, (b) production-oriented rather than trading firms (except in fledgling economies where trading is many times the only point of entry for entrepreneurs into the marketplace), and (c) established firms with proven capability, rather than start-ups.

• For long-term growth and development, Central and Eastern Europe countries will need to learn how to become competitive in regional and global markets, developing trade relations with nearby markets to the West and to the East, and over time with more distant partners. SMEs can

play an important role in this effort, and should be encouraged through foreign assistance to learn the skills necessary to compete globally.

- Through greater collaboration among A.I.D. and other donors, programs can pool resources, share ideas, and exchange information. Grantees and contractors should be encouraged to cooperate on a regional or municipal basis. Lessons learned could be highlighted in national, public forums.

Chapter III: Strategic Approaches to SME Development in Central and Eastern Europe

A. Purpose of SME Development Strategy

Over the course of the past three to four years of A.I.D.'s SME development program in Central and Eastern Europe, numerous lessons have been learned about what factors contribute to successful interventions. A major purpose of this strategic planning exercise has been to document these lessons, and assess how they should be applied in guiding future program directions.

To do this, the team has met with A.I.D. officials, grantees and contractors, consultants who are being sponsored by other U.S. agencies, representatives of other donor agencies, CEE governments, banking institutions, as well as entrepreneurs themselves. A list of contacts appears in Volume II, Attachment B.

The approach we have taken has been first to articulate what are the factors for successfully assisting the transition to private-sector-lead economic growth, and second to shape these factors into a set of strategies which will help guide future A.I.D. programming to the private sector in Central and Eastern Europe. The result is intended to serve as a tool, or what we have also referred to as a 'strategic framework', to facilitate decisions about future SME program priorities and resource allocations. At numerous points along the way, we have structured workshops with experts in the field and in Washington, D.C. to solicit feedback on the strategy and its implications for U.S. assistance to SMEs in Central and Eastern Europe.

Although this exercise has been undertaken on a regional basis, we are mindful of the important and unique differences between countries[12]. The status of the private sector in each CEE country is affected by numerous factors:

- Status of reforms in banking and financial sectors which affect the availability of financing (debt or equity) for SMEs;

- Pre-communist history, economic status, political ideology, and access to regional and global markets;

- Current status of national debt and agreements with international financial institutions;

- Ease of conducting private transactions (affected by degree of clarity or confusion in national regulations governing private ownership and sale of private property);

- Status of physical infrastructure -- communications, roads, manufacturing plants;

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[12] See Chapter V for a discussion of country strategies and recommendations.

- Skills -- labor, management, entrepreneurship -- of human resources;

- Progress in the privatization processes.

On the other hand, it is just as important to recognize that, in order to be economically viable, the individual CEE countries must become linked through trade and investment with their neighbors, and wherever possible, into the global marketplace. This will help ensure viable economic growth over the longer-term. We have been mindful of these broader needs which the strategy must also serve.

What makes A.I.D.'s approach strategic? A strategic approach is one which will (a) build on opportunities in the sector, and (b) contribute to stronger political and economic relations with the U.S. These opportunities will be largely determined by the status of reforms in the areas outlined above. Because the needs are so many, and resources are limited, it is important to identify key areas which will help to leverage the transition away from centrally planned economic principles. This is another important criteria for the SME strategy. Over the long-term, the efforts A.I.D. supports must add to the structural changes needed to sustain an open-market economy.

B. Goals of the Strategy

Based on the team's interviews and research in the field, we have formulated a two-part goal statement that captures both the immediate purpose of the U.S. involvement in Central and Eastern Europe, as well as the longer term goal of the assistance program.. These goals are applicable to the CEE region, whereas the U.S. role in helping to attain these goals will be dependent on factors unique to each country. (See Chapter V for guidelines in determining country specific programs and projects.) In the long run, it is in the interest of the U.S. to build both political and economic relationships with these newly emerging democracies. Fostering SMEs through technology transfer, institutional development, as well as trade and investment, will help strengthen U.S.-CEE ties.

1. Long-Term Goal: Aiding the Transition to an Open Market Economy

The fall of communist governments in former Soviet Bloc countries presented the U.S. with an unprecedented opportunity to help reshape the failed approaches of socialist-style planning into viable economic systems based on the principles of capitalism and free enterprise. Not only was this an opportunity, but it was indeed a responsibility which we have shared with other economic powers around the globe. The long-term goal statement articulates this assistance effort.

> ***Long-term Goal Statement:*** *To assist countries of Central and Eastern Europe in undertaking the transition from an economic system based on the socialist principles of centralized planning and management, to the capitalist system of open markets, competition, and free-enterprise.*

Discussion/Indicators

It is clear from the team's field work that this transition is influenced by numerous political and economic factors, many of which are outside the control of either U.S. or other donor programs. However, the U.S. can play an important role in facilitating this transition, based on our experience at home, tempered with knowledge about conditions and realities that are unique to Central and Eastern Europe.

Of course, ultimate responsibility for reforming the economy lies with the individual countries and their elected officials. Because of the slower-than-expected benefits of economic reform to the citizens of CEE countries, many people, to varying degrees among countries, have become critical of the benefits of foreign assistance espousing the virtues of free-markets. It is unlikely that there will be a reversion to socialism, but the pace of change will vary. It will not be a clear-cut, smooth process either. [13]

We have concluded from our studies that foreign assistance programs will have a greater likelihood of success in aiding this transition if they are aimed towards:

- Encouraging a strong public base (advocacy) in favor of reforms that will benefit the emergying private sector.

- Educating policy makers and administrators in government about the benefits, and the timing of them, from instituting legal and regulatory changes that allow businesses to easily form, grow, and, when necessary, die-off.

- Encouraging the formation of private, non-governmental groups which, on a voluntary membership basis, represent the interests of businesses in an organized fashion to government and the general public.

- Promoting diversity in the marketplace for services to emerging SMEs -- training, consulting, accounting, marketing, for example.

- Helping to improve the knowledge base about SMEs and their contribution to the national economy, so that this information can become useful in public debate and policy-setting.

- Demonstrating how a viable, well-managed private business operates both in the local economy, as well as in a regional or global marketplace.

We have based the proposed SME strategy on what we feel is an important operating assumption. That being, that it is not the role of foreign assistance to direct this process, or to presume its outcome. Building partnerships with local institutions, both public and private, will

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[13] The outcome of elections in Poland last year, and more recently in Hungary, suggest that many people favor a slowing down of the pace of reform, and greater emphasis on building a social safety net to catch those who are adversely affected by changes in the economy.

help ensure that reforms take place, but these institutions must be providing the leadership. Nonetheless, we are advocates of a system which we feel (and recent history has shown) is more stable than communism, and it is our role to provide support and counsel where we are able to have the greatest impact.

Indicators of goal achievement are summarized in Table 4.

Table 4: Indicators of Progress in the Transition to an Open Market Economy
- *Increasing support among the populace for reforms needed to encourage private sector.*
- *Policy makers and administrators are increasingly aware of legal and regulatory changes needed, and of ways to implement them.*
- *Private groups are forming and becoming more active for the purpose of representing the interests of business.*
- *A diverse range of locally provided, commercial business support services (including financing) are becoming increasingly available to SMEs.*
- *Information about SMEs and their contribution to the national economy is available, to both private sector and public sector groups, and regularly maintained.*
- *Viable, well-managed private sector SMEs are becoming more prominent around the country.*

2. Intermediate Goal: A Strong and Independent Private Sector

The intermediate goal statement for the proposed SME strategy describes the immediate aim of of A.I.D. SME development programs. Like the process of economic transition described, this target is not static. It is rather a dynamic situation, which, unlike the former system of socialist-style politics and economics, is characterized by a greater respect for individual rights in the marketplace.

It is the team's view, in fact, that the rights of the individual are fundamental to the strategy for small business development. A small business venture is an extension, and an expression, of the individual. The aim of U.S. assistance is to create the kind of environment in which individual entrepreneurs can (a) access the marketplace with their ideas, (b) compete and (c) benefit from their successes. Creating this environment will ensure that the transitions, both towards democracy and private-sector lead growth in the economy, will be irreversible.

Intermediate Goal Statement: *The creation of an SME sector capable of contributing to and competing effectively in both the economic and political marketplaces which characterize a modern open market economy.*

Discussion/Indicators

How can we characterize this goal? The team, in its discussions with experts in the field, has identified several elements which contrast where the CEE economies are (hopefully) headed, with their socialist past. These elements are listed below, and then further elaborated upon in later sections of the report that discuss programmatic strategies and objectives.

- A strong base of independent businesses.
- Functional incentive structures (market-based economics) that provide the basis for decision making, and the allocation of resources efficiently.
- Legal and open private ownership structures, with transparent sets of rules and regulations governing transactions among individuals.
- A dynamic market place, with numerous points of entry, as distinct from the socialist, centrist system of centrally planned production and distribution.
- Ease of doing transactions vital to the establishment, growth, and liquidation of private companies.

Indicators of goal achievement are summarized in Table 5.

Table 5: Indicators of a Healthy (Private) SME Sector
- *Majority of GDP coming out of the private sector.*
- *Businesses able to operate independently, subject to the basic rule of competition.*
- *Market-based incentive structures which provide the basis for entrepreneurial decisions about investment, expansion, and contraction of ventures.*
- *Legal and open private ownership structures, with transactions being governed by transparent sets of rules and regulations.*
- *A dynamic marketplace, into which SMEs of all sizes can enter, compete, and benefit when successful.*
- *Public sector and private sector interacting regularly, with the common aim of achieving growth in the economy, and improvement in services and products to the consumer, international as well as domestic.*

3. How Long Will A.I.D. Assistance be Needed in the SME Sector?

One of the reasons for having a second goal statement is that it helps to make explicit the issue of "how long should A.I.D. remain in a country undergoing economic transformation?" Ideally, support to SME development would continue until the transition is complete and the private sector is firmly established. However, based on the program's experience, it is clear that many of the factors which determine how quickly and smoothly the transition takes place are beyond A.I.D.'s manageable interest. A.I.D. is involved in aiding this transition because the host countries are asking for U.S. assistance, and we have something valuable to offer in the way of expertise and experience. That is a pretty clear scope of work.

What is less clear, however, is (a) how our relationship with these economies will change as the transition takes place, and (b) what we should look for as signals to trigger that there need to be changes in the relationship. In most of A.I.D.'s work worldwide, sustainable economic development is the principal goal. As we know, this is a long-term process with an elusive time horizon. In many of the CEE countries, the situation is changing rapidly enough to instill some confidence that there will be reasonable progress towards the goal of free-enterprise and open markets. This, in fact, is a primary reason behind A.I.D.'s decision to make withdrawal plans for the Czech Republic, Hungary and a few other countries where the economic indicators are encouraging.

On the other hand, even in the more economically advanced countries, many people we interviewed argued that it is premature for A.I.D. to declare "success" and pack up to return home. They pointed primarily to two factors. First, many of the largest state-owned enterprises are retaining redundant labor which will be shed as privatization continues, and the private sector is not yet in a strong enough position to absorb labor that will be displaced.

Secondly, it is their opinion that some countries are riding a tide of short-term successes which doesn't necessarily mean they will experience medium to long-term economic growth. More time and assistance is needed to better prepare governmental agencies, private sector groups, and businesses so that they can operate effectively under a free-enterprise system -- in short, SMEs must compete, and the government must set the rules that allow them to be competitive.

What does this issue mean to the implementation of A.I.D.'s SME strategy? For the most part, we are presently focused on improving structures and systems within the CEE economies, but it is also important for the A.I.D. program to help shape relations between the U.S. and CEE countries that will contribute positively in the longer term to SME development.

Over the course of time, as economic transition takes place, U.S. relations will evolve to a situation where they are based more on the economics of trade and the politics of global cooperation, and less on foreign assistance. During the past several years since the fall of communism there has been a strong and growing interest among private groups in the U.S. to re-forge relationships with CEE countries. The types of relationships that are established -- through foundations, volunteer exchange programs, association chapters, and sister-city type programs, as well as trade and investment -- will continue beyond the U.S. foreign aid program. These are positive events that will have an impact on the longer-term SME development goal.

Encouraging the development of these linkages can be an important element of A.I.D.'s "phasing down" strategy. There is no clear-cut point at which A.I.D. should decide to cease assistance. As a country becomes more advanced economically, there is less need for foreign assistance. The indicators outlined above help us to understand where an economy is at along the transition to an open market economy, and to balance foreign assistance as needs decrease.

As programs begin to slow down, the U.S. government should continue to encourage:

- Trade and investment relations with CEE countries.
- The formation of partnerships among associations, both from the private sector as well as the non-government groups serving public administration (e.g. non-profit municipal management associations, public administration groups, etc.).
- The formation of exchange programs for continuing training opportunities -- universities, business schools, and other management training institutes.

In general, A.I.D. should seek to promote U.S.-CEE partnerships in which the U.S. counterpart can supplement resources needed to help strengthen the economic and institutional linkages that serve business in CEE.

C. Strategies and Objectives

The team identified six strategic areas of programming that support development of SMEs in Central and Eastern Europe. See Table 6.

Table 6: SME Development Strategies for Central and Eastern Europe
- *Strengthening the ability of entrepreneurs to compete more effectively in the open market place.*
- *Improving the availability of commercially viable, locally provided, SME support services such as technical assistance, management consulting and marketing.*
- *Encouraging competition in the provision of SME financial services, and improving the ability of financing agents to make good decisions.*
- *Strengthening the public sector institutions -- legislative, administrative and executive -- which are critical to supporting reforms.*
- *Improving the "enabling environment" of SME sector policies and regulations.*
- *Improving the flows of information about private sector business and its importance to economic development.*

The following section discuss these strategies, their related objectives, and illustrative programs which A.I.D. may consider carrying out. There are some activities already underway that fit well into the strategic framework, so that our mention of them is intended to validate their relevance to the SME development strategy.

1. Improving Entrepreneurial and Business Management Capabilities

Strategy: Improve the capability of indigenous entrepreneurs/managers to manage their SMEs in a world characterized by increasingly rapid change, and by intense competition both in domestic and international markets.

Discussion

If the CEE countries maintain open economies, they will face constant challenges from companies in other countries introducing a continuous flow of new and improved products, as well as a continuous stream of cost-saving innovations affecting supply relationships. CEE politicians can limit this competition by intervening to close markets through tariffs, quotas, or non-tariff barriers, or they can maintain relatively open markets and work to make domestic businesses more competitive. Farmers in most CEE countries have already shown a preference for increased protection. SME owners, many of whom have a comparative advantage in the short run related to inexpensive, but capable labor, have not pressed for such protection. A.I.D. projects can help educate entrepreneurs, national and local officials, and consumers to the benefits associated with strong efforts to increase productivity and to maintain open markets.

Objectives and Activities

Objective 1: Sponsor joint activities between economics and business faculties in the United States and economics and business faculties in CEE to improve economics and business curriculums in CEE universities.

- Working with an American university and a local counterpart faculty, sponsor the development of specialized short courses in management techniques which are of particular use to indigenous consultants.

- Using new curriculum materials developed, sponsor a series of training sessions for local consultants, business owners, or managers of SOEs or privatized SOEs.

The goal is general improvement in both the economics curriculum, so that graduating students have a better understanding of the working of market economies, and the management curriculum, so that graduating students have better decision-making skills based on modern analytic techniques, and better knowledge of and ability to operate with modern management techniques. The cooperative work to develop improved curricula can be accomplished in country, using visiting American faculty, or in the United States, with CEE faculty visiting at an American campus. The latter model may produce better materials, because the CEE faculty member(s) can be exposed more completely to the strength and variety of American management practices.

Objective 2: Development and use of curriculum materials that teach behaviors and understandings appropriate to activity as a producer or consumer in a market economy.

- Develop training programs for entrepreneurs that are tailored to their "on-the-job" needs, and which will help them improve their abilities and their company's growth potential. Such training should be housed in a local institute, or could even be promoted as a local business, perhaps even a franchise.

- Use an American teacher(s) to work with teacher's associations, university faculties, or other appropriate venue to review curriculum materials from the United States and localize materials to the CEE country. The American teacher could be a curriculum development specialist from a teacher-training program, or from a major U. S. school system.

- Utilize Peace Corps volunteers teaching English as a Second Language to teach a joint curriculum which focuses on entrepreneurial training in the classroom as well as English language training. The training could make use of numerous curricula focused on entrepreneurship.

- Introduce entrepreneurship as a focus in vocational training courses. The vocational skill curriculum would be augmented with courses or training sessions in problem-solving skills, and business management skills. [14]

Building entrepreneurial skills is primarily a long-term objective. Students must be introduced to the concepts of a competitive, free-market economy, and they must learn the behaviors associated with success in that economy. Part of that learning comes from observation and participation in the society, and part can come from focused interventions in the educational process that highlight appropriate behaviors such as hard work, planning, problem-solving, and management skills. The interventions described here are intended to start the education process, and provide models which can be replicated on a local or national scale, as appropriate.

Objective 3: Introduce the concept of strategic planning reviews for firms with 50 to 200 employees. These reviews would help management review the quality of operational procedures, including production control systems, sales and distribution systems, inventory and materials control systems, personnel practices, financing methods and financial control procedures. The goal of the review would be the improvement of existing systems and methods, and the development of strategic planning goals and objectives related to the improvement and growth of the economy.

- Working with a team comprised of U.S. experts in management consulting and industrial engineering, develop a series of analytic instruments to document the quality of existing systems within a sample of medium-sized private or about-to-be privatized firms. These instruments will provide a base of consistent information

[14] An example of curriculum content are those materials developed by the National Center for Vocational Education at Ohio State University.

about the quality of management across all of the firms examined through this project, and can serve as a base for development of specialized training or process improvement courses.

- Using the instruments developed above, subsidize the application of the instruments to a sample of medium-sized firms, using a two-step process. In the first step, a U.S. team, working with indigenous management consulting, accounting, and/or industrial engineering firms will apply the instruments to a company, identifying systemic weaknesses, and suggesting several improvements that can be accomplished with little or no capital. This step is intended to build the subject firm's confidence in the process, and convince firm management that they should participate in step two.

- Step two is a strategic planning exercise to develop short, medium, or long-term goals, as appropriate for the company. The exercise would be led by the outside company (and the indigenous partner), but would be heavily dependent on the quality of participation by the subject firm's management. This model is based on a demonstration program funded by the Government of Norway. The goal of the project is to make medium-sized businesses aware of the potentially large returns available from a management analytic/strategic planning process using capable outside consultants to assist management.

This proposed intervention is expensive, with the complete process costing in the range of $15,000 to $25,000 per intervention. The intervention will accomplish two major things. First, it will introduce medium-sized firms to the gains that can be accomplished through the use of skilled outside consultants. These gains can be many times the cost of the outside consultation. Second, the firm will be trained in the use of a sophisticated strategic planning process which will help management choose an optimal path to necessary changes and desired growth.

Objective 4: Develop basic written materials providing guidance and instruction to owners/managers of SMEs on subjects such as business planning, marketing, site selection, personnel management, etc. These materials can be based on excellent training materials already available through a number of programs in the United States, Europe, or Japan.

The local or regional small business service centers being established by various sponsors (A.I.D., ECPHARE, UN, etc.) provide counseling services to business, as well as limited training in basic business subjects. Training materials covering a wide range of management topics have been developed in a number of countries. These materials are generic in nature, describing management processes and activities, but not providing specific information of use only to one company.

Most governments have found it appropriate to provide such written materials at cost, and have subsidized the development of such materials. Many of these materials can be rewritten and republished, at low cost, to meet specific local institutional patterns or references. A small investment in such materials could greatly increase the availability of management information. These materials would not provide a special advantage to any company, and would not produce

a conflict with local consulting firms that are producing more specific or specialized management information for paying clients.

2. Improving the Local Marketplace for SME Support Services

Strategy: Strengthen the marketplace capability to deliver business support services.

Discussion

Almost all CEE countries have seen a rapid increase in the number of new business startups over the past three or four years. This increase in the number of businesses has occurred even though Gross Domestic Product in most CEE countries was falling by 25 to 50 percent over the period. Thousands of other small and medium-sized state-owned enterprises have been privatized. Some of these startups, and some of the former SOEs have been helped by expert consultants provided through donor projects. Many AID projects fall within this category. It is standard practice to insist that every outside business consultant placement have an inside counterpart who works closely with the outside consultant. The goal of these projects is not only the solution of existing business problems, but transfer of the knowledge, methods and techniques necessary to identification and solution of the problem.

Few projects have focused on actually developing an indigenous consulting capability, however. Learning has been incidental to business assistance on a firm-by-firm basis, although a number of existing projects appear to have taken opportunities which arose to expand the process by training trainers, engaging local business practitioners (such as accountants) in existing projects, or otherwise expanding the impact of their targeted assistance. In some cases, manuals developed to help one company have been generalized and made available to other firms.

There are numerous ways that projects can be designed with the specific intent of expanding the local capability to support SMEs in a CEE country. Deciding how to approach this strategy should begin with an appraisal of the current market situation. Is the local marketplace showing evidence that markets are responding to the expressed needs of local businesses? Is there a steady increase in the number of firms advertising their capability to assist a firm with business planning? financial planning? access to local (venture) capital? assistance with industrial (plant and/or equipment, production lines) engineering? access to marketing information or help with marketing research? assistance with advertising? Many of the advertisements may come from foreign firms attempting to move into the marketplace to exploit clear market opportunities. Many of the ads, however, will be from local firms.

The flow of local consulting services will increase as local individuals gain experience working with expatriate specialists or foreign firms. If local economics faculties, business school faculties, or professional associations in accounting, finance, law, and management take active steps to improve the capabilities of their members, the flow of valuable services will increase even more rapidly. In some CEE countries, however, the university faculties are reluctant to depart from a theoretical view of the world. Some faculties abhor practical approaches to business, and others are determined that they will not shift their educational activities towards more active, problem-oriented, and outward-reaching activities which would "lower the status" of the faculty. This

attitude is not restricted to academic institutions in the CEE countries. Many faculty members in American Universities strongly believe that academic work should be isolated from too much interaction with current problems. Fortunately for business in the United States, business school faculty have not held this view, and have attempted to combine traditional university education in the arts and sciences with specialized training in functional management skills including accounting and finance. Suggestions to expand business consulting skills in CEE countries are described below.

Objectives and Activities

Objective 1: Utilize the network of business assistance centers being developed in most CEE countries as a locus for programming intended to train local consultants to assist businesses with business planning, financial planning, basic accounting, basic market research and marketing development including pricing, cost analysis and cost control, and other basic subjects. These training activities would be "generic" in nature, stressing process and procedure, but not focusing on the particular needs of an existing business. If analytic skills are focused on the needs of one business, so that the training or problem analysis centers on improving profits for that specific business, then the education or problem analysis should be paid for by the business receiving the assistance. (This would not prevent a case where one business served as a "model" to help the training of consultants.)

One lesson from the United States is that a large number of business owners in any economy, including even the supposed "developed Western economies" can benefit from better knowledge of basic management practice. Local consultants are critical to this training process because they can bring a mastery of modern business management technique to bear, as well as a full of understanding of local business cultural patterns that may affect business decision-making processes. Outside consultants may be very knowledgeable in business techniques, but they will rarely have the knowledge or insight necessary to incorporate fully the effect of local culture as it affects management process. The training of local consultants is important, therefore, to maximize the quality of training delivered to SME owner/managers. Training could be provided for local business assistance specialists (including individuals with experience working with donor projects or foreign companies, local lawyers specializing in business issues, local bankers or loan officers, local accountants, market specialists, etc.) using a variety of techniques:

- Add a central training component to the business assistance center program. The training specialist(s) would be knowledgeable business trainers, who could work with the business assistance center staff, train the staff as necessary, and develop additional training for the (potential) local consultants. If additional training time is available, courses for local business people could be added. Having expert business trainers on staff provides flexibility to the training delivery process.

- Business assistance center staff could work with economics or business faculty (where available and where willing) to develop specialized training programs for the local consulting community. This project might be made more interesting to faculty by adding a research dimension to the training component. The training program could incorporate a survey component to identify the needs of local

businesses, so that training could be more specific. The survey could also provide benchmark data regarding the business knowledge of the consultants prior to training, so that the efficacy of the training could be measured upon completion of the training. Many of the economics faculties may be reluctant to work in this kind of program, however, since it is more "applied" than their traditional work.

- Many associations of business professionals in the United States have continuing education requirements that are met by participation in training courses held on a regular basis. Many of the courses are aimed at the functional needs of businesses, and many of the courses focus on training the business professional (consultant) to be better at servicing business owners with specific problems. The courses are often prepared by committees organized by the business professional's association. This model could be transferred to CEE with assistance of U.S. association networks.

Business associations that represent business support professionals such as accountants, lawyers, engineers, and bankers are beginning to emerge in CEE countries. There may be newer associations representing other specialists such as advertising or marketing specialists, and systems developers. Some of the organizations may have developed continuing education programs for their members, but it is likely that many of the associations could use some financial support and some expert technical assistance from counterpart groups (such as U. S. associations) to help them develop effective programs. Business management faculty from U. S. business schools may be very helpful in the design of these projects, and may help in recruiting local support. The actual training programs are probably best developed using local professional committees, however, with some outside technical assistance.

Each of the sub-objectives discussed here focuses on helping the professional and educational organizations recognize the importance of the SME market for their services. The projects can also help overcome the generic bias that smaller businesses are unimportant. This is strongly-rooted in the Socialist bias towards large organizations, including organizations that could exist only with assured Soviet bloc markets.

The projects can also emphasize to SME owners the importance of seeking professional help on an ongoing basis, and particularly, at critical points during the development process such as startup and first expansion. The delivery of consultant training can take place through a variety of local institutions. In most U. S. cities, Small Business Development Centers, the American version of business assistance centers, often serve as a catalyst for development of such training.

Objective 2: Help local, regional, and state governments understand governmental business support functions as practiced in Western and Asian economies. Specifically, attempt to secure funding for at least partial support of business assistance centers in each CEE country.

A review of assistance programming in the CEE countries reveals that many of the business assistance projects were initiated on the assumption that they would become "self-supporting" after a short period such as two or three years. While this goal is reasonable for consulting-type counselling that is specific to a firm, and clearly adds value to firm activities, it is probably not

realistic for those business centers that focus on more generic, base-level education of business owners. Introductory education of business owners may be extremely valuable, particularly in areas such as business and financial planning, marketing, and strategic planning. Even a little training may help an entrepreneur focus more clearly, and develop a better assessment of the risks associated with a startup, an expansion, or a complex business problem.

It is unlikely that the business assistance centers now operating with donor funds will ever become fully self-supporting, unless they shift towards providing higher-level, more firm-specific interventions similar to those provided by expert consulting firms. Such expert consulting firms will develop over time, but they will not be interested in producing the basic training which will be needed to help the continuing flow of newer entrants to the business community.

Some SBDCs have managed to reduce their subsidy by focusing on a market niche. the UN supported program in Romania, for example, has centers which sell business planning services to SMEs seeking financing for their projects.

It is the new business, or the business that has only been in existence for a few years, that needs basic business education. There appears to be a significant return to providing these services with government financial support. In the United States, the Small Business Development Centers (935 centers across 50 states) are housed in public and private universities, in junior colleges, at chambers of commerce, or in local economic development offices, and are supported by a combination of local, state, and federal funds. The centers charge nominal fees for most services, but are not expected to meet their full costs from the fees collected. In almost all cases, the fees represent only a minor proportion of operating funds. This business support network has continued to develop and grow over a 20-year period, as more and more governments are convinced that the small amount paid for business support and education pays high dividends.

3. Improving the Range and Quality of SME Financial Services

Strategy: Improve the flow of financial services to the SME sector by introducing alternative, competitive services to the current banking systems, and by strengthening the capabilities of financial institutions to make viable loans and investments.

Discussion

Most donor assistance to the financial services sector has focused on creating a functioning bank system, with a competent central bank, and with private banks and branches capable of collecting and disbursing funds throughout each country in CEE. The process of creating a functional banking system is hindered by many factors, including the general lack of capital available to the system in most countries, an overhang of non-performing loans to state-owned enterprises and/or private businesses, little experience with loans to small private entities, lack of knowledge of modern banking practices and systems, poor communications which hinder transmission of data between banks and branches, lack of central facilities such as clearing houses, and consumer ignorance regarding credit usage and credit standards. With the exception of the Baltic States,

most banking systems are bankrupt in the sense that bank capital is far less than the value of non-performing loans which are still carried on the books.

Most countries in the CEE are running budget deficits financed through the issuance of state bonds, and many banks choose to invest in these "safe" assets rather than making "risky" loans to business. When loans are made, they usually are for short-term, almost always less than one year, require large collateralization, often 150 to 200 percent of the loan amount, and often carry interest charges that greatly exceed the inflation rate. Banks in several countries are hindered by some combination of poor bankruptcy laws, by poor collateral laws, by lack of basic collateral registers, and by court practices which may be biased in favor of smaller businesses. Most bankers trained under socialist regimes are not used to reviewing business or financial plans, making small loans, or even to dealing with smaller businesses.

The lack of check clearing facilities, and the poor communication systems in many of the CEE countries mean that most transactions are carried out in cash. U.S. dollars are used as a secondary currency in many countries, and foreign exchange services are readily available in most cities. With the exception of the Estonian currency (which is based on a currency board system with the local currency pegged to the German Mark, and with all domestic currency backed by reserves of gold or hard currencies) and the Latvian currency, none of the CEE currencies are readily convertible. Business loans are sometimes made in dollars or other hard currency to eliminate interest rate risk associated with inflation.

Inflation rates in most CEE countries are high by Western standards, but in most countries, central bankers working with IMF and World Bank guidance (and the promise of loans based on good performance) have made significant progress in bringing loan rates down and in stabilizing the inflation rate. There is a widespread belief among policy analysts, business owners and business associations that the high level of interest rates makes it almost impossible to borrow funds for projects that require real capital investment. Most loans to businesses, therefore, are for short-term commercial purposes involving the buying and selling of goods rather than the production of goods. There is evidence (decreases in start-up rates for commercial enterprises, increasing bankruptcies, positive GDP growth rates for the first time in several years) that several countries (Hungary, Poland, Estonia, Latvia, even Albania) are ready to entertain a greater emphasis on investment in production facilities.

At the policy level, central banks are established in each country, and assistance is being focused on the specific functions carried out by the central bank. With the currency board system in Estonia, central bank functions are more limited, but in the other countries the central bank is the key institution with respect to interest and inflation rates, stable currencies, ultimate convertibility, bank regulation and supervision, and the general capability of the banking system. Given this wide range of responsibilities, the short period during which CEE central banks have been exposed to Western banking, and the continuing responsibilities the banks have for the funding of money-losing SOEs, some functions have received little attention or have been left undone.

At the central bank level, general donor assistance has come most strongly from the IMF and World Bank, with additional assistance from advisors from the United States, Germany, Great

Britain, the Netherlands, and France. The World Bank has focused on improving bank structure and performance. Bilateral advisors have generally focused on one function of the central bank. Many advisors have concentrated on some area of policy development, often requiring legal changes before operating policy can be established and central bank employees trained.

Some banking advisors have been more capable than others, and have moved their functional area ahead rapidly, even when bilateral assistance has been closely coordinated. Consequently, some banks are unbalanced in the sense that some functions are being carried out with great competence, while other functions are performed less capably. The performance of advisors has also been compromised in some cases by the failure of central bank officials to assign necessary resources to critical functions such as establishing accounting standards or bank supervision.

At the local bank level, assistance usually encompasses the following activities:

- Training of bank officials, including training in use of modern banking instruments and practices. From the standpoint of SMEs, the most important training is in the area of evaluating loan proposals submitted by local business entities. Much attention has also been given by donors training business owners/managers to prepare business and financial planning documents to submit to banks in support of loan requests.

- Establishing standardized bank accounting practices and training the banks to maintain standardized accounts.

- Introducing good banking practices that are common in more developed banking systems, e.g., making backups of transaction files and storing them at some safe site outside the bank, delegation of authority to branch officials or to bank loan officers, routine auditing of bank loan files, etc.

There has been great emphasis on increasing the use of loanable funds for both business startup and expansion. Much less attention has been paid to the use of investment or equity funding for SMEs. The exceptions to this approach include CARESBAC in Poland, which has followed an explicit policy of using both equity and loan funds, sometimes simultaneously.[15] The International Finance Corporation (IFC) originally aimed to fund equity investments in Poland, but found that the local entrepreneurs could not demonstrate the business experience or knowledge to justify the sizeable equity positions which the IFC wished to establish.

A.I.D. has sponsored, usually in cooperation with the U.S. Treasury, numerous banking advisors in a variety of functional areas. Some projects have been focused at the training of local bank officials in the review of SME loan requests and business plans. Most of the advisors appear to have been very useful in improving central bank function, but there is less evidence of success at the local banking level. The lack of success at the local level may be related to the fact that

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[15] American bankers, who are prevented by law from holding an equity position in any firm, frequently refer loan applicants to an informal network of private investors so that equity funds from these investors can be used to strengthen an equity-deficient, but otherwise quality loan request.

loanable funds have not been made available to local banks in many countries because of government policy or government deficits which have captured domestic saving.

Objectives and Activities

Objective 1: Continue to stress financial training on both sides of the loanable fund market, i.e., training bank loan officers to analyze and evaluate business and financial plans submitted as part of a loan request, and training SME owner/managers to prepare more effective loan documents, including better business and financial plans.

- Financial plans should be prepared as a routine part of the preparation of a business plan. The two documents are closely inter-linked, although the business plan should probably take priority, since financial planning really presumes that basic business decisions have been made. Often, training of entrepreneurs has focused on the business plan and the financial plan as part of a loan application process. The plans are viewed as useful only as part of the funding process. This approach undervalues the role of the business plan as a living document which should be updated regularly and used as a key part of the strategic planning process necessary for the longer-term growth and development of successful businesses.

- More emphasis should be placed on training the analytical processes and methods needed to establish the loan requirements for a given business. Many of the trainers the team interviewed noted a consistent pattern of business plans which requested significantly more funds than were actually needed for successful conduct of the business venture requesting funds. Many entrepreneurs also would benefit from additional training in project control and financial control methods. This training will be particularly important if the business being supported is engaged in production activities which require more roundabout methods of production and longer lead times before first product sale and/or profitable sales.

Objective 2: Improve collateral law or collateral registers so that banks can fund startup loans when collateral assets are available. Banks in almost all countries provide only limited funding for business startups. Usually, such funding requires full collateralization of the loan. In some CEE countries, collateral laws, collateral registers, and judicial practices mitigate against use of collateral or require that collateralization be equal to 150 to 200 percent of the loan size being funded.

- Policy advice and assistance may be required to facilitate the development of legislation in some countries, while other countries may require technical assistance to implement the concept of collateral registers.

- In some cases a demonstration project at the municipal or district (regional) level may help actualize a collateral register system that has been feasible legally but not funded because of lack of local funds. Such projects are best accomplished in

areas where local banks have loanable funds or a reasonable probability of having loanable funds by the time the register is developed and in place.

Objective 3: Introduce alternative sources of SME funding outside of the banking system. Most banks prefer to loan funds to more experienced businesses which have demonstrated the capability over time (in many countries this means at least three years) to generate "free cash flow." "Free cash flow" means funds that are not required to cover any ongoing current expense of the firm. Since many of the new firms in the CEE countries are approaching age three or four, some of them may be able to qualify for funding on this basis, assuming that CEE banks feel comfortable with this rule of thumb.

Many firms will still not be eligible for bank funding, however. These businesses may be able to meet some of their financial needs through the following mechanisms:

- Development of leasing firms which specialize in the lease/rental of small capital items (office furniture, computers, other office equipment, display cases, refrigerators or other restaurant equipment, trucks, tools, etc.) often required by smaller businesses.

- Development of specialized financial subsidiaries which finance equipment produced by the primary firm. In the U. S. such firms include GMAC (General Motors Acceptance Corporation) which finances automobile purchases, and similar firms which finance other large equipment, office equipment, computers, etc.

Leasing, including the leasing of small items, is an industry that has grown tremendously in the U.S. during the past two decades. Large firms which produce items used by small businesses are the logical choice to start specialized financial subsidiaries in CEE countries. Outside capital may also be required to initiate general leasing firms which can lower the need for loanable funds among SMEs. USAID may consider demonstration projects to test the feasibility of these concepts.

- Some countries may also be suitable for the introduction of "factoring." Factoring occurs when one firm sells another firm liabilities which remain to be collected. The second firm, which specializes in efficient collection, buys these liabilities at a reasonable discount, and then manages the collection process. Obviously, no such liabilities exist unless sellers offer credit to customers to assist with the purchase of durable "big-ticket" items. Both the initial seller and the factoring firm are knowledgeable about the extension of credit to retail customers. The extension of such credit clearly helps smaller firms attempting to purchase equipment to improve the production process.[16]

4. Improving the Enabling Environment for SMEs

[16] The legal structure of the country must allow for the extension of such credit, and for the repossession of items when payment is in default. SMEs using such credit must also learn to manage it as part of their overall financing plan.

Strategy: *Support the establishment of a rule of law, with particular emphasis on the establishment and implementation of those laws which constitute an "enabling environment" promoting the growth and development of small and medium enterprises in the economy.*

Discussion

Through much of its work world-wide, A.I.D. has learned that policy reform requires not just "sound policy," but also the ability of governments to implement, monitor, and revise when necessary the process of policy change. It is not just the ability of governments, but also the ability of the private sector, through its own independent advocacy groups and representatives, to participate effectively in guiding the economic and social systems that serve society. The result is not a static condition wherein all the pieces are in their proper place. Rather, it is a dynamic environment -- which is often times called the "enabling environment" -- wherein the various players are allowed to participate and influence the directions being taken based on the principles of democracy.

The concept of an enabling environment for SMEs is discussed at some length in this section. This discussion is necessary because the enabling environment affects virtually every business and every transaction which takes place between businesses or between businesses and consumers. It is almost intuitive to say that the basic laws establishing private property, contracts, and competitive markets will be critical to the effective operation of a complex market economy. But most governments recognize this fact for a very limited period of time.

New laws are needed to replace old ones that clearly do not pertain to the new open market economy, but the Parliament is besieged by needs for new laws. Concepts and laws are borrowed from other countries, therefore, with property law following a German model, perhaps, and pricing laws based on U. S. practice. Labor laws are gathered from France, and judicial laws are developed from earlier models in the CEE country. The result is a jumble of laws stemming from differing legal traditions, different institutional frameworks, and differing economies. The jumble may work for a while, but it will not produce optimal results, and it may make transactions more costly. Money spent making transactions is money that is not available for investment, or for consumption. Poor law can inhibit the growth of the economy severely.

Yet there is no constituency for the passage of competitive market laws. Like all generalizations, this is an overstatement. There are many economists and lawyers (primarily resident in the Western countries and in Japan) who would like to see modern and efficient law be put in place quickly. Within the typical CEE country, however, there is little pressure for more effective basic laws in the areas defined below. No minister will push for laws enhancing competition, when many businesses are asking for protection from larger competitors, or foreign competitors, or underground competitors. Consumers, who would benefit from enhanced competition with lower prices, better quality, and more choice of goods and services, are not organized as an effective lobby. Businesses are not organized well, and holdover institutions, such as mandatory business chambers are riddled with conflicts of interest, since their membership is made up of both SOEs and private businesses. Existing state monopolies are well-entrenched, and even

though the government has changed in many ways, it is the old-timers in SOEs who continue to work with the old-timers in the various state ministries.

Despite all odds, many of the CEE governments have made a good start on the process of establishing good legislation to enhance competition and establish functioning markets. As will be suggested in the objectives described below, it may be time to review the laws that have been passed, noting their disparate parentage and heritage, noting the inherent conflicts between some of their provisions, and noting how they fall short of establishing clear property rights or straightforward contracting rules. The laws should be judged in terms of how easy (inexpensive) they make transactions, or how expensive they make it to interact in the economy.

The government may need encouragement from outside institutions such as independent policy analysis centers (think tanks), legal faculties, or legal associations. Businesses have to be encouraged to organize and to study the effects of the law on their ability to do business. Businesses have to learn how to lobby the government to petition for change in the legal framework for business. Governments have to learn how to seek out feedback from constituents, and how to provide forums where the competing views in the society can be collected as part of the record informing the legislative debate. Building these competencies requires time. Time that may be shortened somewhat by effective interventions organized or financed by outside donors.

The Enabling Environment

Basic exchange or production relationships are dependent on the enforcement of a set of rules (laws) which ensure that the outcomes of exchange transactions are predictable by all parties to the transaction. Laws may be established and enforced by private parties, but most governments reserve the ultimate enforcement capability, such as the use of force, to themselves. Governments therefore, bear the responsibility for establishing the set of rules which allow individuals and businesses to conduct exchanges between themselves in an efficient manner. All businesses benefit when the rules are clear and well-established, and when disputes about the effects or implications of rules can be clarified within a functioning dispute resolution mechanism. Smaller businesses do not have the specialized legal staff often found in larger businesses, nor do they have the large volumes of output over which the costs of disputes can be spread. Functional dispute resolution mechanisms are, therefore, even more important to smaller businesses than to larger ones.

For convenience, the set of laws related to the efficient conduct of business is called "the enabling environment" for business. Some rules are clearly more critical than others, and these critical laws and regulations should be considered as necessary from the standpoint of establishing a well-functioning market economy. These "necessary" laws make up an enabling framework within which businesses can transact business both efficiently (at minimal cost) and effectively (in terms of maximizing welfare within the economy). These laws and regulations should be developed before considering explicit "small business policy" as normally construed. Most "small business policy" relates to legislation establishing subsidies of some sort for selected small businesses. The exact contents of this enabling environment may be debated, but there is reasonable agreement that the following laws are essential components.

Property Law

Property law defines a person's right to hold and use property. Private, for-profit business cannot exist without the recognition of private property. This law is critical since it provides the basis for the incentive structure underpinning the working of the market system. Clear knowledge of property rights guides individuals making decisions about the use and conservation of their property.

In addition to the law defining property rights, the government must provide the institutional framework for tracking ownership of real property (land) and improvements to real property (buildings). This tracking system should provide proof of legal title (a deed to property) and should provide a listing of liens (claims) which have been legally filed against the property. An example of a lien would be a claim by the government stating that local property taxes are in arrears. Many countries allow craftsmen who have made improvements or repairs to a property to establish a "mechanic's lien" against the property, if full payment has not been made for the work done. Before title to the property can be transferred, the owner of the property must clear these "liens" or claims against the property.

Contract Law

Contract law provides definitions of contract terms in clear, understandable, and enforceable terms, and provides for resolution of disagreements regarding performance or terms in a court of law or through some other dispute resolution mechanism. The contract should be enforceable, that is, the state should enforce the terms of the contract providing that the terms are legal to begin with. Enforceability implies that the state maintains courts, arbitration mechanisms, or mediation mechanisms that provide for conflict resolution when there is a difference of opinion related to completion of a contract. Whatever the method specified by the state for conflict resolution, the method should provide for the conflict to be resolved quickly and at minimum cost to all parties. While the court system is the most frequently used conflict resolution method in most countries, other methods, such as arbitration or mediation, may prove more efficient.

Taken together, property law and contract law should work to minimize the cost of business transactions, thus making it easier for firms to focus on their production or exchange activities.

Laws Providing for Competitive Markets

Many CEE governments seem to be working under an implicit assumption that the existence of markets is sufficient to ensure that resources will be used more efficiently in an open market economy. It is not the existence of markets which guarantees improvements in the use of resources, but the existence of competition in the market which leads to lower prices, improved quality, and a flow of innovative ideas relative to better products and services, or improved production methods.

Markets must be structured by laws which provide for competition. Necessary laws are laws which prevent arbitrary closing of markets, or prevent the use of fees, licenses, performance bonds, threats, extortion (of protection fees) or other illegal means to inhibit entry to the

marketplace. Governments use licensing methods or performance bonds to ensure health and safety or to ensure that contract damages can be paid, if a contractor fails to perform. Licensing and bonding help prevent the use of threats or illegal force in resolving business disputes.

Health and safety arguments are used frequently to inhibit market entry, when there is no valid health or safety argument. In these cases, active participants in the market wish to use the government to prevent entry of competitors. This restriction allows existing businesses in the market to enjoy "economic rents." Economic rents are (excess) payments which do not lead to a larger supply of the product for which excess payments are being made. In effect, by preventing entry, the government transfers wealth from the purchasers of a good or service to the suppliers of the good or service. In a competitive market, the high price for a good or service is a signal for other businesses to enter the market with additional production. This leads to lower prices, which fall until there is no excess profit to be made, and therefore, no additional incentive to shift resources.

Inhibiting entry in response to political demands by constituents is one of the ways in which governments most frequently reduce competition and the efficiency produced by competition. The owners of SMEs (and of larger businesses, which also like the government to arbitrarily close markets to protect their competitive position) choose to use political means to limit competition from actual or potential competing businesses.

Competition policy should call for the maintenance of competitive markets throughout the economy, and should specifically outlaw cartels intended to raise prices or limit the supply of a product or service coming to market. The policy should allow for extensive cooperation among businesses in an industry, but should not allow competing businesses to discuss prices or customers.

Many economists would insist that laws are necessary to regulate existing monopolies in the public interest. Many of these monopolies exist because in some industries, as a business gets bigger, the cost of a unit of output falls continuously. The first firm to become large, therefore, enjoys lower costs than any smaller competitors, and eventually drives all competitors from the marketplace. If competitive markets are established, and the economy is kept open to outside competition, it is unlikely that any firm will be able to maintain a monopoly position over time. Realistically, given the widespread use of large production facilities, and the continued existence of these SOEs, it is unlikely that any of the CEE countries will use competition rules and clear property rights definitions to eliminate monopolies. Anti-trust policy will be necessary under these conditions.

Other aspects of market regulation might include regulations such as truth-in-labeling or truth-in-advertising that make false or insupportable factual claims illegal.

Uniform Commercial Code

Business transactions can also be made simpler with the use of a uniform commercial code. This code should provide standard terms defining the rights and responsibilities of buyers and sellers.

Warranties, for example, can be clarified in a commercial code. Conventions can also be established covering activities such as pricing, delivery terms, insurance requirements, etc.

Other Essential Laws

The four laws or areas of law described above, if properly written, should minimize the cost of transacting business in an economy. In addition there are several areas of law which govern markets that are critical to business.

Financial Market Law and Regulation

Financial intermediaries are critical to the growth of the economy since these intermediaries attract savings on one hand, and provide loanable funds to investors on the other. Financial intermediaries should be regulated for safety, if they are holding funds for depositors. Banks, savings banks, and similar institutions such as credit unions should be regulated for safety purposes to ensure that depositors do not suffer losses because the financial institution loses money through loan defaults, or through excessive or unwarranted risk-taking by bank management. Financial regulations usually call for banks to maintain certain capital reserves, and additional reserves for potential bad debts. Banks usually must follow carefully prescribed accounting standards, and are usually subject to close supervision by bank regulatory authorities.

Many financial intermediaries deal in the issuance, sale and distribution of securities. These securities and the rules related to their issuance and sale should be carefully considered. Basic law in this area will include securities law, providing definitions of different securities and the markets in which they can be sold, and bankruptcy law, which defines the rank order of various classes of creditors in a bankruptcy proceeding. The laws governing the sale of securities should specify the nature of the information which must be provided to potential purchasers in the marketplace. This information must be descriptive of the purposes of the fundraising, and must realistically assess the risks associated with the venture. Information must be available to all potential purchasers.

Labor Laws

Labor law, particularly the laws defining the powers of unions are critical to the development of a competitive marketplace. Almost everyone would agree that labor unions have a role to play in representing labor interests. If labor unions are allowed to exercise monopoly power, however, then labor will be able to develop economic rents (such as a wage high enough to encourage other workers to want to join the union to obtain the high wages). Government-mandated restrictions on entry of new workers will prevent the wage from falling to competitive levels.

High labor prices introduce a number of distortions into the economy and into the unionized industry in this case. The high wages will distort product pricing in the economy, with unionized products costing relatively more than they would if produced competitively. Output and sales of these products will be lower, therefore, than in a competitive market situation. Businesses will attempt to raise worker productivity to justify the high wage. This may be done by investing in

additional capital per worker. This capital is thus not available for other potentially productive uses in the economy.

Labor law should provide standards and guidelines helping businesses to protect workers health and safety. The labor laws should allow maximal flexibility with respect to work hours and wages, but should define conditions under which overtime pay is required. Child labor should be severely restricted, and where allowed, should be carefully supervised.

Taxes

Taxes on business can be levied in a number of forms. Authorities can tax business income or receipts, or business profits. These taxes may be balanced against taxes on personal income, value-added or sales receipts. Value-added or sales taxes discourage consumption, making funds available for saving and investment. Generally, taxes on labor should be roughly equivalent to taxes on other factors of production. If this balance is achieved, then at equilibrium in the economy neither capital or labor is left unemployed.

The key tax issue in most of the former Socialist states appears to be the overall level of taxation on business. With high business income taxes, high VAT taxes, high taxes for social security and health programs, and possible additional labor taxes (workers compensation, unemployment), many businesses are unable to retain much in the way of profit. This tends to lower investment and growth by these businesses, since it is retained earnings that serves as the main source of capital for most smaller firms.

High tax rates and poor tax enforcement may also drive more businesses underground over time, and even those businesses that remain in the legal sector will have a strong incentive to cheat on taxes. All CEE economies have relatively large underground (gray market) sectors when compared to the Western or developed Asian economies. During the transition to an open market economy, the gray market may prove helpful, since businesses operating in this market are avoiding taxes and, at least in some cases, generating large profits. After a possible initial surge of consumption, successful business owners are likely to plow profits back into the business helping to fuel growth and job creation.

The underground economy hurts development in the longer term, however. Business owners who don't pay taxes develop an aversion to paying taxes, and are reluctant to comply with tax rules, even if the business owners are eventually forced into the legal sector. The inequity between businesses paying taxes and those not paying is clear to all parties, and is particularly destructive of morale in those businesses paying taxes. Efficient tax-paying businesses may be forced out of business by less efficient, but non-taxpaying competitors. If the underground economy is large enough, it may be necessary for tax-paying businesses to move underground. This lowers government tax receipts, and exacerbates the budget problems which created high taxes initially.

Macro Policy

Macroeconomic policy usually encompasses government fiscal policy which includes both spending policy and tax policy, as well as policies affecting the supply of money in the economy. The money supply may be controlled by a central bank. Most governments consider the goal of macroeconomic policy to be the establishment of stable conditions for economic growth. These conditions usually include a rough correspondence between government spending and government tax receipts on the fiscal side, along with sufficient growth in the money supply to finance growth in the economy without excessive inflation. Successful fiscal and monetary policies keep real interest rates low and relatively stable, enabling businesses to borrow funds at relatively low real interest rates in order to finance investment in plant and equipment.

Macroeconomic policy, inflation and the level and rate of change of gross domestic product are not part of the enabling environment, per se, but they are an integral part of the real-world framework within which business operates. The rapid decline in Gross Domestic Product as the CEE countries entered the transition period, for example, obviously limited business growth and development. Nevertheless, in every CEE country, thousands of new businesses were established. Most CEE governments initially experienced very high levels of inflation, as they used the printing press to finance initial government activity. Within three years, however, every CEE government has made major strides in reducing inflation, in controlling the budget deficit, and in generally improving the fiscal and monetary policy base for the economy.

Objectives and Activities

The objectives presented here focus on the legal and regulatory framework, and the ways in which more productive laws can be developed and passed.

Objective 1: Working with an appropriate local institutional partner(s), conduct a review of the laws affecting business. This review would include existing laws, as well as the laws under consideration by the government, and laws which may be necessary, but have not been proposed by anyone yet. The review should identify conflicts between laws, missing laws, poorly written laws and regulations, and aspects of the law which do not help maintain competition or minimize the transaction costs of doing business.

Appropriate institutions may be difficult to identify in some countries. Independent think tanks, not associated with any political party or narrowly-defined power groups, may be few in number. Law and/or economics faculties may provide an alternative source of expertise, if they are willing to enter into the spirit of the exercise. In some countries they will be reluctant participants.

One way to encourage participation is to consider sponsorship of a number of national (or even international) seminars on appropriate legal questions. Papers could be commissioned from local scholars, and from one or two international experts, who could provide the comparative framework for the discussion. Since faculty wages in many CEE countries are extremely low, use of faculty participants may be particularly cost effective.

One purpose of the review exercise is to try to encourage participation by those institutions and individuals, which have the knowledge and the vested interest in improving the legal framework for business. Many of the appropriate institutions have been started. Few appear to be very effective yet, and many might benefit from small grants or sub-grants to encourage effective participation in the review process.

Activities could include:

- Use the ABA/CEELI project, if available, or use the counterpart organization to ABA/CEELI, to assist with the conceptualization and planning of the project. This project appeared to be an asset in every country in which the project participants were interviewed. The only critical point made about the CEELI program was that they were not active enough in seeking changes in proposed or existing legislation. It is appropriate that the leadership from this project come from some domestic organization, or from a group of organizations encompassing the appropriate interests. In addition to the ABA/CEELI possibility, the CIPE project, and particularly, some of the CIPE sub-grantees may be useful participants in the exercise.

- Examine not only the law, but also the implementing regulations, if they exist, and the institutions implementing the laws and regulations. Who maintains property registers, for example, and how well are they maintained? Who in the Parliament maintains oversight of the law and the manner in which it is implemented? Are there any interest groups watching implementation? Examples of important institutions include the courts, with respect to the enforcement of contracts or the enforcement of bankruptcy rules.

- New governments take time to get fully-organized. Lack of organization can inhibit the effective functioning of the government, and of the many organizations which are developing to represent the many interests in a democratic society. It would be useful to examine the structure of the Parliament and the Government from the standpoint of efficiency, and the extent to which the structure encourages the development of democratic feedback from organized interest groups.[17] Are laws not being improved, for example, because the current government organization doesn't provide an appropriate owner for a piece of legislation? The failure to pass or improve the (very) old bankruptcy law appears to have inhibited the development of investment markets.

It is critically important that any large scale review of legislation, or of the structure or functioning of the Parliament or the administrative ministries, be undertaken by competent local organizations. The good news is that there are competent organizations in most countries. The bad news is that some of them may not wish to participate in this type of exercise. Encouraging them to participate is important to the development of democratic structures in the economy, as

[17] See also discussion of information/feedback under Strategy 6, below.

well as to the development of better law for businesses. Judicious use of funds can provide a variety of incentives to encourage participation. Funds can be used to finance internal papers, finance comparative studies from outside experts, or to provide sample analyses of existing rules or laws.

Objective 2: In cases where a total review is too much to undertake at this time, then a review of one major law may be an appropriate focus. Examples of important laws would include property law (and related enforcement, property registers and the restitution issue), contract law, and the role of the courts.

Given the size of the review, it may be best to piecemeal parts of the work. A seminar might focus on property transactions, for example, with support from the university law faculty, or from the bar association. The commercial code (or Civil code, if that is used) may be more than enough for one conference, depending on the country. Some countries are using old laws which are clearly out of date relative to their current situation. Other countries have yet to adopt a code, so it is difficult to take a retrospective look. It may be possible to help pass an effective law, however, by assisting in the current debate.

Objective 3: Hold a region-wide conference to discuss administrative procedures in government ministries. How are regulations issued for example? Is there a period for public review of proposed rules? Is any attempt made to clear the rule with appropriate interest groups? How do administrative procedures compare to other European countries?

This is only one possible subject of potential interest to SMEs. Another possibility would be a conference on bank supervisory procedures. How about a conference on bank lending to small business? or the inflow of direct foreign investment funds? A regional conference would probably have little effect unless it produced carefully written and carefully-researched documentation that would help governments to identify a better administrative process.

Objective 4: Help existing small business organizations to learn how to lobby effectively. Most small business organizations could use some professional help in organizing their resources to improve their lobbying capability. If local experts are available, they should guide the learning process, and produce a "how-to" manual to assist the many private organizations now in existence. SME advocacy and the development of advocacy groups (associations, NGOs, independent chambers, etc.) were consistently presented to the strategy team as priorities in the field. (See "Lessons Learned" section in Volume II.)

All of the activities related to this strategy have multiple objectives. The direct, and most important, is the development of better laws and a better enabling environment for business. A second objective is the development of institutions which can feed back information and opinion from the business community, from university faculty, and from independent researchers to parliamentarians, or to government bureaus. Imagination should be exercised in bringing together the participants for training. Linkages built during the training period will have more importance over time, as participants grow their businesses or rise to higher levels in government or academia.

5. Promoting a Public Sector with the Right Attitude and Ability to Support SMEs

Strategy: Creation of a public sector with a positive attitude towards SMEs, and with administrative capability to support SMEs.

Discussion

Local governments are having a rebirth in many CEE countries, as power formerly centralized in functional ministries in the capital is delegated back to local officials. In some cases, such as Poland, 2,500 new local governments were created through a democratic election process. In several countries, new regional governments have also been introduced or strengthened. Unfortunately, while responsibility for some services has been delegated, authority to tax has not always followed. Many cities find themselves in budget difficulties because the budget made available from the central government is not enough to cover the range of services which the local government is charged with providing.

Many of the local officials have no experience with small businesses. There is little knowledge of economic development methods practiced in Europe, the United States, or other developed countries. Many localities have been given title to all state property within the city limits, but the officials have no experience in valuing this property or in disposing of it in a way that will be most productive from a local standpoint.

Some local officials may have an active dislike for smaller businesses, believing that the larger Socialist institutions are more economic. This belief dies hard, even though there is ample evidence that smaller firms are more flexible, and more capable of growing rapidly. Few officials have any idea of whether they should support business training programs, or whether they should adjust school curriculums to better train workers or potential business owners.

One major issue for local development officials is whether they should adopt the practice found in the U. S. and in Europe, where businesses are offered packages of tax breaks, support programs, infrastructure improvements and other benefits in order to convince them to move a plant to a given location. Many American officials believe that they must use such program incentives, because cities competing against them stand ready to make similar offers. There is some evidence that this bidding, particularly for large plants does not pay off for the city or the region, because the benefits simply transfer risk of loss from the business owners to the taxpayers. If the business does close down, it will be the taxpayer actually paying for the losses incurred. It would be better from both a management and an efficiency standpoint to leave the risk with the company, which almost certainly has better knowledge of the risk involved with the business, and how to handle it.

Objectives and Activities

Objective 1: Acquaint city officials (mayor, economic development officers) with the importance of SMEs in the United States, and with information about business support methods used by similar-sized U.S. cities. Training could be accomplished through directed travel in the United States.

Local officials attitudes toward SMEs may be colored by ignorance, or biased because of Socialist belief. The training in the United States would have one goal of improving attitudes towards smaller businesses, and a second goal of teaching local officials business support and economic development techniques.

Objective 2: Develop and deliver in-country a training program for local officials with SME support responsibilities. Course content would cover techniques for supporting businesses through both indirect and direct activities. The program could be developed in the United States for delivery in several CEE countries. Appropriate materials would have to be translated into several languages, and training could be given in the local language using translators. Using the course in more than one country would spread overhead development costs over a larger audience base. Where feasible, the training could be delivered through the local small business advisory center.

Objective 3: Encourage the development of sister-city relationships between CEE cities and American cities. Encourage visits by local officials by providing some subsidy for travel if visit agenda is developed sufficiently to ensure a good training outcome. Assist American city and county officials with development of training agenda.

Objective 4: Assist local school officials in introducing market economics into the local school curriculum using materials developed from U. S. educational institutions. Materials are available from various sources throughout the U.S.

Objective 5: Assist local officials with training related to their administrative responsibilities in the local communities. Training subjects would not be directly related to support SMEs, but would have strong indirect affects on the capability of the local government. Again, the curriculum materials could be developed in the United States or Europe, and delivered to large numbers of students through translated materials and the assistance of translators.

Objective 6: Train local officials in measurement techniques so that they can develop information about growth in the local community. The information would assist officials with their policy development activities, and would give them some indication of the possible benefits of different policy alternatives. This training could also be incorporated into the above objective.

6. Information Flows and Feedback Loops That Assist the Private Sector

Strategy: *Creating information flows between government and SMEs which support business needs and assist the government with SME policy development and evaluation.*

Discussion

It is difficult to measure small business activity in any economy. This difficulty stems from the fact that there are large numbers of small businesses in almost every industry and in every geographic area. In order to produce usable numbers for multi-industry, multi-location, multi-size group tables, very large samples are required. These samples are usually too expensive for the central statistical agency, which concentrates its sampling on larger firms. This makes sense

in countries where large businesses produce the larger share of total output. In most countries, however, SMEs produce the larger share of national product, and SMEs produce the larger proportion of new jobs. Dynamic changes such as rapid growth, new business starts, and bankruptcies are found more frequently in the smaller business sector.

The failure to measure activity in the SME sector can greatly bias government policy, which is taking signals from the larger businesses that are often growing or changing more slowly than smaller businesses. In the CEE countries, the problem is made even more difficult because anywhere from 25 percent to 40 percent of the economy may be in the underground (gray market) sector. Only the most anecdotal evidence is gathered on these businesses. Little effort is made to measure activity in SMEs separately from activity in larger enterprises, and the information produced in most CEE countries is heavily weighted towards those industries dominated by SOEs that are experiencing rapidly declining sales.

There is no advocate for SMEs in most of the CEE countries. Nor is there a strong advocate for the need to devote more resources to better measurement. No organization attempts to educate the general population to the rapidly increasing importance of SMEs in the economy. Nor does anyone attempt to highlight the relative proportions of wealth, jobs, and innovative goods and services coming from SMEs. Existing and long-held biases against smaller businesses may continue to be held by many citizens.

The production of better information about the role of small businesses would improve support for SMEs among the general population, and would assist policy makers with the formulation of effective policy. If the government will not attempt to measure the economy in a useful manner, then some other organization might be asked to attempt the task. Using modern cluster sampling techniques, useful information can be developed to help everyone understand the role of SMEs in the economy.

The lack of meaningful descriptive statistics about the entire business community not only hinders policy, it also hinders the marketing activities of many firms. One of the most universal complaints from SMEs in CEE is the lack of marketing information available to them. It is almost certain that there is a high social return to production of this data, as well as a high private return for the businesses making use of it.

Finally, information is used in a third sense here. One valuable form of information for government managers is the feedback they obtain from constituents commenting for or against existing or proposed legislation. It takes considerable time to develop SME organizations capable of representing small business interests before the government.

While many business chambers and trade association have been opened in CEE countries, some of them have not been effective advocates for smaller business. Many chambers of commerce make poor advocates because they have compulsory membership[18]. Once dues are collected, union officials often retire on the job. Other chambers attempt to represent both SOEs and

[18] This is the "German Model" which CEE is consistently adopting.

private firms. This produces an almost certain conflict of interest, since policy favoring one group will often hurt another group.

Objectives and Activities

These objectives are related to Strategy 4, and can be carried out in coordination with that set of activities.

Objective 1: Encourage the production of useful economic data covering SME activities by providing funds and technical assistance for a respected local research institution to develop a measurement program. This data should be used to highlight the role of SMEs in the economy, helping to educate the general population about the importance of smaller enterprises in the economy.

Objective 2: Assist the local, regional, and national policy making-process by increasing access to SME information. One way to accomplish this is to help grass roots business organizations improve their information and data-collection techniques. Transmitting the information in a timely and easily-digested format is also critical to effective advocacy. Many organizations can use simple survey techniques to obtain the views of their members.

Objective 3: Small business organizations in the CEE countries can probably measure their members' feelings reasonably well. The major problem for many of the organizations is recruiting and retaining members. The founding members of organizations are most familiar with the socialist form of business organization, which often favored policies in the best interests of the government and not of the business members. The concepts of providing value-added services which will motivate a business owner to join and actively participate in an organization are still to be learned. One possibility for assisting SME development is to bring CEE SME organization managers to the United States to study the methods used by our SME associations. Numerous case studies can be developed utilizing business and trade associations located in the greater Washington area.

Chapter IV. The Importance of SMEs and the Role for U.S. Foreign Assistance

A. What We Know About SME Roles Based on the U.S. Experience

The role of micro, small and medium-sized businesses in the U.S. economy was not systematically studied prior to the late 1970's. This inattention to a large part of the American economy was probably not intentional, but stemmed more from the difficulty in obtaining the data required to understand the relative importance of smaller businesses in the economy. The development of large scale data bases in the private sector, and the introduction of large-scale computers capable of handling very large data files made it possible to examine detailed industries and groups of companies within industries.

In 1976, the U.S. Congress enacted legislation requiring the U.S. Small Business Administration to introduce an Office of Advocacy to represent the interests of smaller businesses before the U.S. government. The legislation called for an Office of Economic Research to support the Chief Counsel for Advocacy. The Office of Economic Research immediately contracted with the Brookings Institution to develop a Small Business Data Base (SBDB) using longitudinal data provided by the Dun and Bradstreet Corporation. Although the private data had some shortcomings relative to U.S. Census or Internal Revenue Service data, the government files were held strictly confidential, and could not be used for study of individual firm dynamics.

In addition to commissioning work on the SBDB, the Office of Economic Research instituted an annual program of competitive contracts on economic subjects related to the broad subject areas of the effect of smaller businesses on the economy, and the effect of the economy on smaller businesses. Approximately 400 studies were completed during the first 12 years of the research program. These studies provide the base for the findings described below.[19]

1. Increasing Efficiency in the Economy

Smaller businesses are still often written about in a pejorative sense, because their role in the economy is not widely understood. Many writers think that smaller businesses are too small to capture scale economies, and therefore, cannot produce at as low a cost as larger, more specialized producers. It is true that smaller businesses cannot, generally, capture economies related to size of operation, but smaller businesses can and do compete in numerous other ways.

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[19]Documentation of findings and of the studies themselves may be found in the annual Report of the President to the Congress on The State of Small Business, 1982-1993, U. S. Government Printing Office, and in the Catalog of Completed Research Studies, 1990 edition, published by the Office of the Chief Counsel for Advocacys, U. S. Small Business Administration.

2. Niche Markets, Smaller Markets, Convenience

For example, smaller businesses fill niche markets, markets so small or so highly specialized that larger firms ignore them, or find it difficult to meet the specialized requirements of the buyers in the market. Smaller businesses also serve smaller markets in geographic areas where the population will not support larger-scale output or service delivery. Smaller businesses also populate markets where convenience is a major factor, for example in services such as dry-cleaning or laundry, restaurants, etc. Much of the quality of life comes from the specialized smaller businesses that focus on providing customized service or differentiated goods or greater convenience to consumers who want more than a (relatively) few mass-produced goods.[20]

3. Contributions to Efficiency

Smaller firms contribute to the efficient working of the American economy in a number of ways. First, smaller businesses facilitate the testing of new markets and new products or services. Smaller businesses test hypotheses about these markets and products on a small scale. If the test demonstrates that the hypothesis of a viable opportunity was incorrect, then the small business can be closed with a minimum waste of resources. The large number of new startups and business closings in the U.S. economy (about 1.25 million startups and .75 million closings annually) provide a constant stream of new and/or better products and services to American consumers.

When smaller firms close their doors, much of their equipment and unused inventory is recycled into other uses through used equipment markets or auction markets. These effective markets for used goods lower the cost of testing new ideas about products, services, or locations, by moving the resources of the failed business to other uses which are (or may be) more productive.

Conversely, when smaller firms initiate a new product or service, and find that there is a large demand for the item in question, they attempt to expand output as rapidly as possible. This moves resources again in the proper social direction, from lower-valued uses to higher valued uses. It is the process of starting and operating the small business that reveals the underlying preferences of the consumer in the marketplace. Smaller businesses that are successful tend to put most of their profits back into the business, expanding output and reaching more customers. If financial markets are efficient, more successful smaller businesses can augment their internal resources so that they can grow more rapidly. Lack of external finance can be an inhibiting factor, however, if financial markets do not attract sufficient savings, or if financial institutions do not perceive the market opportunities available to them in servicing smaller businesses.

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[20] More recently, the introduction of inexpensive micro and mini-computers has changed the nature of scale economies, allowing some smaller companies to expand their span of control. Many small restaurant firms, for example, now control more outlets or subsidiaries than in earlier days. Larger firms, on the other hand, are learning how to control production processes that allow them to produce smaller runs of output on an economic basis. This allows the larger manufacturer to produce a wider variety of goods, and to displace some smaller firms that previously competed by producing similar, but differentiated products. Larger retailers have found that they can control many more sites with computerized control systems. Large chain retailers have displaced many smaller competitors in recent years, therefore, and large retailers are gradually increasing their dominance in retailing.

Both the birth and death of smaller businesses and the expansion and contraction of existing smaller and medium-sized businesses serve to improve resource allocation and increase welfare. The small business contribution to welfare can also be measured along four other dimensions, competitive markets, innovations, jobs, and wealth, described below.

4. Competitive Markets

Smaller businesses frequently operate in competitive markets with other smaller businesses or with larger businesses. It is not the existence of a market which makes consumers better off, but the competition between firms in the market which improves quality and lowers prices. Left to their own devices, most business owners would choose not to compete by lowering prices or by improving the quality of service, but the existence of competition makes it costly to make this choice. Many smaller businesses cannot compete with larger competitors on a straight price basis, but they can compete most effectively by offering better service, differentiated products, better locations, etc.

5. Innovations

Smaller businesses in the United States are responsible for more than half of total innovation in the economy. This fact is sometimes obscured because very successful innovating firms tend to grow from small to large very rapidly. Both Apple Computer and Compaq Computer grew into Fortune 500 firms within four or five years because their innovations were very successful in the marketplace. Neither of these companies are thought of as small companies, but both started out as very small firms, with Apple's beginnings traceable to two people and an unused garage. While Apple's computer was a more innovative machine, Compaq innovated more in the marketing sense, thinking on a world-wide basis, and organizing inputs from other producers in a very cost-effective manner. Smaller firm innovations range from simple variations in design or style, to path-breaking technical innovations that open entire new industries.

6. Jobs

Smaller businesses in almost every industry in the United States tend to use more labor-intensive production modes than larger competitors in the same industry. When smaller businesses expand, therefore, they tend to hire relatively more workers per unit of output. Over the past 20 years, labor has been relatively abundant in the American marketplace, and smaller businesses have tended to choose more labor-intensive methods of production. Larger businesses, particularly in manufacturing, have chosen more equipment-intensive production methods, primarily to attain economies of scale (lower per-unit production costs).

Manufacturing industries in the United States have more than doubled the capital-per-worker ratio over the last 20 years. The extent of unionization may account for some of the choices made by smaller and larger businesses. Larger firms are more likely to be working with unionized workers than smaller firms. Smaller firms are probably able to adjust wages more easily, therefore, and can still find workers willing to work for the wages being offered. Larger businesses facing union contracts and some degree of monopoly in the bargaining process have chosen to substitute machines for workers. For the remaining workers in larger firms, wages are

high because the remaining workers are using more and better equipment. Those workers shed by the manufacturing industries have obtained jobs in other industries, where employment growth has been stronger.

Smaller businesses with fewer than 20 employees account for approximately 20 percent of private employment in the United States, but account for approximately 40 percent of employment growth in the private sector. All other business size groups (including other small businesses with 20 to 99 employees, medium-size businesses with 100 to 499 employees, and larger firms with more than 500 employees), account for approximately 80 percent of private employment, but produce only 60 percent of total employment growth in the private sector. Smaller businesses are important, therefore, in helping maintain full employment.

Some observers point out that approximately half of the small business startups do not survive for five years. The jobs created by these startups, they argue, cannot be very good jobs, because they don't last very long. As long as the number of new startups exceeds the number of closings in any time period, there will be jobs available in new businesses to (more than) offset jobs lost in closing businesses. Similarly, jobs created in expanding businesses generally exceed jobs lost in contracting (but surviving) businesses. It is the jobs generated by startups, however, that account for between 60 and 75 percent of net new jobs in most years.

7. Wealth

Smaller businesses are the important job generators in the American economy. Smaller businesses share the wealth generation responsibility with larger businesses. Successful smaller businesses generate wealth and opportunities for their owners. As smaller businesses become larger and switch to stock ownership, they generate wealth for their shareholders. There are two important aspects of this wealth generation. First, since smaller business owners tend to reinvest most of their profits, the growing wealth of the owner means growing opportunities for others as expanding businesses hire more workers. Second, as other workers perceive that business ownership is a way to greater wealth, more people are given an incentive to become business owners themselves. The success of small business owners provides an incentive for other people to attempt to meet consumer wants by organizing resources and producing a good or service. Potential business owners also perceive that there is a real risk of failure (and of loss of capital), but they are enticed into small business by the potential reward related to success.

8. The Role of Flexibility in the Success of Small Businesses

Smaller businesses compete with larger businesses in many markets. Larger businesses have more specialized employees in most functional areas. More highly specialized workers should be able to accomplish most management functions better than less highly skilled workers. Larger businesses should have an edge, therefore, in business planning, finance, control systems, marketing, etc. And, in fact, most larger businesses are better run, in general, than most smaller businesses. Despite this edge, smaller businesses appear to compete very successfully with larger businesses in the United States.[21]

The key to this relative success probably lies in the flexibility of smaller businesses which results in quicker decisions and more rapid adjustment to changing conditions in the marketplace. Larger businesses may produce more and better information about conditions in the market, but it is unclear that larger firms can act on this information as rapidly as small businesses. Part of the gain due to specialization of labor is lost to the inertia present in any large organization. It takes time and energy to overcome this inertia. Once larger businesses do initiate appropriate changes, they do carry them out well. It is only the nimbleness of the smaller business owner, that allows the small firm to compete

The micro-computer, and the ability to organize information rapidly and cheaply in a computer will tend, over time, to give smaller businesses a chance to become as sophisticated as their larger competitors in many functional management areas including marketing, inventory and receivables control, etc. At the same time, larger businesses are learning to behave more like smaller businesses, by breaking into smaller operating units, and delegating decision-making authority.

The market is an unbiased observer of these changes, and the ultimate distribution of business between smaller and larger businesses will be determined by the extent to which both groups implement better techniques. Clearly, effectively managed larger businesses will be larger than before. Many of these businesses will be world-wide in scope. In some industries, however, production units will be smaller, and small firms will compete very effectively over time. The general improvement in small business management capability will open new domestic and foreign markets to capable small businesses. Both small and large firms can prosper in a fully-computerized world.

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[21] One measure of how well they compete is that smaller businesses' share of Gross Domestic Output and of employment, which had been falling fairly rapidly since the early 1960's, stabilized during the late 1970's and throughout the 1980's. The introduction of micro-computers has recently improved management in both large and small businesses, and may have shifted the comparative advantage in growth, at least temporarily, toward larger businesses. But the continuing decline in the costs of computing has given smaller businesses a tool which can mimic anything done by a larger business. Eventually, the micro-computer may shift the comparative advantage back towards the smaller firm.

9. A Final Note: Small Businesses and Democracy

One last and very fitting note about small business in the United States is that the presence of small businesses tends to reenforce not only economic welfare, but also social and political welfare. Many small business owners choose business as a career because they choose not to work for someone else. About 40 percent of entrepreneurs in the United States cite independence as the major reason why they chose to go into business for themselves. Entrepreneurs understand that they are still subject to the discipline of the marketplace, and to the wants of the buyers in the market, but each entrepreneur is free to respond to that discipline as he or she sees fit.

As might be expected, independent entrepreneurs are not easy people to get along with. They tend to be irascible, and difficult to organize. They also tend to distrust politicians. This distrust is demonstrated frequently, in opposition to proposed legislation, and in some cases, in opposition to the legislators. Another way of saying this is to point out that a large entrepreneurial class produces a large class of reasonably wealthy, reasonably independent yeomen that will guard their freedom avidly. Recent experience in developing countries indicates that the growth of small businesses in the economy is closely correlated with the growth of effective democracy. Taiwan provides a good example of this phenomenon, as does South Korea.

It appears that entrepreneurial values are good for democracy.

B. Suggestions for Building on the U.S. Comparative Advantage in Providing Assistance to SMEs in Central and Eastern Europe

Micro, small and medium enterprises in the United States have several advantages relative to similar businesses in other parts of the world. Some of these advantages are related to basic values that we don't think about very often. Therefore, in considering methods to strengthen smaller businesses in emerging economies, we may not think of some implications that stem from basic values and knowledge of a market economy.

The following paragraphs outline characteristics of and experiences from the U.S. situation which the team feels are strengths to be brought to bear in determining the strategy for SME development in Central and Eastern European countries.

1. Knowledge of How a Functioning Market System Works

The U.S. Situation

Most people in the United States are comfortable with the working of a market economy, although relatively few have any real idea of how the market system works. Workers are used to competition in the work place, understand intuitively that wages are a function of productivity, and understand that performance is the key to better wages. Most people also know that profits are an incentive for entrepreneurs. Most individuals also have an intuitive understanding that profits can be increased by developing a better product (or service), or by lowering the cost of

producing an existing product (or service). The role of incentives is both understood and appreciated. Hard work is considered to be a virtue, and most people believe that good behavior or performance will be rewarded.

Smaller businesses are appreciated for what they provide in the way of goods and services. And it is understood that business provides the opportunity to become rich.

Prices are generally understood to be determined by supply and demand conditions. People appear to understand that prices are determined in reasonably competitive markets, and that both smaller and larger businesses contribute to the competitiveness of these markets. Prices are believed to reflect real costs, for the most part, and prices do not incorporate large economic rents. The market is presumed to be a fair market in which competition insures reasonable prices for good quality outputs.

The Planned Economy Situation

Socialist economies generally distort pricing since prices don't have to reflect either consumer preferences or relative scarcity of particular goods. Because prices are independent of real or market-determined value, goods are made not to a market standard, but to some politically-determined standard of acceptability. In simplest terms, goods tend to be shoddy, poorly built and restricted in number. People are led to believe that only these few, simple goods are necessary, and that it is wasteful to introduce competitive goods into the market. Factories and farms tend to be very large, in order to produce standardized outputs at minimum cost per unit.

Workers are supposedly treated in an egalitarian manner -- meaning that neither wages or productivity are related to worker skills or worker performance. As might be expected if wage incentives are not used to differentiate on the basis of performance or output, then workers will not consider working harder to be an effective response to an incentive system. Wages, like prices, will be determined by the central planners, but both wages and prices are subordinate to more basic decisions about the allocation of labor and materials to various activities.

In a planned socialist economy, little room is left for unused resources. All apartments are occupied, and all factory space is allocated to someone. Pensions and social welfare services are linked to the factory or farm, and housing allocations are made through the worker's factory, or through political connections.

Addressing Problems in Transition to the Market Economy

Almost all aspects of the market economy will bother the individual starting from experience in a planned socialist economy. The market appears to offer one benefit, a greater variety of goods, but it is almost impossible to afford most of these goods. Prices are now uncertain and fluctuate from day-to-day. Prices will eventually have to adjust to reflect the wants of consumers, and the relative scarcity of goods and services in the economy. Domestic producers will have to face the reality of external competition offering goods at world prices which reflect competition in production and competition from other consumers. The new post-Socialist government will find it difficult, if not impossible to maintain the previous system of subsidized prices for certain

goods (apartment rents, for example, or the price of basic goods such as bread and other food items).

Consumers will face the possibility of plants closing, and of jobs being lost. The uncertainty associated with the market will disturb consumers, workers, and managers, all of whom will have to face challenges that were absent from the planned system. One of the most important U.S. contributions to be made, therefore, is explaining how markets work, what incentives mean, and why markets mean a better quality of life over time. Business ownership should be shown to be a viable alternative to wage work, but education will be needed to explain what business ownership entails in the way of knowledge and skills. Individual initiative should be encouraged both in business owners and in workers. The theme of incentives operating through prices (wages are a price, also), and through competition in markets should be introduced into school curriculums and into everyday life. It will take considerable time to change how markets work in formerly planned economies, and to give most citizens an appreciation for the role of markets and incentives.

Suggested ways to build on this U.S. comparative advantage:

- Introduce the working of the market into school curriculums at all levels. Extensive curriculum materials are available from a number of institutions across the United States.

- Introduce programs such as Junior Achievement to supplement school activities.

- Translate, overdub and convert television materials available in the U.S. (or other market economies) to teach market economics to the general public. There are at least two very good series available in the United States, one produced for PBS, featuring Richard Gill, and another series featuring Milton Friedman. (This may be a task for USIA, which already has several series featuring the role of small businesses and small business owners in the American economy.)

- Bring selected members of economics faculties to the United States for a course in market economics -- The course should emphasize practical aspects such as the setting of prices, the role of incentives, the difference between economic decision making and political decision making, intermediation, etc. The course could be as short as four-to-six weeks, or as long as a semester. The ability to speak and read English is essential for all attendees.

2. Understanding the Proper Role of Government Support to Smaller Businesses

All levels of government in the United States attempt to support business. The Federal government focuses on macro-policy, including fiscal and monetary policy. Fiscal policy deals, in part, with taxes imposed on business, and also deals with expenditures in support of business. Monetary policy deals primarily with the supply of money, attempting to maintain monetary growth that will support real growth with minimal inflation and with low real interest rates.

Federal expenditures in direct support of non-farm smaller businesses are relatively low. Loan guarantees are provided for some small business loans from banks, but the proportion of loans with guarantees is very small, generally less than 2 or 3 percent of total bank loans to smaller businesses. Federal resources also provide some management assistance to smaller businesses, with most Federal spending matched by state governments. Federal resources provide economic information of use to smaller businesses, but Federal statistics covering smaller businesses are deficient in a number of ways. Some improvements to the statistical system are being made over time.

State governments are generally more active in economic development support to smaller businesses. State governments frequently provide direct tax incentives for businesses that are moving into the state or expanding local operations. State governments may finance infrastructure investments, or provide training support for workers in new or expanding businesses. Many states have introduced the concept of "enterprise zones" to encourage businesses to locate or expand activities in a given location. In an enterprise zone, businesses are exempt from some state and local regulations, and eligible for some special subsidies or tax relief. Some state government support programs provide export development assistance to smaller firms. Almost all states provide management assistance to smaller businesses through state-sponsored or private universities in each state (this program is called the Small Business Development Center program, and is co-sponsored by the Federal government).

Local governments are the most active governments in support of small businesses. City and County governments provide information to aid firms which wish to move or establish a new plant in the local community. Many local governments provide industrial parks (land zoned for commercial or industrial use, usually with infrastructure improvements already made) to encourage new businesses. Local governments also provide most of the support activities noted for state governments, above.

Both local and state governments may provide special financial support for smaller businesses. Some states do this through issuance of state or local bonds, the proceeds of which are then used to provide loans to smaller businesses. Since states and localities can generally borrow at lower rates than businesses can, the state can provide loans at lower than normal rates. There is an equity problem here, since the state or local government can provide loans to only a few of the businesses which operate in the state. State and local governments may also work with the Federal government to sponsor community development loan authorities which can put together loan packages encompassing funds from entrepreneurs, federal funds (a loan from the Small Business Administration financed through sale of guaranteed debentures) and local bank funds. Some states and some localities also make funds available for venture capital investments in smaller businesses, with funds coming from tax proceeds or from government pension programs seeking good investments.

Ways to build on this comparative advantage:

- Local authorities in the U.S. are keenly aware of the many ways in which small businesses contribute to the local economy. Local officials from selected city or county governments in Eastern Europe could be brought to the U.S. for study

tours in which they visit a set of communities in the U.S. that have active small business support programs.

- Technical assistance could be provided to city or county officials in Eastern European countries, through training programs developed with universities or institutes in each country. The curriculum development process for these institutes could involve similar study tours in the U.S. In most CEE countries, the local government structure is still evolving and it is still unclear what authorities and taxing capabilities will be placed in local government hands. Many local government authorities, even those established and functioning over the longer term, have not thought systematically about their potential role in supporting smaller private businesses. Simple descriptive training would at least acquaint them with possibilities. The training could also point out that governments compete just as businesses do, but government competition is focused on providing a positive and supportive environment for business.

3. Assisting in the Rationalization of the Legal and Regulatory Environment

The Federal government provides a general legal framework for smaller businesses, particularly for those businesses engaged in interstate activities. Based on the constitutional distribution of authorities, certain legislative and regulatory areas are left to the state governments. State governments regulate the insurance industry, for example, with the Federal role limited to providing some exemptions to insurance companies from certain anti-trust rules. Federal rules do cover monopoly and anti-trust provisions, but utilities, which often have monopoly rights in given geographic areas are regulated primarily by the states.

Basic property and contract law are established by state laws, but both the Federal government and state governments charter and regulate banks and bank holding companies. Securities traded in open markets are governed by Federal legislation, but many securities are also subject to state legislation. There is a Federal bankruptcy law, but the states are free to amend this law at their discretion. There is a uniform commercial code, which has been agreed to by all states (with the possible exception of the State of Louisiana where the law is based on the Napoleonic code). Private property rights are enforced by all levels of government, and property records are maintained at the local or county level. There is a highly developed court system featuring courts at every level of government. Disputes are generally handled at the lowest level of court available, with appeal rights to higher level courts. The courts are considered for the most part, and with respect to business issues, honest and fair. Business litigation may be expensive, however, and businesses may use alternative dispute resolution mechanisms including arbitration, mediation, and private judges.

Regulation of business behavior occurs at all levels of government. The regulations promulgated by Federal regulatory agencies have the effect of law, and affect many of the day-to-day operations of smaller businesses. Federal regulations implementing the complex Federal Tax Code are particularly onerous, as are regulations covering activities by business that affect the environment or deal with the use or disposal of hazardous material. Federal regulations issued under the fair labor standards act govern the length of the work day for employees subject to

wages, and also provide rules governing overtime work. Other labor rules ensure that children are not exploited. Federal regulations and supplemental state regulations provide for unemployment insurance, workers compensation insurance, and social security taxes. Federal and state laws also cover occupational safety and health rules.

States and local governments provide licenses and permits related to business activity, although some licenses are required by the state because of Federal mandates. Many local governments have introduced "one-stop centers" where local businesses can obtain necessary permits and registration, and where local and state tax identification numbers can be obtained. Most business people starting a new business have no idea of the amount of paperwork associated with meeting federal, state, and local regulations.

The U.S. legal situation is idiosyncratic enough that we may be leery of suggesting that other countries look to us as a model of either efficient or effective legal regulation of business. The one area where we do seem to be different is our insistence on competitive markets. This insistence is enforced through a wide range of laws which affect everything from the licensing of businesses to taxation, enforcement of anti-trust legislation, and effective use of the Judicial system to resolve disputes.

Ways to build on this comparative advantage:

- Policy intervention should take place primarily at the highest level of government, using local institutions to suggest appropriate changes to existing legislation or additions to legislation. University law and/or economics faculties could be subsidized to sponsor seminars in various areas of law or policy that particularly affect smaller businesses. Subsidies would include funds to prepare comparative studies of a given law in various Western countries. These studies could serve as the framework for a seminar involving senior government officials, parliamentarians, representatives from business organizations, etc. Follow-up funds could provide for the drawing up of a model or draft statute. Initial efforts in policy intervention should be restricted to laws and regulations which are critical to smaller businesses as part of the "enabling environment" for business.

- Although policy intervention should be aimed at the highest levels of government, institutional development in support of advocacy for small business should begin at the grassroots level. Local business organizations should be helped to develop in any way possible. National trade or industry associations should also be supported. The intervention should help train organizational staff in the provision of value-added services which can be used to attract and retain dues-paying members. The concept of competitive organizations should be emphasized at all times, and entrepreneurs should be encouraged to join more than one organization. Initial training of trainers could be accomplished through seminars and site visits in the United States.

4. Promoting a "Self-Help" Attitude and Supporting Institutions

One strength of U.S. small businesses has been their consistent ability to develop institutions which can support their advocacy, technical, and managerial needs. American businesses use local organizations such as chambers of commerce and industry, regional organizations such as state associations, industry and trade associations, both regional and national (and even metropolitan areas surrounding large cities), to represent business interests in legislative and regulatory debates. Many of these organizations, particularly the industry and trade associations, provide technical leadership by helping to define standards of performance, provide technical assistance through publications and through seminars and related training events, and provide management assistance in areas such as marketing, strategic planning, and operations management through similar events. Almost all of the organizations serve their members by providing opportunities for networking, i.e., meeting other members with similar or complementary interests.

Although most institutions are managed and staffed by professionals, the strength of most institutions is in their volunteer participation. Members serve on boards of directors and on executive committees, on legislative liaison committees and on standards committees, on business development and business skills committees, and on other committees providing services wanted by members. Most organizations are successful only if they provide valuable services, and many of those services are best provided through volunteer leadership and volunteer work.

Perhaps the strongest aspect of business organizations in the United States is that they represent a democratic way to support business interests through volunteer activity. The organizations reenforce the tendency of the independent business persons to look inward for help when help is needed. In the case of a business organization, business people turn to other like-minded people to form a mutual support system.

Recently, smaller businesses have found that very small numbers of similar businesses can help each other, if they are willing to work together to help improve every aspect of their businesses. This help is accomplished through the intervention of an outside management or technical expert, who is paid to lead a group of smaller business people in the same industry through a comprehensive review of their management activities. The only activities off limits to the group are discussions of customers and of pricing. Technical matters such as the layout of production areas, the use and maintenance of machinery, the scheduling of work, etc., are open for discussion. Each plant is visited in turn by the owner/managers of each firm, who observe a particular operation or area in the plant and critique its operation. Host firms are free to adopt any or all suggestions.

In other communities, smaller business owners, may join an entrepreneurial forum. On a weekly or monthly basis, a member of the forum will present a business plan, which will be critiqued by those present. In addition to business owners, these meetings are often attended by bankers, venture capital specialists, or other individuals interested in financing all or part of a business venture. In most cases these forums are restricted to high-technology businesses or startups.

Smaller businesses in a neighborhood may also help themselves by meeting on a monthly basis in small groups (generally no more than 30 or 40 attendees) to discuss common problems and common solutions. Business owners come from different industries, but most are retail or service businesses, and most have problems which have been encountered or solved by other local businesses. These meetings also can help local business owners seeking to meet other business owners in order to develop new business. Local chambers of commerce often sponsor similar meetings for this networking purpose.

Ways to build on this comparative advantage:

- An educational tour of U.S. business organizations can help to demonstrate the range of possibilities and the operating methods of American business organizations. Study trips could be focused on Chambers of commerce, or on industry associations or trade associations. Emphasis should probably be placed on value-added activities, although most organizations perform advocacy functions also. Advocacy functions could serve as another focus, with emphasis on business advocacy at differing levels of government. The self-help through support of a business organization is one of the strong elements of the democratic political process in the United States. The strong volunteer emphasis in most of these organizations demonstrates the importance of taking responsibility for helping yourself when encountering problems or when seeking to improve your business.

D. Timeline for Achieving Results from Foreign Assistance

The U.S. model which we have presented above is of course one which evolved over a long period of time. The strategies laid out in Chapter III will begin to produce results depending on numerous factors that are outside of A.I.D.'s management control. Based on the team's field research, it is apparent that eventual success of SMEs will depend heavily on the existence of enabling institutions, policies, and regulations, as well as equal access to, and the ability to compete in, open markets, domestically as well as regionally and globally.

Some A.I.D. project interventions can be expected to produce immediate results at the output level (see Chapter V, Section B). Firm level assistance, training, financial assistance, for example, should all result in better operating businesses, better entrepreneurs, and better informed and capable public administrators. The challenge, however, is to create a structure which sustains this momentum over time.

Improving the basic structures underlying the economy is a long-term effort. A.I.D. can assist in providing the proper guidance to this process by working with the institutions and the individuals who will provide leadership to these change efforts. The challenge will be to develop productive relationships with indigenous groups, both in the public and the private sector, which are based on mutual respect and goodwill. Even interventions which are short-term in nature should have this as their goal.

The process of economic and political transition taking place in Central and Eastern European countries is of course not linear. No single formula for assistance can be expected to move

reforms forward along a pre-defined pathway. However, there are major constraints which, when taken together, suggest a set of phases leading up to what we might call a stable, private-sector-lead. economy. Such a model has been suggested by Zbigniew Brzezinski, and seems applicable to the strategic planning focus of this study. This model is phased over a period of fifteen years. and addresses changes taking place in the economic, legal, and political realms, as outlined in the table below.

Phases of Post-Communist Transformation

Factors	Phase One: 1 - 5 Years	Phase Two: 3 - 10 Years	Phase Three: 5 - 15 Years
Economic	Elimination of price controls and subsidy; end of collectivizaton.	Banking system; small and medium scale privatizations.	Large scale privatizations; entrepreneurial culture.
Legal	Elimination of state controls.	Legal framework for business.	Independent judiciary; full legal culture.
Political	Basic democracy; free press; end of one-party state.	New constitution; elections; stable democratic governing coalition.	Formulation of stable parties

Source: The Economist, May 7th, 1994. Adapted from Zbigniew Brzeznski, National Review, Autumn 1993.

According to Mr. Brzezinski, the experiences to date with the post-communist societies in Eastern Europe and the NIS teach us that the transition won't take five years, as many had hoped or even projected, but it will take more like 15 to 20 years. The second "lesson" recent experience has taught us is that the transition is not a contiuum, but rather a series of distinct phases, which he lays out in the above table.

This assessment is relevant to the SME strategy because it illustrates two points. First, that in order for businesses to grow, the policy and regulatory environment in which they operate must promote, or at least not discourage, private sector growth. Second, the expectations which donors have about influencing positive change in the system, and the programs which they design, shouldn't be laid out in a linear fashion, or as a series of sequential "targets." Rather, the programs need to effectively promote the economic, legal and political structures which must be set into place before SMEs can make a significant contribution to the economy. This must be done while at the same time strengthening technology improvements, skill development, and improved management within the businesses themselves.

A third point illustrated, of course, is that the process of region-wide change will take more time than was originally anticipated. Some countries have been more successful in tackling Phase One. Some are even close to negotiating change in the Third Phase -- Poland, the Czech Republic and Hungary are candidates. It is apparent that other countries will indeed need time to successfully move through Phase One -- Romania and Bulgaria are probable examples.

E. The Importance of Promoting Diversity and Competition in the SME Marketplace

In addition to building relationships with local institutions for long-term benefit, U.S. assistance should endeavor to promote competition at numerous points in the transition process. This includes promoting competition in the marketplace for goods and services, as well as competition in what we call the 'marketplace for ideas.'

Innovation is the key to success in the small business sector. Innovation has been a distinguishing characteristic of American businesses since the industrial revolution began. We should target and strengthen approaches which encourage this same innovative attitude in Central and Eastern European countries. We don't suggest this approach simply because it brings distinction, but because we think it works, particularly when there is a need for the private sector to move quickly to take over from formerly state-run enterprises, and learn how to compete in the open market.

The marketplace for ideas also includes the world of policy and regulatory reform. Some changes may seem to be straightforward, whereas others might effect a broad range of stakeholders with differing interests. Seeking solutions to systemic problems will require debate and participation from many sides.

This process of promoting diversification and competitive markets adds to another key goal for A.I.D. in CEE, democratization. Competitive markets are the place where free-market economics and democracy intersect. (This relation between enterpreneurship and democracy was discussed also above in Section A.)

Chapter V. Application of the Strategy to Future SME Development Programming

A. Priorities and Approaches in Providing Assistance

Through the course of the team's field research, we tried to identify principles for successful program implementation. These are partly based on lessons learned to date, and partly on what the team regards as important SME program management strategies in the context of Central and Eastern Europe.

- There are many needs to be met in successfully improving the environment for SMEs in CEE. Different countries are at different stages, requiring that the programs be tailored in light of country-specific problems, priorities, and current efforts being made.

- Foreign aid can be the most successful if its strategy is based on a combination of interventions, designed to demonstrate factors which result in success. This can be done through joint-efforts with other donor organizations or through indigenous efforts being led by the government. Depending on the scope of problems being addressed, and the resources available, A.I.D. might consider moving to a municipal or regional approach in which it can address several strategies at once. In any event, most practicioners were of the opinion that A.I.D. should focus its resources outside of capital areas to municipalities or regions which are well-positioned to benefit from assistance.

- Every intervention must be done in collaboration with local institutions or organizations, and have local capacity building as a principle outcome. This is particularly important now in order to help develop the indigenous momentum for continuing economic reforms.

- Other A.I.D. efforts not under 1800023 are closely tied to the future success of SMEs in Central and Eastern Europe. These include democratization and privatization. Trade and investment, whether led by the Agency or another US government body, are also important for SME growth, employment and income generation. CEE SMEs need to be tied through trade and investment into the European regional community, and where feasible global markets, for long-term success.

- Smaller, start-up operations (micro-enterprises) can be serviced through low-cost standard assistance and training packages. Large economic and employment benefits can be gained by helping those established SMEs which show signs of being able to expand their business. The bulk of SME development resources should focus on these enterprises which are in a position to grow and create jobs.

B. Performance Indicators and Impact Measurement

1. Output and Purpose Level Indicators for Six Strategic Areas

Performance indicators at the output level should inform project managers whether the assistance provided had the desired effect on the immediate beneficiary. Did the profitability of the company improve? Did the business advisors trained learn the necessary skills to be able to provide effective management assistance to SMEs? The project design should include a set of outputs which contribute to achieving success in one or more of the strategy areas.

In addition to the client impacts, the strategy is focused on achieving a broader set of benefits which extend beyond the immediate recipient of A.I.D. development resources and services. The hypothesis of the strategic framework, which the team has developed based on its field research, is that if progress is made in realizing each of the six strategies and their objectives, then the transition to an open market economy has a greater likelihood of benefiting SMEs.

This broader set of benefits is measured by the use of purpose level indicators in the strategy. Are privately owned SMEs operating more competitively in the economy? Is the demand for SME support services being met by local service providers in the marketplace? Has the government adopted the necessary laws to allow SMEs to operate more efficiently? Are SMEs voicing their interests through volunteer, grass-roots organizations and associations? Is marketing information available to SMEs? Are SMEs and public policy makers discussing needs for the future?

Suggested indicators are outlined below.

Strategy One: Strengthening the Ability of Entrepreneurs to Compete More Effectively in the Open Market Place

Outputs

- Client companies show positive effects of assistance -- reduced costs, increased profitability, increasing sales.

- Privatizing companies assisted become privatized.

Purpose

- Private sector SMEs becoming more prominent, increasing their share of markets, and providing a wide range of goods and services.

Strategy Two: Improving the Availability of SME Support Services in the Marketplace

Outputs

- Local professionals are trained to provide technical and business advisory services to SMEs, and are able to sell those services in the marketplace.

- SBDCs assisted become competitive, unsubsidized service providers in the marketplace, with the exception of low-cost standardized training services and courses for the smallest, 'new start' ventures.

- New businesses assisted include service providers important for growth of the SME sector: transportation, market information, communications, office services, financial management, accounting services, etc.

Purpose

- SME support services are becoming more common in the marketplace.

Strategy Three: Improve and Broaden the Range of SME Financial Services

Outputs

- Loan officers trained are better equipped to evaluate applications, and entrepreneurs trained are preparing better business plans for use in securing financing for their businesses.

- Venture capital operations for SMEs are successfully implemented, and provide a demonstration in how such schemes are managed.

- Other financing possibilities are studied and where appropriate implemented on a demonstration basis, for example leasing operations (working with a local entrepreneur), factoring and the formation of credit unions.

Purpose

- SMEs better understand their financing needs and alternatives for meeting them.

- Financial services for SMEs at all stages of development are more readily available.

Strategy Four: Promote Positive Attitude and Administrative Capability in the Public Sector as Regards SMEs

Outputs

- Public sector officials at the municipal, district, and national levels are trained in the (a) role of SMEs in economic growth and development and (b) role of the public sector in supporting an 'enabling environment' for private sector activity in the economy.

- A program is established at a local institution (probably academic) which will provide ongoing courses and seminars for public officials in private sector development.

Purpose

- Public sector agencies are enacting needed reforms to support SME development.

Strategy Five: Improve the "Enabling Environment" of SME Sector Policies and Regulations

Outputs

- An inventory of laws and regulations effecting SMEs is completed in collaboration with local researchers and analysts. Priorities are established, and a program for reform drafted.

- The results of this exercise are discussed in detail in forums involving both the public and private sector. Opportunities and venues for ongoing dialogue are established.

- Indigenous business associations and NGOs are assisted in improving their organizational ability to represent the interests of SMEs.

Purpose

- Public sector agencies are enacting needed reforms to support SME development.

- Associations and other non-governmental organizations have increasing membership from the private sector, and are actively involved in advocating on behalf of SMEs.

Strategy Six: Strengthen the Production and Dissemination of Information about SMEs and their Importance to Economic Development

Outputs

- Local organizations are trained in the collection and dissemination of information about SMEs. These organizations develop and implement a strategy for continuing this effort over time.

- Information generated is being utilized by (a) SMEs for their market development and (b) public/private sector groups for policy and regulatory reform efforts.

Purpose

- Information about SMEs is both reliable and readily available to the public at large.

- Numerous channels and venues exist through which SME issues are debated and discussed.

2. System Management

The tracking of output indicators should be the responsibility of every grantee or contractor working in SME development. In designing their project M&E systems, implementing organizations should keep in mind that the strategy is not a static 'point A to point B' model. The management information system they settle on must include a learning loop through which lessons are applied to mid-course correction if contributions to achievement of purpose level objectives are not being made.

Purpose level monitoring would typically be managed through a third party or an evaluation officer in the A.I.D. office, and can also be aided by the participation of project implementors. Monitoring and evaluation of the strategy should begin with a baseline, which can be developed through the steps outlined in the following section "Steps in Applying the Strategy for SME Development Programming in Central and Eastern Europe." This baseline will provide a set of strategic indicators which can be compared over time as the country progresses in the transition to an open market economy.

One final note. The factors which contribute to the success of a project intervention need to be well enough understood so that the intervention can be replicated given the right conditions. Our aim should be to demonstrate (and in the process learn from) how foreign assistance can assist the SME sector in specific CEE countries.

C. Steps in Applying the Strategy for SME Development Programming in Central and Eastern Europe

1. Overview

Although the strategy has been described as a tool, it is not a formula. Its application needs to be tailored to meet the needs of individual countries. The steps outlined in this section will help in 'custom-fitting' A.I.D.'s programs to particular economic, legal, and social environments.

The direction which A.I.D. pursues in SME development will be shaped by several factors. These include:

- What progress the country has made to date in terms of privatization, creating an enabling environment, and promoting private sector growth. (Refer to the "Three Phases" model discussed in Chapter IV, Section D.) How well is progress being made in each of the six SME development strategies?

- What key constraints, main issues, or major obstacles need yet to be addressed before the transition to an open market economy is complete, and irreversible. (See Table 5: "Indicators of a Healthy Private SME Sector.") Which of the six strategic areas is holding the transition back? Which could serve as a leader in pulling the others, and the economy, forward?

- What work is currently being supported, by the host-governments, multi- and bi-lateral donors; what are their priorities? what are likely to be the outcomes of this work? Also, what work is currently underway with A.I.D. support?

- In light of the above three sets of analyses, what role can A.I.D. best play in moving the SME sector forward. What is the U.S. comparative advantage in terms of the needs of that country? (See Chapter IV, Sections A and B.) What is the best balance of firm-level TA, institutional development, financial assistance and policy reform? In which of the six strategic areas can A.I.D. resources make the best impact? Is a concentration of several activities in a limited region the best approach? Or, is progress being made along enough fronts that A.I.D. can use its resources on more of a national basis?

These factors group themselves well into a four-step assessment tool, the end result of which is a portfolio of programs, projects and performance indicators for A.I.D.'s work in each CEE country. The team has been able to put together some country specific information based on its field work. However, more in-depth assessments must be made before determining the content of each portfolio.

This Chapter presents a detailed set of questions for completing the first and second components in this four-step analysis. The questions allow investigators to pull together information about what progress has been made, and what problems still exist. In the process of conducting this

research, the investigators will also collect most of the data necessary for step three, which is an assessment of current government/donor program priorities.

The fourth step, determining A.I.D. program priorities for individual countries, is best done through a combination of "expert thinking" on the part of the investigators, and facilitated meetings involving stakeholders. (This "stakeholder analysis" is a feature of A.I.D.'s Implementing Policy Change project, and can be easily adapted for this purpose. Copies of the analytical tool can be gotten from MSI, which manages the project.) These meetings would be similar to the "roundtable" discussions which the strategy team held in each country while doing this study.

3. A Framework for the Strategy Tool

The six strategic areas describe in this chapter can be usefully grouped into two major categories, shown in Table 7.

Table 7: Major Grouping of Six Strategic Areas	
Strategies which improve the ability of entrepreneurs to run their businesses	- *Strengthen entrepreneurial skills and capabilities.* - *Strengthen marketplace capability to deliver business support services.* - *Develop stronger and broader SME financial services*
Strategies which improve the relationship between government and business	- *Improve the enabling environment (rules, regulations, policies) for SMEs.* - *Strengthen the public sector's positive attitude towards SMEs and its administrative capability to support SME development.* - *Strengthen information flows between government and the private sector which support business needs and assist in policy development and evaluation.*

2. Investigating Strategies to Improve the Ability of Businesses to Operate Profitably

The first three strategies can be thought of together, in the sense that they relate directly to improving the capability of the entrepreneur, or directly to removing constraints that may keep entrepreneurial businesses from surviving and growing. The two constraints identified as critical are (a) lack of local consulting capability, training, technical assistance, etc., that services the needs of SMEs, and (b) lack of access to equity or loan capital. The strategic goal in each case is to help the host country eliminate or minimize the effect of the constraint.

Even with Gross Domestic Product falling by 25 to 50 percent or more over the course of two or three years, most countries seem to have been able to generate thousands of new startups. (See discussion later which deals with improving the legal and regulatory framework supporting small businesses.) The decline in Gross Domestic Product seems to be bottoming out in most CEE countries, with the possible exception of the Southernmost countries which are being affected by civil strife in the former Yugoslav states, or by the current Greek blockade affecting access to the sea.

Some countries are beginning to see a wave of bankruptcies following the wave of startups in earlier time periods. This behavior is well understood in the Western world, although not well accepted in every country. The CEE countries are still learning to deal with and accept the concept of bankruptcy, and hopefully, will learn to accept it as part of a natural learning policy in a competitive economy. Every business is an experiment, and not every experiment turns out successfully. If necessary lessons are learned from each failure, then the competitive market will produce better entrepreneurs over time.

The competitive market can be assisted by systematic efforts to educate entrepreneurs and improve the quality of entrepreneurial management. Systematic efforts can also be devoted to the development and growth of companies which provide expert consulting services required to support business owners and managers. Donor countries have focused on providing expert consultants, familiar with Western management practices, to assist new and expanding businesses in the CEE countries. These outside consultants, even though they are experts, lack a dimension of knowledge about local culture and local business practice which can best be supplied by a local consultant. The outside expert can work to train the local consultant in modern management techniques, as suggested in the discussion of strategic area two, below.

It is clear from Eastern European experience that many businesses can be started from local capital, even if local bank or non-bank loan markets are not working well, and even if the economy is not working well. Most of the startups in these conditions tend to be retail or wholesale trading businesses, however, which concentrate on rapid turnover of small amounts of working capital, or on development of service businesses such as bars and restaurants which require relatively small amounts of capital. The mounting number of bankruptcies indicates that many businesses are undercapitalized, however, and cannot survive if business conditions worsen, or if new competitors arrive on the scene. Access to equity capital or to loan capital, while not necessary for many startups, does contribute to potential success, because better capitalized firms have the capability to survive entrepreneurial mistakes, new competitors, or other adverse business conditions. Capital, in short, may enable you, as an entrepreneur, to

survive long enough to learn from your initial mistakes. Lack of capital can mean a quick death from any adverse circumstance.

Improving the flow of equity funds and loanable funds is an important function, therefore, and is the focus of strategic area three. The strategy suggests that banks are not the only source of funds. Other financial markets should be examined, and other sources of funds should be developed. Equally important, but addressed more in strategic areas one and two, is that SMEs should be taught to estimate financial requirements more precisely, as part of a business and financial planning exercise. While many businesses are underfunded because of lack of access to capital, many other businesses waste available capital because of sloppy management practices. Better management knowledge can lower financial requirements, and ensure that funds are available for necessary expenditures.

Assessing Strategic Area One: Supporting More Capable Entrepreneurs

The strategy does not cover all entrepreneurs. It is unlikely that outside assistance can provide training for all startups, for example. Outside assistance can focus on those firms that have survived for at least some time (even one or two years), and have shown that they can generate some growth.

What is a 'capable entrepreneur?' These are essentially individuals who can use the full range of modern management techniques and tools to direct their companies. In a closed economy, the definition would not be relevant. Local entrepreneurs could use older techniques, and local knowledge to run their businesses. In a modern world, with relatively open economies, local business owners must compete with companies on a cross-border basis, and must be able to manage as efficiently as their foreign competitors.

Many companies don't export or plan to export. Do *they* need modern management knowledge? Yes, if they are to compete effectively with other local entrepreneurs who gain and use such knowledge. It is true that local entrepreneurs don't have to acquire a complete management education in order to compete. Initially, an improved knowledge of good bookkeeping practices, production and cost control techniques, quality control techniques, and international trade documents and practices (shipping, insurance, finance) will be needed for manufacturing companies. Almost all businesses moving beyond the single person/family stage will have to have better knowledge of business planning techniques, sources of marketing information and marketing techniques, and financing techniques.

Given these needs, the following questions can help in identifying the level of entrepreneurial capability.

- Do ongoing businesses use banks as a source of financial help? Do businesses prepare business plans as part of the bank loan application process?

- Is there an association of chartered (registered) accountants (equivalent to our national or state certified public accountants association)? Is there an association

of lower-level bookkeepers or public accountants? If yes to either of the above questions, has either of the associations sponsored training for business owners?

- Are bank loan officers being trained to evaluate and process SME loan applications? Are banks attempting to help business owners prepare better loan applications? Are foreign donors sponsoring any training of this sort?

- Is there evidence of new business training schools being started? Are courses available in foreign language? Computer applications?

- Are there local consultants offering assistance with financing? business planning? exporting? Are there local firms specializing in the marketing of products or services, and offering to assist other firms with marketing problems?

Assessing Strategic Area Two: Marketplace Capability to Deliver Business Support Services

All CEE countries have seen a major increase in the number of new business starts in the past few years. As the number of businesses increases, there should be an increase in demand for business support services, including basic training in business functions, and accessibility to local consulting firms which can assist with business planning, finance, marketing, and production problems.

The marketplace should show evidence that consulting firms are responding to business demands. In larger market centers (large cities), more specialized businesses may also be noted, such as industrial engineering firms, specialized audit and accounting services, venture capitalist firms (firms which specialize in finding equity capital for investment in growing businesses), specialized marketing or advertising firms, etc. Some of these firms will be staffed with foreign specialists, establishing new offices to service a recently-opened market, but other firms will be locally owned and operated. A number of questions may help evaluate the strength of local business support activity.

- Does the marketplace appear to be able to provide necessary business assistance functions at this time, or in the near future? Are foreign business assistance programs providing good counterpart training? Is the indigenous capability to provide business support activities being strengthened by current donor activities?

- Are the universities or business schools attempting to establish useful training curriculums to train local specialists? What about non-academic training institutes? Is there any evidence of students leaving the country to take advantage of training programs in other countries? Are there any donor programs supporting either curriculum development, business school startup, or funding of students for foreign training? What is the level of support?

- Have foreign donors started business assistance centers? Does the network of business assistance centers cover the country, or at least the major cities or

districts? What criteria are being used to locate these centers? How are these centers doing? Are they receiving any local or national government support? Will they survive the elimination of foreign funding? Are local consultants or other professionals working with these centers? What skills are they being trained in?

- Is the national government or district governments aware that most countries provide some sort of state support for basic business education activities? (Basic business education means training in business functions that is not specific to the needs of a particular firm. Teaching accounting to an individual would be basic education. Designing the book of accounts for a particular firm would be specific education or assistance. This would normally be paid for by the company receiving the assistance.)

- Are the professional associations in accounting, law, engineering, aware of the growing demand for services from the business community? Have these associations initiated or supported courses for their members on how to better serve the needs of SMEs? Are any of the associations working with counterpart associations in the West in order to improve member ability to meet SME requirements?

Assessing Strategic Area Three: Developing Stronger and Broader Financial Services

Much attention has been given by multilateral donors (IMF, World Bank) to assisting in the setup of a functional central bank. Many donors have also attempted to assist local banks with the development of clearing systems, improved communications, standardized accounts, improved supervisory and reporting systems, and, most importantly from a small business standpoint, improved loan evaluation and processing methods.

Despite these efforts, banks in many CEE countries are not providing a significant flow of loanable funds to SMEs. In some cases, the failure of the banking system to provide loanable funds to SMEs is a function of government policy. The government may have instructed banks to give first attention to state-owned enterprises (SOEs), for example, or the state may be issuing bonds which banks are required to (or in some cases find it advantageous to) purchase. The bond funds are then used by the government to subsidize remaining SOEs.

In other cases, banks may not be making loans because of a lack of basic law or because of deficiencies in basic law. An example would be the lack of a well-specified bankruptcy law, or the absence of a collateral register system which would make it difficult for banks to register collateral for a loan. Banks in some countries may choose not to loan to SMEs, if the judicial system is lax about enforcing default judgments, or if the court system is not capable of enforcing judgments due to a lack of staffing, or enforcement authority. (See the discussion of rules and regulations below, regarding the 'enabling environment' for business, for more examples.)

A number of questions should be asked in evaluating the flow of financial services in a country. Some of these questions relate to the capability of the banking system, including both the central

bank, and the public or private banks which mediate between lenders (savers) and borrowers (businesses or individuals). Other questions should be asked about non-bank financial intermediaries which may also be sources of business loans.

Examples of non-bank intermediaries would include credit unions, finance companies, specialized asset-based lenders such as General Motors Acceptance Corporation, and leasing firms. These non-bank intermediaries may raise funds by accepting deposits (credit unions) or by raising funds in local or world money markets through issue of short-term paper or through sale of longer-term liabilities such as bonds. Leasing has developed into a very large scale business in the United States, with virtually every type of business equipment need (not to mention office, commercial or industrial space) being met through rental type leasing. Leases allow small firms to use specialized equipment on a rental basis, without having to borrow funds to purchase the equipment.

Questions Related to Inflows of Foreign Capital

- Does the country have a convertible currency or a currency that is backed by foreign hard-currency assets? Is the government encouraging the inflow of foreign funds to support equity investment or business lending?

- Are foreign companies allowed to start new businesses, or purchase a majority share in existing businesses? Can profits made by a foreign firm be repatriated without restrictions? Can clear title to land or real property (buildings) be obtained relatively easily? Are there special restrictions on purchase of agricultural land?

Questions Related to the Banking System

- Is the banking system open in the sense that the government is chartering new (private) banks? Are many of the banks still state-owned? Are there plans to privatize state banks? Is the government encouraging the development of a competitive banking sector?

- One way of testing for the extent of competition is to look at the difference between the banks cost of funds, and the banks lending rate. Are state banks being asked to focus their support on SOEs? Are the state or private banks in the country adequately capitalized? Adequate capitalization may be a complex regulatory issue, but the essentials for this exercise include answers to just a few questions.

- Are non-performing loans (using the Western definition of the term) being written off on a current basis? If not, is the amount of non-performing loans held on the books of the bank greater than the banks invested capital plus any allowance for loan losses on the books? If capital is positive, is it equivalent to six to ten percent of bank assets?

- Are advisors from donor countries or from multilateral organizations working with the Central Bank? with State-owned banks? with intermediary organizations such as clearinghouses? Are there training programs in place for bank personnel? particularly for bank loan officers? Are banks making reasonable numbers of loans to SMEs? to consumers? to SOEs?

- Do banks have very high collateral requirements for loans (such as 150 percent of the amount being loaned)? Can banks register collateral items in a central register that is maintained on a reliable basis? Is such a system being developed? Do banks have reasonable standing under current bankruptcy law? Do the courts enforce the bankruptcy law as written, or are there delays which effectively negate the law in certain cases? Can the bank put a business into bankruptcy, if the business is not making regular loan payments?

- When making small business loans, do the banks make loans for periods less than a year? more than a year? Are the loans made only for working capital (purchase of inventory or goods in process) or are loans being made for investment purposes (purchase of long-lived equipment or purchase or rehabilitation of production facilities)?

Questions Related to Non-Bank Lenders

- Is any institution other than banks making loans to SMEs? Are there any informal money lenders making loans to SMEs? Are large equipment distributors offering to finance purchase of heavy equipment used for farming or for construction? Can an SME lease automobiles for business use? Can an SME lease computers?

- Are there any formal local institutions such as savings banks, mortgage funding organizations, or cooperative banks which lend to SMEs? Can small equipment (office equipment, for example, such as copiers, printers, mail-handling equipment, etc.) be leased from vendors? Are there any specialized vendors that focus on leasing or renting other business equipment or machinery to SMEs or to private individuals?

- Is any institution factoring, ie., purchasing receivables at a discount and acting as a collection agent for the receivables? Is there any evidence that smaller businesses are using credit cards to assist with short-term SME financing needs?

3. Investigating Strategies to Improve the Functions of the Public Sector in Relation to SMEs

Strategies four, five and six form a triad similar to strategies one, two and three. Where the first three strategies focus on the entrepreneur and constraints directly related to the entrepreneur, the second three strategies stress the nexus between governmental activities and business behavior.

Strategy four focuses on the fact that the government (particularly the national government, although lower-level governments can also have some affect) is responsible for the legal and regulatory framework which defines the "enabling environment" which supports business. Poorly written or poorly coordinated legislation can make business transactions more difficult, more expensive, and less likely to occur. If transactions occur because buyers and sellers are both attempting to improve their economic positions, then poorly-written legislation and regulation can decrease the number of transactions which occur, and lower total welfare. The thrust of this strategy, therefore, is to help the government and other institutions within the society to develop better legislation and regulation.

Strategy five calls for development of a supportive public sector, with positive attitudes towards SMEs, and with the necessary administrative skills to support SME development and growth. This strategy is focused at local level, rather than at national level, since it is the actions of local and regional governments which most directly support the SME business community. Many local governments in the CEE economies are new, with officials who have no knowledge of business support activities, and no idea of the range of activities and programs which governments can use to support economic development at the local or regional level.

Strategy six calls for the creation of an improved flow of information which supports both entrepreneurial activity and the development of a continuing public policy dialogue between business and government. The strategy begins with the realization that there is no effective advocate for SMEs in most CEE countries. Governments are used to working with relatively few large SOEs, and have not developed the support structure needed to deal with thousands of smaller businesses. The government finds it difficult to produce information about the new businesses, and census or central statistical bureau measurements lag far behind the structural changes in the economy.

One consequence of this lag in information about newer businesses is that government policy is made in the complete absence of correct information about what is really happening in the economy. The lack of good information makes it easier for the government to stay with old policies subsidizing SOEs that are making large losses, while not supporting private firms that are generating profits, wealth, and jobs in the economy.

The concept of information used here is a multi-faceted one. One information problem is the lack of data to support government policy development. Another is the absence of good information to support market research and business development in the private sector. A third lack is the absence of information about the attitudes of SME owners towards the policy efforts of the government. One of the most important aspects of a democratic society is the development of feedback loops by which those individuals or organizations affected by legislation or regulation or government programming can inform the government about the positive or negative affects of the government intervention. This last information problem may be called the problem of effective advocacy.

Advocacy for better policy or programming relies on good information about the factual position of the economy, but it also requires good and timely information about the geographical and industry-related affects of government policies. Geographic organizations such as chambers of

commerce and industry or trade associations representing industry views must be developed to produce timely feedback on actual or proposed government policies affecting SMEs.

It takes time to develop the organizations which can produce this information at the grass roots level. Based on experience in many Western and Asian countries, it also is difficult to maintain organizations that focus only on advocacy information. Most business organizations survive only if they produce a mix of value-added services such as standard setting and enforcement, identification of best practice and best technology, training, etc., which meet the interests of their clientele.

Information produced by the government or by an independent private research group can help the government make policy and support economic development programming for SMEs. The same data can be used to support marketing research and new product or service development activities in the private sector.

Assessing Strategic Area Four: Improving the Enabling Environment

The shift from a socialist economy with state control of the means of production to an open market economy entails many legal changes, all of which are intended to establish a more effective incentive system which will help economic agents make better decisions about the use of resources. The key to a better incentive system is the establishment of rules which govern the rights of people to hold and use property.

In addition to a new property law, it is clear that new or revised laws governing contracts are required. The law must establish that the state, through its court system, and through other conflict resolution systems such as arbitration and mediation, will enforce legal contracts established by private parties. Improved property law and improved contract law are the beginning of a better "enabling environment" which helps businesses accomplish the many transactions needed to operate a complex, open market economy.

Although almost all CEE countries have introduced some of the necessary new legislation, few countries have approached the legislative process with the concept of making the market system as effective as possible. In some cases it appears that the government and the legislature believe that simply establishing markets is enough to get the benefits of a private property, free enterprise system. In other cases, parliamentarians appear to have discovered that there is no widespread constituency advocating for the passage of better rules defining markets and market behavior. Many parliamentarians have maintained business as usual, looking for programmatic activities which can be introduced to induce groups of constituents to vote for the reelection of the parliamentarian. This approach to legislation favors organized special interests, and leads to ineffective and expensive subsidy programs which rarely move resources in the direction of more effective utilization.

In approaching the issue of what legislation should be passed to create an effective open market economy, it is suggested that two goals be kept in mind. First, any legislation passed should help to define *competitive markets*. It is competition in the market place that produces better

products and services and lower prices. Simply allowing the opening of markets is not sufficient to guarantee the existence of competition.

Second, on the assumption that most transactions between individuals and businesses in a marketplace are freely entered into, with both participants to a transaction better off after completing the transaction, then it is important for the government to establish laws and rules which *minimize the cost of accomplishing business transactions*. While this seems almost self-evident, it is clear that few members of parliament or of the government see the need to minimize the cost of doing business. In most CEE countries there does not seem to be a strong business lobby calling for improvements in basic legislation. Countries which do not recognize this need will see themselves continuing to fall further behind those countries that are trying to help their businesses operate more efficiently within a competitive market framework.

Numerous questions can be asked to track the status of the enabling environment for SMEs (actually for all businesses, since a better legislative and regulatory environment helps every business, including large private businesses, and SOEs).

- The most important questions to be asked relate to property laws and contract laws. Is there a property law which clearly specifies the rights of individuals to hold and use property? Has the state established effective, up-to-date, and easily accessible property registers so that ownership of property (land and improvements to land) can be tracked? Are the registers being maintained in a timely manner?

- Are transfers of property being taxed reasonably or not at all? Are fees related to the registration of property reasonable (i.e., reflective of the real cost of running the property register)? Note that while the law is critical to defining effective property rights, it is the implementation of administrative registration systems that is critical to making transfers of property readily achievable.

- With respect to contracts, does the law establish the principle that performance of lawful contracts will be enforced by the state? Has the state established an effective judiciary system to deal with conflicts concerning performance of contracts? Is there a small claims procedure that can deal with minor conflicts? Has the state established arbitration and mediation systems (or allowed these systems to be established on a private basis) to minimize the cost of enforcement? Are court rulings on contracts enforced?

- Has the legal profession, acting through the bar association, taken an active role in attempting to define a reasonable enabling environment for business? Have any other projects had any influence on legislation passed by the parliament? or submitted by the government to the parliament?

- Are there any independent (not related to any political party) think tanks that have suggested necessary legislation? Has the business community through its organizations (what are they?) attempted to specify what the government can do to

make the business environment work better?

- Is the government organized in a manner which contributes to the identification of rules which will improve the economy? Have issues such as restitution of property overwhelmed the government or prevented passage of rules leading to a more effective land registration system?

- Has the government passed laws encouraging investment? These laws would include a bankruptcy law specifying the hierarchy of claims against the remaining assets of a company in liquidation. The law would also protect assets from creditors, when there is a reasonable possibility that the firm can be reorganized with minimum loss to creditors. Other investment related laws would include laws defining investment instruments such as stocks, bonds, warrants, etc., along with rules specifying the conditions under which these instruments could be traded or sold. These laws should ensure that there is sufficient information provided regarding new securities so that potential buyers can reasonably assess the risks and returns associated with the venture being funded.

- Other important laws for the enabling environment include the banking laws. Does the banking law provide for a sound banking system? Are banks adequately capitalized under the law? Are banks held to stringent accounting rules by law? Are the banks supervised adequately under the banking laws? Does the banking law encourage/allow a competitive banking structure to develop? Do the banking or securities laws support competition not only within banking, but also between banking and other financial institutions?

- Is there a uniform commercial code which specifies the normal expectations in relationships between buyers and sellers? Does the commercial code (or civil code, if preferred) establish rules about liability for performance, about implied and expressed warranties, and about reasonable expectations on the part of both buyer and seller? Is the commercial code reasonably congruent to the rules established by major trading partners?

- Has the country established membership in major international organizations designed to assist with the orderly conduct of international trade? Organizations would include the GATT (General Agreement on Tariffs and Trade).

- Has the country established laws regarding worker protection with respect to health and safety conditions? With respect to hours of work and overtime rules? Is there any flexibility in labor rules based on employment size of firm?

- Has the state established a tax regime that is the same for all businesses regardless of size? Does the state impose high taxes to cover social security and access to state health programs? Has the state considered different tax rules for smaller businesses? Is the state taking a high proportion of profits through taxation? Is the size of the underground (gray market) economy declining? stable? or growing?

How is the government attempting to deal with the gray market? Is the government taking any credible steps to bring gray market firms into the tax base? Is tax administration being improved? Is the government working with accounting associations or business associations to improve tax collection procedures? Are other donors providing sufficient expert assistance in these areas?

Assessing Strategic Area Five: Improving the Public Sector Role in SME Development

One characteristic of almost all CEE countries during the socialist era was the centralization of government power and government administrative capability in the capital of the country. Some countries, such as Poland, virtually eliminated local level governments, and reduced mid-level governments (*gmina* or county in Poland, region, district, etc., in other countries) to appointive bodies which carried out what limited duties were delegated to them. Power remained at the center of the state, and functional bureaus or ministries delivered services through a hodge-podge of differing administrative systems.

Many social services were delegated to the SOE or collective farm which provided employment for large numbers of workers. These large SOEs produced not only market outputs, but also housing for their workers, health services, pensions, and other necessary social services. In many instances the number of retirees affiliated with an SOE was larger than the workforce. Not surprisingly, in some circumstances the provision of ancillary services became more important to the SOE managers than production of output.

The movement towards privatization and towards open markets has been accompanied by a trend towards decentralization of state power. In many cases new governments have been elected at local level, and intermediate level governments have been created to assist with the actual delivery of services by functional bureaus. In many cases these new governments are handicapped because they have been delegated authority, but not the power to tax. In other cases the local government has been given title to all state property within the town boundaries, with little guidance about how to use it or dispose of it effectively.

In some countries, the functional bureaus have not decided how government services will be delivered at regional or local levels, leaving local officials unsure of what authority they have to meet local needs. Even when local governments have some continuity (i.e., when they existed through the communist period), local officials have very little knowledge of modern economic development practices.

In the United States, in Japan, and to a lesser extent in some European countries, government support of economic development activity is strongest at the local level, with support decreasing at county or state level, and with the lowest level of support at the national level. Many local authorities, many county governments, and most state governments in the United States (prefectural governments in Japan) have established economic development programs that coordinate services aimed at increasing and improving economic activity in the local or regional area. The administrators of these programs have used a variety of techniques to support business growth, and have learned over time that some techniques work much better than others.

Many states, for example, originally concentrated on enticing existing plants to cross the state line in return for a package of benefits which included tax relief, state or local provision of necessary infrastructure, assistance with recruiting and training of staff, financial assistance through state bond issues, etc. From a national standpoint, however, such movement of existing plants is a zero-sum game: the gains to one state are offset by losses in another. Because the gaining state has spent considerable resources to entice the moving firm to move, actual global welfare may decrease.

More modern economic development efforts have focused on improving the climate for local businesses in order to encourage their development and growth. Local governments focus on improving the business tax structure, providing convenient access to government offices, reducing regulatory burdens, improving local infrastructure for business, providing skilled workers, and otherwise improving conditions for local businesses. Localities that have been able to produce a good supply of well-trained college graduates with skills in mathematics, physics, the hard sciences and life sciences, engineering, and business management, have grown more rapidly than areas which did not produce a pool of talented and creative people.

A number of questions can be asked to determine the current capability of local (regional) officials.

- Have the local officials been in place for several years or longer? Were they elected or appointed? Were they delegated significant authority to manage local affairs? Did that authority include the authority to use or dispose of state-owned property within the town limits?

- Do local officials have the power to tax? If so, is the power limited to certain types of taxes? If the local government doesn't have the power to tax, does it play a strong role in the development of the local budget allocation from the central government? If not, how does the central government apportion funds to local or intermediate governments?

- Has the central government coordinated the shift of service delivery from central (functional) ministries to local delivery? Or has the dispersion of responsibility been left to the individual ministries? Have local people been asked by the local government about their preferences in the service delivery area?

- Are most (some, all) of the SOEs in the local government area privatized? If so, has responsibility for social service delivery been separated from the former SOEs and shifted to the local government? Have worker houses been privatized? Or, have they been shifted to local government ownership?

- With respect to SME support, has the local government recognized that it has an active responsibility to support local businesses? Has a local economic development office (business promotion office, business regulatory bureau) been established? Is there any sense among local officials that support can be provided in a variety of ways from minimizing unnecessary regulation, improving general

infrastructure, providing good schools, both academic and vocational, providing business counseling, access to unused property, improved zoning, financial assistance, or procurement from local businesses? Have local government officials sought help from donor organizations?

- Has the local government consulted with local businesses concerning their need for support? Has the local government attempted to measure the level of local business activity to establish a bench mark for future measurement, and to provide information to assist with policy development?

- Has the local government done anything to encourage local businesses to develop an organization or local chamber? Is there any evidence that local businesses are working with the local government to establish ways to market local products or services? Is there any attempt at developing sister-city relationships with cities in Western (or Eastern) countries? Have there been any exchanges of officials between cities in different countries? Has there been any contact with organizations such as the National League of Cities in the United States (or the National Association of Counties, the Conference of Mayors, etc.) or in European countries?

The answers to these questions, for a sample of cities, will give program designers a good idea of the attitudes towards private businesses on the part of local officials, as well as a good idea of local government capability to support SMEs through provision of appropriate government services.

Assessing Strategic Area Six: Information Flows and Feedback Loops in the Economy

Businesses need flows of information about business conditions, about local, regional and national market demographics, about international opportunities, about competitors at every level, and about consumer wants. Governments in most countries provide much of the basic demographic information, about individuals and families, and also about businesses and industries. Most of this information is produced by a census bureau, central statistical bureau, or similar organization. The information is usually widely distributed to universities, research libraries, and to the public for nominal cost, usually the cost of printing and distributing the materials. The cost of collecting and organizing basic information is supported through tax receipts on the basis that the information benefits everyone.

In most of the CEE countries, the statistical agency is lagging badly in collecting new information, and is often overwhelmed by the large numbers of new businesses which complicate the data collection process, and raise the cost of producing even the simplest data. In some cases the statistical bureau appears to have continued to measure only activities related to state-owned businesses, or has made only feeble attempts to measure newer businesses. The result is a flow of data which emphasizes the declining sector of the economy, and all but ignores the growing sector which is producing jobs, wealth, and goods and services. The government policy-development process is obviously handicapped by the lack of good information about changes in

the economy.

One reason for the lack of good data is that there is no strong advocate for such information. Business owners complain constantly about the lack of "marketing" information, but very few of them seem to understand that marketing data is a byproduct of the statistical system which produces (or attempts to produce) information for government policy purposes.

Business owners often complain about the problems imposed on them by some governmental policy, or by the lack of some governmental policy. But very few business owners appear to think of creative ways to assist the government by developing organizations which can inform the government about business needs. In a democratic society, business owners compete for government attention along side consumers, educational institutions, social service organizations, and other groups.

Small business owners have to find some way of collecting information about business needs and about ways in which national, regional, and local governments can help meet those needs. In short, small business owners must find ways to advocate effectively, if they are to influence government policy. In doing this, the organizations representing small business must also develop an appreciation for what governments can do for business, and what governments cannot do.

Many small businesses, for example, wish to close the market to new competitors. This is often done by convincing the local or regional government to restrict entry through a licensing process. The license is often defended as part of a process for guarding local health or public safety. Many of the arguments may refer to health or safety, but the more important goal for the businesses asking for the licensing process is the elimination of new competitors which would compete away the "excess" profits which are being earned by the existing businesses. The protection, if granted by the state, produces a continuing transfer of wealth from consumers to the producers which have received protection. Market competition, which would normally lead to lower prices which would eliminate "excess" profits, is prevented from working.

Small and medium-sized businesses often combine in geographical organizations such as local or regional chambers of commerce and industry. Most businesses also join trade or industry organizations which focus on more specific industry issues such as technology or marketing issues, while chambers focus on local business conditions such as environment, infrastructure, taxes and local regulations. Both types of organization can be important in feeding back to government information about the effects of government rules and actions on businesses in a geographic area or an industry.

Few organizations can support themselves only through advocacy, however, and almost all organizations produce some set of value added services, such as training seminars, identification of best technology, provision of insurance services (health, liability, life, etc.). It takes time to develop effective organizations, and some of the early starters will not survive long enough to develop an optimal set of activities. Examples of good organizations can be found in many industries and localities, and in many countries. In the United States there are approximately 45,000 organizations which attempt to advocate for business interests.

Many of the questions related to information flows are straightforward.

Questions Related to Government Production of Information

- Has the central statistical bureau produced information on the distribution of production between SOEs and SMEs? Does the government attempt to track the output of privatized businesses? Has the government issued counts of new business startups? of business failures? of mergers or acquisitions of businesses? of joint ventures?

- Does the government produce data on private business output, inventories, and sales? Does the government produce information on employment in the state-owned sector? in the private sector? Does the government provide public information about investment expenditures in the public-sector (actually, in SOEs and in the government "services" sector)?

- Does the government provide timely data on the distribution of businesses and establishments (a business is an independent entity which may operate one or more establishments or places of business) by size or industry?

Questions Related to Private Production of Information

- If the government doesn't provide much of this information, is there any private entity, such as a "think tank" (defined as a non-partisan, non-profit organization with widespread and influential public backing) which attempts to provide some of the data? Do any of the economics or business faculties attempt to provide some data? Are there any private business organizations which might provide some useable information?

- Are there any firms in the marketplace which claim to have "marketing" information? Is the telephone system producing a yellow pages for at least the urban areas of the country? Is any business focusing on providing directories of businesses in a geographic location or in a particular industry or set of industries? Are credit-information bureaus starting up?

Questions Related to Advocacy

- Are many business groups being organized? Are they functioning on a voluntary basis? Is there a mandatory membership organization such as a national chamber? How fast are the newer organizations growing? Is there a clear focus on advocacy as a function? Do the business organizations appear to understand how to lobby with government agencies? with the parliament? Is the parliament organized in a manner which makes lobbying more effective?

- Do business organizations appear in the local newspapers or on local radio or television broadcasts? Do local business organizations undertake any civic

activities designed to educate the local community about the importance of business to the local community? Are there any local business organizations that feature networking among businesses as a key service?

- Are the business organizations which have developed organized on a democratic basis, with elected officials, and with frequent interactions between members and officials? Do the business organizations appear to have a "representative" membership in the local area, or in an industry? If not, are they attempting to develop a representative membership?

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Strategies for Small and Medium Enterprise Development in Central and Eastern Europe

Volume II
Backgound and Lessons Learned

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Preface

This report was prepared by Management Systems International (MSI) for the Office of Enterprise Development, ENI Bureau, A.I.D. Washington. The content is based upon five month's of field research and reviews in Washington, D.C. conducted between March and July, 1994. The MSI team was staffed by: Larry Cooley, Tom Gray, Steve Silcox, Cathy Silverstein, and Russ Webster. All of the comments and recommendations in this report are those of the team, and do not necessarily reflect USAID policy or program directives.

The team would like to thank all of those individuals who committed their time, energy, and knowledge to this exercise. Their experiences and insights were invaluable to us in helping to articulate what USAID's priorities should be for promoting small and medium enterprise (SME) development in Central and Eastern Europe. Most of all, we would like to thank Melissa Brinkerhoff of AID/W for her participation, and her dedication to this project.

Russ Webster, Team Leader

ACRONYMS & ABBREVIATIONS

ABA	American Bar Association
ABS	American Breeders Service
ACDI	Agricultural Cooperative Development International
ACE	American Cooperative Enterprise Center
BAEF	Bulgarian American Enterprise Fund
CARESBAC	CARE Small Business Assistance Corporation
CBI	Cooperative Business International
CCET	Center for Cooperation with the Economies in Transition (of the OECD)
CDC	Citizens Democracy Corps
CEE	Central and Eastern Europe
CIPE	Center for International Private Enterprise (of the U.S. Chamber of Commerce)
DSTI	Directorate of Science, Technology & Industry (of the OECD)
EC	European Community (now known as the European Union)
ECU	European Currency Unit
FSVC	Financial Services Voluntary Corps
GEMINI	Growth and equity through Microenterprise Investments and Institutions
IDA	International Development Association
IDLI	International Development Law Institute
IESC	International Executive Service Corps
IFC	International Finance Corporation

IFDC	International Fertilizer Development Center
ILE	Local Initiatives and Employment Creation Program (of the OECD)
KHF	Know How Fund
LOL	Land-O-Lakes Cooperative
LOP	Life of Project
MSI	Managments Systems International
NCBA	National Cooperative Business Association
NGO	Non-Gevernmental Organization
NIS	Newly Independent States (former Soviet Union)
OIC	Opportunities Industrialization Centers
PIET	Partners for International Educational Training
PIT	Partners in Transition
PVO	Private Voluntary Organization
SEED	Support for Eastern European Democracy Program
SME	Small and Medium-scale Enterprise
TA	Technical Assistance
USAID	United States Agency for International Development
USDA	United States Department of Agriculture
VOCA	Volunteers in Overseas Cooperative Assistance

Volume II: Background and Lessons Learned
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Chapter I. Overview of SEED Act Programs

A. Major Objectives and Funding Levels

The SEED Act (Support for East European Democracy) was passed in 1989 by Congress to provide U.S. assistance in the political and economic transitions taking place following the fall of communism in the Soviet Bloc countries. Funding obligations through September 1993 totaled $1.29 billion (see Table 1)[1].

Table 1: Annual SEED Act Obligations

(000s of US $)

Year	1990	1991	1992	1993	Total
Amount	$285,705	$311,519	$433,156	$259,653	$1,290,033

Under the SEED Act, programs are focused primarily in three areas: economic restructuring, improving the quality of life, and strengthening democratic institutions. Seventy-seven percent has gone to the first category of activity (see Table 2).

Table 2: Program Categories and Funding Levels

(All Years, 000s of US $)

Category	Amount	Percent
Economic Restructuring	$987,545	8428%
Improving the Quality of Life	$201,997	1724%
Strengthening Democratic Inst.	$88,774	??
Miscellaneous	$11,717	1%
Total	$1,290,033	100%

Poland has received by far the largest amount of funding, nearly $600m to date, or forty-six percent of the total. This is followed by Hungary with twelve percent of the total. All other countries have received less than ten percent of the total funding (see Tables 3 and 4).

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[1] Data for all tables in this chapter were taken from the January 1994 SEED Act Implementation Report.

Table 3: Country Funding Levels Under the SEED Act

(Total Funding to Date, 000s of US $)

Country	Amount	Percent
Poland	$592,332	46%
Hungary	$152,254	12%
Regional	$106,677	8%
Bulgaria	$98,485	8%
Czech	$86,308	7%
Romania	$77,084	6%
Slovakia	$63,957	5%
Albania	$52,038	4%
Former Yugoslavia	$18,027	1%
Lithuania	$17,453	1%
Latvia	$13,264	1%
Estonia	$12,144	1%
Total	$1,290,023	100%

Table 4: SEED Act Funding by Country and Category

(1990 - 1993, 000s of US $)

Country	Category				
	Strengthening Democratic Inst.	Economic Restructuring	Improving the Quality of Life	Miscellaneous	Total
Poland	$15,408	$515,336	$60,384	$1,204	$592,332
Hungary	$10,500	$116,067	$25,196	$491	$152,254
Regional	$16,623	$55,224	$26,643	$8,186	$106,676
Bulgaria	$13,138	$65,402	$19,450	$495	$98,485
Czech	$5,094	$67,087	$13,918	$210	$86,309
Romania	$9,506	$39,175	$27,975	$427	$77,083
Slovakia	$2,890	$49,627	$11,234	$206	$63,957
Albania	$6,478	$38,073	$7,362	$124	$52,037
Former Yugoslavia	$4,234	$8,303	$5,458	$33	$18,028
Lithuania	$1,576	$13,968	$1,823	$86	$17,453
Latvia	$1,731	$10,160	$1,283	$89	$13,263
Estonia	$1,595	$9,123	$1,259	$167	$12,144
Total	$88,773	$987,545	$201,985	$11,718	$1,290,021

B. Overview of Economic Restructuring Programs and Activities

As seen above, Economic Restructuring constitutes 77 percent ($988m) of the SEED Act obligations to date. This program is further broken down into several components (see Table 5). The portfolio which the team focused on, Technical Assistance to Enterprises (1800023), falls within the subcategory Privatization and Assistance to Enterprises. Total funding to date for 1800023 has been about $32m, or 28 percent of the Privatization and Assistance to Enterprises subcategory under Economic Restructuring. However, other projects outside of 1800023 are also providing assistance to development of the SME sector in Central and Eastern Europe. A summary appears later in Chapter III, "Other A.I.D. Programs and Other Donor Activities in SME Development."

Table 5: Funding Levels for Economic Restructuring Activities

(000's of US $)

Subcategory	Year				
	1990	1991	1992	1993	Total
Agriculture and Agribusiness	4,225	16,650	41,524	42,518	104,917
Energy Efficiency		21,516	29,950	18,506	69,972
Human Resources	7,459	26,531	19,049	31,217	84,256
Improving the Business Climate		6,129	33,161	28,276	67,566
Investment and Trade	39,154	99,179	156,731	15,799	310,863
Macroeconomic Support	199,140	35,000			234,140
Privatization and Assistance to Enterprises	**895**	**24,855**	**38,486**	**51,620**	**115,856**
of which: ***Technical Assistance to Enterprises (1800023)***		***10,949***	***10,975***	***10,177***	***32,101***
Total	250,873	229,860	318,901	187,936	987,570

C. Technical Assistance to Enterprises

Funding levels under 1800023 by country and implementing organization are presented in Tables 6 and 7. Consistent with the overall SEED Act, Poland is receiving the largest share of assistance, $15.0m, or 47 percent of the total to date. Hungary comes in second with $4.2m, thirteen percent of the total.

Among the implementing organizations (see Table 7), IESC has received 47 percent ($15.1m) of the total obligations to date. Funding to the Peace Corps ranks second, with eleven percent ($3.6m) of the total.

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Table 6: 1800023 Funding by Year and Country

(US $000s)

Country	1991	1992	1993	Grand Total	Percent
Poland	6,144	3,770	5,086	15,000	47%
Hungary	1,676	1,971	505	4,152	13%
Czech	1,013	1,047	527	2,587	8%
Slovakia	435	1,048	361	1,844	6%
Yugoslavia	461	628	594	1,683	5%
Lithuania	316	176	860	1,352	4%
Estonia	317	550	423	1,290	4%
Latvia	316	510	416	1,242	4%
Bulgaria	233	302	577	1,112	3%
Romania	14	663	400	1,077	3%
Albania	24	310	347	681	2%
Regional			81	8	0.02%
Grand Total	10,949	10,975	10,177	32,101	100%

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Table 7: 1800023 Funding by Country and Implementing Organization

(For all years, $000s)

Country	IESC	Peace Corps	IFC	MBA Ent. Corps	WOCCU	IRIS & Gemini[1]	Gemini[1]	IRIS[1]	CIPE	PIET	New Activity	Grand Total
Poland	3,860	1,526	2,500	1,016	2,100	1,925	1,355	643			75	15,000
Hungary	2,521	138		492					1,000		1	4,152
Czech	1,869	72		626							20	2,587
Slovakia	1,427	72		345								1,844
Yugoslavia	1,683											1,683
Lithuania	405	235							167	500	45	1,352
Estonia	843	235							167		45	1,290
Latvia	795	235							167		45	1,242
Bulgaria	320	744									48	1,112
Romania	868	184									25	1,077
Albania	467	176									38	681
Regional	81											81
Total	15,139	3,617	2,500	2,479	2,100	1,925	1,355	643	1,501	500	342	32,101

Notes:
1. Line items in the SEED Act report sometimes combine IRIS and GEMINI obligations.

Chapter II. Elements of Current A.I.D. Programs in SME Development in CEE

A. Portfolio of Current Projects Under 1800023, Technical Assistance to Enterprises

In January, 1991 the 1800023 project was authorized as part of the Regional Mission for Eastern Europe's Office of Economic Restructuring portfolio. The project was founded with the goal of providing direct assistance to private enterprises and facilitating improvements in their operating environment to assist in the successful transition of CEE countries to open market economies.

On this basis, the project's purpose is to develop the technical, management, and other skills necessary to restructure the region's economies and to assist in developing competitive markets and businesses. Special emphasis has been placed on providing direct technical assistance to individual SMEs, and on working to improve the legal, regulatory, and policy environments in which these firms operate.

The 1800023 portfolio of projects includes a range of activities being implemented by ten organizations which have received A.I.D. funding to operate in the region. Most of these organizations provide firm-level technical assistance, while others concentrate on stimulating policy reform, building institutional capacity, or training. The following is a brief description of each of these implementers working in the region. Additional sections provide details on their targets and objectives, activities, funding levels, countries of operation, (see Chapter 1) and programs costs.[2] Information was obtained from interviews and roundtable discussions with headquarters, field staff, and project recipients throughout the region, A.I.D. officials, and document reviews.

1. Implementing Organizations

The following is a brief description of the ten implementing organizations under the 1800023 portfolio providing assistance to SME enterprises throughout Central and Eastern Europe.

Citizens Democracy Corps (CDC)

CDC, a private, non-profit NGO, was founded in May 1990 to provide voluntary assistance from the U.S. private sector to promote democracy and enterprise development in Central and Eastern Europe. The program aims to strengthen SMEs as an important source of growth and income generation in the transitional economies of the region. To this end, its key objectives are: 1) to provide technical and management assistance to SMEs and privatizing businesses to increase their ability to operate profitably and competitively; and 2) to assist public sector and non-profit

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[2] For additional information on each implementing organization, refer to Volume Two Attachments, "Summaries of 1800023 Grants and Contracts."

organizations to increase their ability to support the development of SMEs and privatizing firms.

CDC's first activity was to establish its information clearinghouse on U.S. non-profit assistance programs in CEE and the NIS. The clearinghouse collects and disseminates this information through its databank, volunteer registry, and regional conferences. CDC has published a compendium of U.S. nonprofit assistance to Central and Eastern Europe and the Commonwealth of Independent States, as well as over twenty country-specific assistance directories.

In addition to its information clearinghouse, CDC has developed three assistance programs in response to the needs of the region. These include the Corporate Assistance Program (CAP), the Citizens Volunteer Program (CVP), and the Business Entrepreneur Program (BEP). Due to funding limitations and recent refocusing of program priorities, only the BEP program is currently operational. Below are brief descriptions of each of these program activities.

- The Corporate Assistance Program was designed to enlist U.S. corporations to provide pro bono assistance to build managerial, technical, and financial skills of public and private sector institutions in CEE. Corporate advisors volunteer for six months to a year working with top managers of host institutions.

- The Citizens Volunteer Program provided skilled U.S. volunteers to strengthen public and private institutions for a minimum of two months. The program mainly focused on assisting municipal governments, NGOs, and educational institutions. CDC helps local or regional authorities to institute new policies and programs to improve the operating environment for SMEs.

- Initiated in June 1992, the Business Entrepreneur Program matches experienced U.S. entrepreneurs with SMEs in the region to provide direct firm-level technical assistance to help companies compete in a free market economy. Entrepreneur Advisors (EAs) volunteer for a minimum of two months. In April 1992, CDC began assigning "Entrepreneurs in Residence" (EIRs) to CDC offices in Bulgaria, Czechoslovakia, and Hungary. These long-term volunteers assess companies and develop assignments for the EAs. In addition, they share advice and ideas with numerous companies in the business community. CDC identified the need for long-term advisors to support their short-term activities as a result of lessons learned in the region. The EIR program was expanded to Poland in October 1992 and to Romania in January 1993.

CDC has been active in Bulgaria, Hungary, Poland, Romania, and the Czech Republic. From 1991 through mid-1994, CDC has fielded 358 volunteers to these five CEE countries.

Center for International Private Enterprise (CIPE)

Founded in 1983, CIPE is an independent foundation affiliated with the U.S. Chamber of Commerce, and mainly funded by the National Endowment for Democracy. CIPE has been active in CEE since 1989, supporting local entrepreneurs, business organizations, and public policy institutes to advocate for better business laws and market oriented reforms. CIPE aims to encourage the growth of private enterprises and organizations as vital elements in the process of democratic development.

In 1992, CIPE received an A.I.D. grant to promote business and entrepreneurship development in the Baltic States (Estonia, Latvia, Lithuania) and a better legal and regulatory environment for SMEs in Hungary. To this end, CIPE provides direct grant support to indigenous business organizations and public policy institutes in these countries who are potential advocates for legal and regulatory reforms. The average grant amount to CIPE sub-grantees is $35,000.

CIPE's objectives are carried out through two main approaches. First, legal/regulatory reform and structural adjustment efforts are carried out through research, lectures by foreign experts, policy papers, newsletters, and mass media in coordinated advocacy campaigns. Policy papers and meetings with government policy makers are then used to shape public debates and emerging legislation. CIPE's other approach is through public and media support. In this way, CIPE helps to educate the public, businesses, and policy makers, promotes a positive image of private entrepreneurs, and builds support for market economic reforms.

In Hungary, CIPE has developed an interactive legal and regulatory reform program which has supplied grants directly to five local organizations to support policy change. These include several research organizations, public policy and economics institutes, and a craftsmen's association with a constituency of over 130,000 members. In addition, CIPE is coordinating the activities of a Hungarian advisory board and is publishing a monthly newsletter. The advisory board discusses project issues and hosts foreign experts in the areas of legal and regulatory reform.

GEMINI

The GEMINI/Poland Small Business Project is a collaborative venture between the Polish Ministry of Industry and Trade (MIT) and A.I.D. In 1991, Development Alternatives, Inc. was contracted by A.I.D. to implement the project as a buy-in into DAI's Growth and Equity through Microenterprise Investment and Institutions (GEMINI) contract.

GEMINI's goal is to build the capacity of the government to create and sustain an environment conducive to the formation and successful operation of SMEs in Poland. To this end, the project has two key elements: 1) to assess the financial needs of small business; and 2) to assist in industry-specific reform in the construction and agribusiness sectors.

GEMINI has been active in providing policy analysis, advisory, and technical assistance to the Office for SME Development within the MIT. Through these activities, GEMINI assists in design and implementation of policy reforms which enhance SME development. For example, GEMINI

assisted in the drafting of an SME Act, which includes provisions for the creation of a Bureau of SME advocacy within the Ministry of Industry. The Act is scheduled for review by Parliament, and GEMINI is working to support its future passage into law.

In early 1994, GEMINI published a report on SME needs in the Polish context entitled "Investing in the Future." This report details constraints facing the SME sector and plausible approaches to address them. Both the Prime Minister and the President of Poland formally confirmed their strong support for the SME sector by endorsing this report. It has been widely distributed in Poland, and is cited many by assistance organizations, local associations, and government officials as a key tool for enhancing the policy environment for SMEs in the future.

A key achievement of GEMINI to date has been its participation in assisting the "G-24 Task Force" in Poland under the aegis of the Minister for Small Business Development. The Task Force's mission is "to recommend measures aimed at sustainable increase of profitable investments by SMEs." The Task Force membership includes representatives of ministries, donor agencies, and SME organizations, with the E.U. Ambassador and Minister for SME Development serving as co-Chairmen.

Currently, GEMINI is working with a network at the grassroots level with ten Polish American Enterprise Clubs supported by a local foundation. GEMINI attends their regional meetings to support the development of grassroots SME advocacy initiatives, and provide follow-up assistance on effective lobbying/advocacy techniques. In addition, GEMINI is developing an SME database and research foundation for the future SME advocacy bureau. The objective of the database will be to stimulate sharing of information and promote the concept of advocacy to enhance private business.

IRIS

IRIS is an A.I.D.-funded project of University Research Corporation International, a non-profit corporation affiliated with the University of Maryland's Department of Economics. The purpose of the project is to benefit the formation and development of Polish SMEs through reforms in the institutional framework under which these enterprises operate. IRIS stands for "Institutional Reform and the Informal Sector," and has two primary objectives: 1) administrative and regulatory simplification; and 2) legal reform.

AID. contracted IRIS services for Poland through a buy-in to that project. The IRIS Poland Project has three key activities as follows:

- Collateral Law Reform: Through its research, IRIS identified excessive bank demand for collateral as a key constraint hindering SME access to credit. To assist in relieving this constraint, IRIS is working with officials from the Commission for Reform of the Civil Code, the Polish Ministry of Justice, the National Bank of Poland, and Polish legal scholars to draft a collateral law for future adoption by the Polish Parliament. The project is also active in establishing a new central ownership registry to track pledging of collateral.

- Insolvency Law Reform: IRIS is working with the Ministry of Justice and the Polish Lawyer's Association to affect bankruptcy law reform. The project has sponsored conferences on bankruptcy, insolvency, and enterprises in financial difficulty.

- Intellectual Property and Technology Commercialization: Activities in this area include working with the State Committee for Scientific Research to set rules on written commercialization policies, helping to develop new model intellectual property contracts, and developing new copyright laws.

International Executive Service Corps (IESC)

Founded in 1964, IESC is a volunteer organization based in Stamford, Connecticut which provides technical assistance worldwide through short-term advisors, mainly retired, private sector, U.S. executives. IESC has a network of 13,000 volunteers with executive-level skills and experience, referred to as "Volunteer Executives". These "VEs" share their skills and experience on a volunteer basis ranging from two weeks to three months.

IESC's operations in CEE began in Poland in October 1990 through a Cooperative Agreement with A.I.D. This program, IESC's Business Development and Support Program for Central and Eastern Europe, has been active in all countries throughout the region. Beginning in 1994, IESC began to focus its program on five target countries: Hungary, Poland, Lithuania, Romania, and the Czech Republic.

The program's objective is to foster the successful evolution of the region's economies to a free market system. This is achieved by providing short-term technical assistance mainly to privatizing SOEs and to private firms throughout the region. In addition, IESC has implemented several other projects in the region to meet specific needs. These projects are detailed below.

- Technical Assistance Projects (TA): The vast majority of IESC projects are in providing technical assistance. VEs offer technical assistance to indigenous consulting and training organizations, business associations, and other groups which support private business development.

- Trade and Investment Services (TIS): Previously, IESC provided volunteer trade and investment specialists to survey potential business sectors, develop sectoral and firm strategies for enterprise growth, provide training, and strengthen local institutions. IESC also provided clients with market research and provided individual firms with information on potential U.S. partners and/or investors. This activity has lessened as a result of a refocussing of A.I.D. priorities.

- Defense Industry Conversion (DIC): As part of its activities in Slovakia and Poland, IESC offers advisors to support joint venture or other investments which will result in conversion of defense production facilities to civilian production in the private sector.

- Public Administration Program (PA): Through this program, IESC has begun providing assistance to local municipalities, regional authorities, and mayors.

- American Business Linkage Enterprise (ABLE): This program provides individual consulting services and business linkages with the U.S. Activities in this area have ceased due to shifting programmatic priorities at A.I.D.

From 1990 through mid-June 1994, IESC volunteers completed over 830 projects throughout Central and Eastern Europe. As of end of 1993, 21.8% were in Poland, 23.4% in Hungary, 13.9% in the Czech Republic, with the remainder distributed throughout the other CEE countries.

MBA Enterprise Corps

Formed in 1990, the MBA Enterprise Corps is a consortium of 22 U.S. member business schools.[3] It was formed to select volunteers to serve in the CEE on a long-term basis after completing their MBA degree. The MBA Corps aims to encourage the development of free enterprise systems in the region and the internationalization of U.S. businesses. It is managed by the Kenan Institute of Private Enterprise (Kenan-Flagler Business School, University of North Carolina) under the direction of a board comprised of representatives from each of the member schools.

MBA graduates, called "Corps Members," provide technical assistance to private and privatizing firms which pay the Corps Members local salary and housing. Volunteers are active in the Czech Republic, Hungary, Poland, and Slovakia under 1800023 funding, and also provide assistance to the Bulgarian-American Enterprise Fund under a separate A.I.D. grant. The average assignment is for 15 months plus two months of training and orientation. Each member school bears the cost of marketing, recruitment, and selection of its Corps applicants.

Based on the recognized need to expand the activities offered to SMEs in the region, the Corps is concentrating its assistance outside the capital cities. As of January 1994, the Corps was operating in 11 cities in Poland; half of the volunteers were working outside of Prague in the Czech Republic; and in Slovakia, a third are outside of Bratislava. Since 1990, over 200 volunteers have been assigned to a total of five countries in CEE.

IFC/Polish Business Advisory Service (PBAS)

At the request of the Government of Poland, the Polish Business Advisory Service was established in 1991 by the International Finance Corporation with the EBRD as its co-sponsor. PBAS's objective is to promote the development of SMEs in Poland, with a focus on enterprises with assets between US$1 and $10 million and 50-1,000 employees. It provides training and technical assistance for the development of Polish business consultants, while assisting firms to prepare for joint venture partners, business investors, and future capital infusion. All sectors are

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[3] Five more schools have been invited to join in sending candidates for Corps 94: Georgetown, Purdue, Texas (Austin), USC, and Vanderbilt.

assisted, from agriculture to manufacturing to services, such as transportation and tourism. PBAS/3P employs 36 staff in its offices in Warsaw and Poznan with satellite offices in Bialystok, Gdansk and Katowice.

Originally, PBAS intended to help develop bankable investment proposals for SMEs which needed additional financing yet were unfamiliar with how to prepare these proposals. The idea was to help these enterprises present their proposals to financial institutions with donor-sponsored credit lines targeted for SME development. PBAS was to provide management and technical advice as needed. In reality, PBAS has had quite a different experience. PBAS discovered managers had little information on markets, competition, and even in their own true financial condition. Lack of information also made the necessary task of due diligence almost impossible, much to the dissatisfaction of financial institutions.

As a result of this experience, PBAS has changed its focus and more attention is being given to preparing firms for technical assistance and future financing through implementing new marketing and management approaches. To achieve this on a sustainable basis, the key aspect of the PBAS program is now the training of future business consultants. PBAS utilizes local Polish consulting firms and individuals on each assignment as appropriate. Consultants have the opportunity to gain additional experience by working as part of an international team on individual assignments. PBAS has also set up training seminars for local consultants on specific topics such as financial analysis and accounting, geared to the needs of SMEs.

Since 1991, PBAS has trained about 250 Polish individuals who are now working as local business consultants. PBAS recognizes that its long-term viability depends upon increasing its earned income and lessening reliance upon foreign donors. Its shortfall for the first 18 months of activity amounted to $2.8m. Although PBAS hopes for this shortfall to be reduced in the future, it is not clear what the long-term has in store. At the end of the third quarter of 1993, PBAS/3P was involved in 49 assignments with 46 companies representing a diversity of sectors and locations throughout the country. Potential clients must submit a request from services from PBAS either for a financial advisory proposal or a technical advisory assignment. In both cases an initial "front end" fee is charged and at the completion of the first phase of the work, a "document" fee is charged. Fees vary according to the complexity of the assignment and the client's financial situation. Both fees have varied between $500 and $5000. In addition, a "success fee" is charged if finance is received or a specific business objective is reached. These fees may be converted into quasi-equity or other forms of profit sharing arrangements. At the end of 1992, PBAS had earned $86,800 fees in cash and $15,000 in shares.

Peace Corps

In November 1990, the Peace Corps established a European Business Development Program for Central & Eastern Europe and the Baltic countries through an Interagency Agreement with A.I.D. The program aims to contribute to the development of free market economies by providing technical assistance, training, and business information through local public and private organizations.

Peace Corps' CEE Business program focuses on meeting three key constraints to SME sector growth: 1) lack of business management expertise and experience; 2) lack of privatization strategies and expertise at local government level; and 3) lack of financial services for the private sector.

To address these issues, Peace Corps' program aims to strengthen local government institutions and democratic practices, promote private sector businesses, and improve quality of life. A description of some selected Peace Corps activities is mentioned below. It is not an exhaustive list, yet provides a brief sample of the range of activities Peace Corps is undertaking in the region.

- Throughout Central and Eastern Europe, the Peace Corps' Small Business Advisors are working to provide institutional and managerial support to the EC-Phare sponsored Enterprise Support Centers. Volunteers provide assistance in preparing business plans required for application of EC-Phare loans. Business advisory services are also provided to entrepreneurs starting or expanding businesses.

- In Bulgaria, the Peace Corps has initiated six Multi-Link Resource Centers (MLRCs) currently operating in six cities outside the capital, plus 11 smaller centers. These centers serve as local clearinghouses for information on English teaching, small business development, and environmental protection. Volunteers are currently working with banks and municipal governments, and are assisting the MLRCs. One volunteer in Plovdiv has trained over 150 bankers in 60 different banks.

- The Free-Enterprise Transition Consortium (FETC) of Krakow, Poland was created in 1993 to support Poland's transition to a free market economy by linking local expertise with the technical assistance provided by Peace Corp's Business Advisors. The FETC provides training, formulates and distributes case studies, and maintains a Privatization Database.

From the beginning of their activities in FY 1992 projected through FY 1994, the Peace Corps will have fielded 252 Small Business Advisors to ten countries in Eastern & Central Europe and including the Baltic states.

Partners for International Education & Training (PIET)

Created in 1982, PIET is a joint venture of four U.S. PVOs: the Asia Foundation, the African-American Institute, World Learning, Inc., and AMIDEAST. Offices of both A.I.D. and PIET in Central and Eastern Europe and the Baltics work with local business associations and groups to recruit entrepreneurs to the U.S. for on the job training with U.S. businesses. These participant training programs in the U.S. are usually three to four weeks in length.

The purpose of the program is to help entrepreneurs better understand the American economic system and to develop personal and professional relationships with American business owners. The program aims to equip a broad base of leaders and professionals in the region with improved

skills and practical knowledge to support democracy, free enterprise, and enhance quality of life. PIET has established regional offices in Warsaw and Budapest, with field offices in their other five CEE countries of operation. PIET staff work with local business associations, other A.I.D. programs, other donors and groups to recruit entrepreneurs for training. Prospective trainees are interviewed and selected on specific criteria, such as English ability, high potential impact in their communities and organizations, middle management status or higher, proven experience as a business owner or manager, and interest in improving business operations.

PIET then identifies American businesses to host the entrepreneurs and makes the necessary arrangements for the U.S. visit with business leaders, educators, U.S. government officials, and others active in the U.S. business community. Each program is individually tailored to the training needs of the participant.

There are two administrative components of the PIET program:

- Entrepreneurial Management and Executive Development Program (EMED): EMED is the umbrella for the business exchange program between the U.S. and Hungary, Poland, Bulgaria, Slovakia, Romania, Latvia, and Lithuania. It's purpose is to enhance management skills and practices among business owners and senior managers of businesses in CEE. EMED has a country director in each of the seven CEE countries mentioned above.

- Participant Training, Project for Europe (PTPE): Under PTPE, PIET is able to operate its core activities, such as staffing of local offices and related administrative expenses.

From FY 1993 through mid-1994, PIET has trained 192 individuals from seven CEE countries. PIET anticipates receiving approximately 33 more trainees by end of FY 1994, for a total of 225 trainees. To date, training has occurred mainly in the computer and tourism industries.

World Council of Credit Unions (WOCCU)

Based in Madison, Wisconsin, WOCCU is an umbrella organization comprised of community credit unions from around the globe. It has been active in Poland since 1992 in establishing a credit union movement. Its Poland program can be divided into the following four general groups of activities:

- Credit Union Growth and Development: WOCCU has been involved in the development of a specific Credit Union Act to be adopted by the Polish Parliament. Passage of this Act is the fundamental legal basis for true credit unions to be able to function as they do traditionally elsewhere around the world. The act will authorize key credit union activities which cannot be undertaken under current law, such as the formation of community credit union organizations.

- Foundation/Association Self Sufficiency: The Foundation for Polish Credit Unions (FPCU) was formed as a non-profit charitable and educational foundation to support development of the credit union system in Poland. To this end, the FPCU carries out

promotion, training, legal, and legislative functions to support this development. WOCCU has also been active in establishing a National Association of Cooperative Savings and Credit Unions (NACSCU) to represent the national interest of Polish credit unions.

- Credit Union Safety and Soundness: FPCU is assisting in setting up a Stabilization Fund as an external service to credit unions. The purpose is to create depositor confidence in credit unions by protecting member savings. It is not government deposit protection insurance, but is created by collective credit union deposits placed in a pool of funds administered by elected credit union representatives. This resource pool enables the Fund to provide its services to credit unions in financial distress.

- Education, Information, and Training: In September 1993, a Credit Union School was established in Gdynia which offers a two-year, licensed, credit union course. In addition, courses are offered in three levels of credit union training, as well as specialized courses. WOCCU provides seminars to inform communities about credit unions, their services, and necessary steps in their formation.

As of April 1994, WOCCU had established 119 registered credit unions in Poland, of which 67, or 56%, were fully operating. This represents a total of over 44,000 primary members.

2. Objectives and Targets

Objectives: The 1800023 portfolio aims to provide the technical assistance necessary to support the growth of SMEs and development of competitive markets in Central and Eastern Europe. As consistent with the SEED Act, the objectives of the overall 1800023 portfolio are to:

- Assist in the transition to a free market economy.
- Assist in development of a democratic society.
- Prepare state-owned enterprises (SOEs) for privatization.
- Support an economic environment more conducive to foreign direct investment.

A related objective of the portfolio is to utilize U.S. assistance resources whenever possible to bring in private capital, goods, services, and expertise to the CEE. This implies that the U.S. assistance program is expected to help the U.S. private sector take advantage of commercial opportunities in the region. Initially, several grantee programs were active in this area. For example, IESC initiated their Trade and Investment Services program to help link CEE and U.S. companies for cross-trading opportunities. Currently, these trade-related activities of the portfolio have diminished due to changes in priority of A.I.D. programming.

Targets: Each project within the portfolio has their individual programmatic targets with A.I.D. under their own grant agreements. The voluntary-based programs such as IESC, CDC, MBA Enterprise Corps, and the Peace Corps, have targets for numbers of volunteers fielded and/or number of projects completed for each country of operation. PIET has targets for numbers of

trainee participants in training programs. The other programs involved in policy reform and institutional strengthening have targets such as adoption of new legislation, number of organizations assisted, or changes made by organizations as a result of program interventions.

3. Activities

In order to assist in the transition to a market economy and the development of a strong private sector, programs under the 1800023 portfolio are implementing projects in four main activity areas:[4]

- Enterprise-level technical assistance (TA), both short-term and long-term.
- Institutional development.
- Policy, regulatory, legal reform, (including the financial sector).
- Training.

The table below shows these key activity areas for each of the ten grantees operating under the 1800023 portfolio.

Table 8: Key Activities of 1800023 Program Portfolio

Activity	1800023 Grantee or Contractor									
	CDC	CIPE	IESC	Gemini	IRIS	MBA	PBAS	Peace Corps	PIET	WOCCU
Short- Term TA	✓		✓							
Long- Term TA						✓		✓		
Policy Reform		✓		✓	✓					✓
Inst'l Devel		✓		✓			✓	✓		✓
Training							✓		✓	✓

Funding levels and countries of operation for each implementor are presented earlier in Chapter I.

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[4] This grouping was chosen by the team in conjunction with A.I.D., in order to highlight training as a specific activity area. We found this grouping more illustrative than the areas scoped out in earlier 1800023 project documents: 1) advancement of privatization and enterprise restructuring, 2) provision of capital and/or technical assistance to new entrepreneurs, 3) removal of legal and regulatory constraints to entrepreneurship, and 4) support for development of the financial sector.

4. Cost to A.I.D. per Volunteer per Week - Firm Level Technical Assistance Programs

Per the scope of work, the strategy team was asked to present data on the cost effectiveness of different programs under 1800023. The tables below detail the average cost to A.I.D. of a volunteer-week for each of the four volunteer-based programs offering firm-level assistance in the CEE. These are: the MBA Enterprise Corps, and Peace Corps, which provide technical assistance on a long-term basis; and IESC, and CDC, which provide short-term technical assistance.

These figures reflect the calculated average weekly cost to A.I.D. only, and do not represent total program costs. Each grantee has other funding sources to cover their total costs of fielding volunteers. The figures are based on a ratio of total A.I.D. funds expended and an average number of volunteers fielded for a given fiscal year. Detailed notes and explanations are provided with each table.

Table 9: Per Week Cost to A.I.D. for MBA EC Volunteers

(Based on average assignment length of 15 months)

Fiscal Year	Funds Used	No. of Volunteers	Volunteer Weeks
1991	$491,370	44	2,640
1992	$769,588	67	4,020
1993	To 5/31/94: $1,087,276	73	4,380
	Total (est.): $1,358,856		
TOTAL:	$2,619,814	184	11,040
Average per Week Cost			$237.30

Source: MBA Enterprise Corps Report, July 1994

The MBA Enterprise Corps provides recent MBA graduates who volunteer for 15 months plus undergo two months of relevant language training. From 1991 through 1994, these numbers include 55 volunteers in the Czech Republic, 32 in Hungary, 72 in Poland, and 25 in Slovakia, a total of 184. Three MBA Corps volunteers working in Bulgaria have been excluded since they are not funded under the 1800023 portfolio but by the Bulgarian-American Enterprise Fund.

Other costs to the MBA Enterprise program are borne by matching and in-kind contributions by corporate sponsors, universities, and in-country client contributions of housing, local salary, and other benefits. For example, each of the 22 member schools of the Corps spends approximately $5,000 per year in the marketing, recruitment, and selection of its MBA applicants.

Table 10: Per Week Cost to A.I.D. for IESC Volunteers

Fiscal Year	Funds Used	No. of Volunteers	Volunteer Weeks
1990	$ 59,691	9	66
1991	$3,658,539	137	728
1992	$6,574,732	346	1,209
1993	$5,275,782	197	1,551
1994 (thru Q1)	$ 721,545	150	887
TOTAL:	$16,290,289	839	4441
Average Cost per Week			$3,668

Source: IESC Report, July 1994

The above figures include IESC's Technical Assistance (TA) and Trade and Investment Services (TIS) activities from 1990 through June 30, 1994. IESC normally tracks outputs in terms of projects completed, but for consistency, the information in this table was compiled to represent actual numbers of volunteers sent to the field, and the average length of their stay. IESC's activities were temporarily suspended from December 1992 through June 1993 due to a funding freeze. Thus, the 1993 figures are lower than the average for 1992. In addition, IESC has been phasing-out in several countries since March 1994.

Table 11: Per Week Cost to A.I.D. for Peace Corps Volunteers

(Based on 2-year assignment, or 104 weeks)

Fiscal Year	Eur Bus Dev.	Bulgaria IAA	Poland IAA	Sub Total	Volunteers
1992	$144,159	$102,986	$40,634	$287,779	79
1993	$107,288	$68,694	$300,058	$476,040	91
1994	$702,905	0	$273,900	$976,805	173
TOTAL:	$954,352	$171,680	$614,592	$1,740,624	343

Expended	Volunteers	Volunteer Weeks	Average Weekly Cost to A.I.D.
$1,740,624	343	35,672	$48.80

Source: Peace Corps Report, July 1994

The above numbers represent an average number of volunteers for each fiscal year. The average length of a volunteer's assignment is two years, or 104 weeks.

It is important to note that Peace Corp's Small Business Advisory Program receives from A.I.D. only a small portion of funding for its activities in the CEE region based on its Inter-Agency Agreement. A.I.D. funds materials, training costs and some procurement items. Thus, Peace Corps' cost to A.I.D. per volunteer-week of $49 is understandably much lower than the other volunteer-based technical assistance programs described in this section.

Table 12: Per Week Cost to A.I.D. for CDC Volunteers

(Based on average of eight weeks per volunteer assignment.)

Fiscal Year	Funds Used	No. of Volunteers	Volunteer Weeks
1992	$700,000	85	680
1993	$2,400,000	170	1360
1994	10/1/93 - 3/31/94: $700,000	0	
	4/1/94 - 9/30/94 (est): $780,000	60	480
TOTAL:	$4,580,000	315	2,520
Average Cost per Week			$1,817

Source: CDC Report, July 1994
Figures rounded to nearest $10,000

In 1991, CDC received A.I.D. funds initially only for Clearinghouse operations. While direct Clearinghouse expenses have been excluded from the figures above, there are some indirect costs that could not be separated. In 1991, CDC used $290,000 to run Clearinghouse operations and to establish the CAP program. Volunteer based programs did not start until 1992.

Due to a funding freeze, CDC ceased its volunteer operations between October 1, 1993 and April 22, 1994. During this period, CDC underwent restructuring and renegotiated their grant with A.I.D. CDC restarted its program on April 22, 1994 and incurred the associated costs of recruiting advisors and marketing to potential clients. The total number of volunteers in the table excludes 15 long-term Entrepreneurs in Residence.

The comparison of costs to A.I.D. for each of these four programs is presented in Table 13.

Table 13: Summary of Per Week Costs to A.I.D. for Technical Assistance Volunteers

IESC	Citizens Democracy Corps	MBA Enterprise Corps	Peace Corps
$3,668	$1,817	$273	$49

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Discussion

As the above table indicates, the cost to A.I.D. of fielding one short-term IESC volunteer for one week is more than double the cost for a short-term CDC volunteer. This is mainly due to the fact that CDC bears a greater share of the total cost of fielding volunteers than does IESC. CDC has mainly accomplished this by requiring their volunteers to pay their own daily expenses while overseas and by providing no additional support to spouses who accompany them.[5]

The weekly cost to A.I.D. of a Peace Corps volunteer for two years is much less than fielding an MBA Corps volunteer for 15 months. Since the majority of Peace Corps funding comes from its own funding sources separate from A.I.D., this large cost difference is apparent.

While cost comparisons are useful, it must be understood that there are differences between programs. IESC volunteers are retired executives with extensive technical experience. They provide direct firm-level assistance typically for two weeks to three months. This is in contrast to MBA Corps volunteers who are recently graduated MBA students who work at the firm-level for 15 month assignments. While these graduates lack the depth of experience of former business executives, they can offer recent innovations in management and business issues currently taught at top U.S. business schools.

In contrast to the other volunteer-based programs under 1800023, the Peace Corps has focussed less on direct firm-level assistance. Instead, their expertise is mainly targeted to the EC-Phare sponsored Enterprise Support Centers throughout the region. Often working without supervision in remote areas, these volunteers offer a combination of skills in business management, organizational development, strategic planning, fund-raising, and other tools needed to support the activities of the Centers and the individual needs of local entrepreneurs. These Small Business Development activities are only a part of the larger Peace Corps program in operation throughout the region which includes provision of English training and other special resources.

B. Review of Other A.I.D. Programs That Contribute to SME Development

Although A.I.D. programs related to various aspects of private sector development in Central and Eastern Europe are financed through the regional Support for East European Democracy (SEED) Program, the activities have become more and more country-specific. Program interventions have often been driven by perceived windows of opportunity and through funding of programs proposed by various entities including A.I.D. officials, host governments, and US Private Voluntary Organizations (PVOs). It is understandable that, within the rapidly changing environment of CEE, it has been difficult for A.I.D. to formulate a strategy that deals with all aspects of the development of a functioning private sector in those countries. This has been particularly so with the myriad of actors (including donors and private sector interests, both for-profit and non-profit) entering the vacuum left by the cessation or diminution of activity by

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[5] For a detailed discussion of CDC host-country contributions and other cost issues, refer to "Volume Two Attachments: Summaries of 1800023 Grants and Contracts."

governmental bodies involved in the centrally planned economic systems of CEE.

This exercise has looked at the various actors in the process of transforming the economies and legal systems of CEE and tried to catalogue the efforts and activities of the major players in this process, and to both note and evaluate the activities of particular American institutions in supporting private sector growth. This was done to determine the role of SME development within the overall private sector development in CEE and to suggest a strategy for A.I.D. to follow in determining interventions which both build upon American institutional strengths and relate to the resources available to A.I.D. in addressing the problems of SME development in CEE. In addition, this study has tried to analyze the strengths and weaknesses of the various programs currently supporting SME development in CEE and to suggest a role for A.I.D. to play vis-a-vis the other major donors active in SME development that would complement, rather than duplicate, those efforts.

Many of A.I.D.'s activities in CEE touch upon SME development to some extent, since the overall programs tend to deal with the totality of the political structure and economy. However, those activities which impact upon SME development to the greatest extent tend to fall under "Economic Restructuring" and consist of five subcategories - agriculture/agribusiness, enterprise development, financial sector reform, legal reform and privatization. The general thrust and scope of these activities are reviewed below.

The description of A.I.D. activities which follows provides a "view from Washington" in that the principal sources of information for this section were interviews with A.I.D. officials in Washington and A.I.D. documents. Statistics on obligated funds were largely obtained from the SEED Act Implementation Report FY 1993 and supplemented with information from interviews.

(N.B. The information presented is a summary of the activities funded by A.I.D. and is intended to be indicative of the types of activities in which A.I.D. is engaged. Although attempts were made to be as complete as possible, some activities may not be mentioned.)

1. Agriculture/Agribusiness

Many of these activities funded by A.I.D. involve SMEs which are agriculture or agribusiness related. Most of the activities have been implemented by US PVOs or NGOs, including universities. The types of activities financed include the following:

- Farmer-to-farmer exchanges to acquaint CEE farmers with agricultural techniques and processes in the U.S. and involving visits by American farmers to CEE farmer and vice versa.

- Encouragement of joint ventures between U.S. private sector agricultural interests and CEE agricultural interests.

- Development of financing mechanisms for agricultural production and agribusiness activities.

- Development of markets in CEE for U.S. agricultural products, both inputs and end products.

- Technical assistance in improving agricultural and breeding production technology, in processing and packaging, and in marketing and market development.

- Technical assistance (TA) in establishing the legal system for registering private agricultural property.

- Training and TA for government officials regarding policy-making and regulation within a private sector agricultural framework.

- Assistance in the privatization of agricultural activities previously conducted by government or parastatal bodies.

Implementing organizations include ABS, ACDI, IFDC, Iowa Farm Managers Association, Iowa Farm Business Association, PIET, Pragma Corporation, Swiss Valley Farms, various U.S. universities (notably Iowa State, Minnesota and Wisconsin), and the USDA.

Total obligated funds as reported in the SEED Act Implementation Report FY93 for restructuring agricultural, agribusiness and agriculture development from FY 1991 through FY 1993 were $100.7 million. Of these, the largest recipients were Poland with $22.3 million, Bulgaria with $14.1 million and Romania with $8.7 million.

2. Enterprise Development

Following the breakup of the Soviet bloc, one of the first activities to capture the imagination of both governments and the private sector in the West was the development of Enterprise Funds (EFs) to encourage the growth of enterprises and to reinforce the entrepreneurial spirit in CEE. Some of these efforts were led by Americans with origins in CEE. The structure of these programs differ from country to country; but, initially, all tended to utilize equity investments with credit as an adjunct and to emphasize investments in medium-sized businesses. In the past two years, credit programs for small and microenterprises have begun to spring up as well.

The general impression is that the success of these enterprise funds has been spotty, although A.I.D. sources close to the program believe that the credit funds to small and microenterprises seem to be working the best. A full-scale evaluation of the enterprise funds is underway and the results are expected in the fall of 1994. Two key issues are the impact and the long-term sustainability of the enterprise funds. Although the enterprise funds are generally run through locally-operated organizations, there has been substantial supervision by Americans (frequently of the same national origins where the funds are located) in the decision-making apparatus of the funds. Advisors from IESC and the MBA Enterprise Corps have collaborated closely with the EFs to provide TA to SMEs receiving monies from these funds. Peace Corps volunteers sometimes work in cooperation with the EFs as well. Training of bankers in credit analysis has been a related activity of the enterprise funds.

Other than finance, the key activities funded under this window involve direct training and TA to enterprises, frequently of an intensive nature. Another related activity, the Eastern Europe Business Information Center (EEBIC) in the Department of Commerce, provides information on business opportunities for Americans in CEE. In Poland, A.I.D. has also contributed to the financing of the International Finance Corporation's Polish Business Advisory Service (PBAS), which is also supported by the EBRD. OIC activities in Poland also involve support to the creation of small businesses. In addition, the Entrepreneurial Management and Executive Development Project (formerly RITE) managed by the PIET project, provides training to SMEs through exchange visits with U.S. companies.[6]

The overall level of effort of A.I.D.'s enterprise development activities to date totaled $32.1 million in obligations for TA to enterprises[7] and $281.3 million in obligations for enterprise funds (as reported in the SEED Act Implementation Report FY93). Poland has received the lion's share of these efforts with 46.7% of the technical assistance and 67% of the EF obligations. Other major recipients are Hungary, the Czech Republic, Slovakia and Bulgaria. LOP funding for EFs currently totals about $440 million with funds for the Baltics, Romania and Albania in the pipeline for $50m, $60m and $30m respectively.

3. Banking/Financial Sector Reform & Capital Markets

Prior to the establishment of a private sector in CEE, the banking sector principally had two functions - providing central banking services, e.g., foreign exchange and investment of government monies and serving as a deposit-taking institution for individuals with disposable income and allocating credit to governmental bodies and parastatal industries. There was typically very little competition among banks and an insignificant amount of money, if any, was lent to private sector enterprises. Consequently, bank officials had little need to learn credit appraisal techniques for evaluating risk factors and determining loan terms. Likewise, with the absence of a need for private sector financial markets, formal capital markets did not exist.

Now, with the transformation of banks into more typical Western models, banks need to understand how private, free market banking works and how to compete with other banks. A related need is for government officials responsible for bank regulation to understand both when and how to regulate the sector in order to assure that banks can function effectively in a free market environment and how to assure that banks do not take on excessive risks which can deplete the capital base in a country and drive private investment underground. Most banks to date have erred on the side of conservatism and have felt uncomfortable lending to private sector, except, perhaps, to old cronies who were former heads of state-run enterprises.

To address this need, A.I.D. has concentrated its efforts to assist financial sector on two main fronts:

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[6] Both PBAS and PIET are funded under 1800023. See Chapter II.

[7] See Chapter I and II for a description of these activities.

- TA and training to Ministries of Finance and Central Banks in economic policy analysis, public finance, bank supervision, bank consolidation and privatization, monetary policy, credit administration, bank clearing and payments, tax policy, the formation of capital markets, etc.

- TA and training to commercial banks on modernization of banking practices, credit appraisal techniques, joint venture lending, portfolio development, international finance, mortgage banking, branch banking, stock & bond underwriting, etc.

A.I.D. is implementing its efforts through a regional program that is adapted to meet specific needs in each country. A key issue to be addressed through this program is how to motivate banking officials both to privatize their operations and to provide a larger proportion of their credit to the private sector. This is a particular concern within the context of limited funds, especially foreign exchange, throughout these economies.

In addition, A.I.D. is currently exploring the potential for a loan portfolio guarantee program to be established in one or two CEE countries. Concern was expressed about its suitability to the existing banks in those countries. A representative of the LPG office visited Hungary last year to determine if a loan portfolio guarantee program might be considered there. They feel strongly that it would only work if it were coupled with extensive training of bank officers administering the LPG and would benefit from the presence of a long-term advisor at the bank chosen.

Organizations implementing these financial sector reforms and capital market establishment include the Department of the Treasury, FSVC, KPMG Peat Marwick, and the Securities Exchange Commission.

Total funds obligated directly to financial sector reform (listed under "Bank Training (Treasury)" in the SEED Act Implementation Report FY 93) were slightly under $7 million. However, we were informed that funding for some other financial sector reform related items may be listed under privatization line items. We were also informed that LOP funding for financial sector reform totals currently approximates $28 million.

4. Legal Reform

Two major components of A.I.D.'s efforts in CEE are strengthening democratic initiatives and economic restructuring. Legal reform is a critical part of both of these components. Without a functioning legal system, a democratic system of government cannot operate. This runs all the way from the ways laws are formulated, to their enforcement, to legal documents relative to contractual and trade relationships, to title for private property, to methods for understanding legal obligations and obtaining legal counsel, to the resolution of disputes via formal mechanisms (such as courts) or informal mechanisms (such as arbitration).

In other words, the legal system could be compared to the skeleton of a democratically functioning government and a free market economy. Without the legal elements in place, governmental decisions and trading become somewhat of a free-for-all where assumptions must be made about relationships which may prove to be unfounded. The end result is an uncertainty

in relationships, both societal and commercial, which often leads to ineffective government institutions and black market trading.

A.I.D. recognizes the importance of a functioning legal system to implement many of the reforms necessary to transform CEE societies from transitional entities and conditions to permanent, democratically-run governments and free market economies. Numerous individuals engaged in SME development in CEE emphasized the overriding importance of a functioning legal system to be able to conduct business in a profitable manner. The lack of legal certainty is clearly one of the key obstacles to SME development in CEE. A.I.D. has principally used training and technical assistance to different to support various areas of reform (this description deals mainly with commercial law reform activities rather than reform vis-a-vis political institutions):

- Training and TA, including workshops and internships, on various commercial law topics such as commercial dispute resolution techniques, government procurement systems, domestic and foreign investment laws, joint venture contracts, privatization issues, international commercial transactions, intellectual property rights, ethics in government, economic competition laws, etc.

- Training and TA in establishing or strengthening indigenous bar associations to advocate legal reform and to build training capacities.

- Training and TA to the court systems in modernizing court procedures and developing compensation systems that will encourage legally qualified individuals to serve as judges.

- Academic training and professional internships for lawyers and law school professors as well as assistance in improving legal training through law schools.

- Assistance in drafting legislation for securities markets, property registration, telecommunications, etc.

- Training in negotiation techniques, particularly for negotiating concession agreements and other investment contracts, for negotiating the sale of State-owned enterprises, and for international agreements.

The targets of the training and TA have been various ministries and government agencies, bar associations, law schools and the court systems.

In Poland, particular legal issues relative to SMEs have been addressed through the GEMINI and IRIS Projects both being funded under 1800023 (see section above). A G-24 Task Force was established under the aegis of the Minister for Small Business Development. Much of the progress on these issues will benefit the private sector as a whole, including the drafting of a collateral law.

An important issue voiced by A.I.D. officials was concern that the legal reform be gradual and "organic", i.e., that legal reforms reflect ownership of the ideas and principles they embody by the

society at large, and not be viewed as something imposed from abroad. A.I.D. officials responsible for legal reform in CEE are now in the process of undertaking a review of their activities to determine the feasibility of a more strategic, regional approach.

Organizations implementing these activities include the ABA, GEMINI (under 1800023), the Departments of Commerce and Justice, the Federal Trade Commission, IDLI, the SEC, the Universities of Maryland/IRIS (1800023) and Wisconsin.

Funds obligated to date for commercial law reform activities have totaled $24.3 million. Regional programs have accounted for $9.5m and the next largest recipient has been Poland with $4m.

5. Privatization

With the end of centrally-controlled economic structures and industrial production as the exclusive domain of governments, Western governments have tried to provide assistance to CEE governments on privatization of industries and other activities which could be better performed by the private sector. This has been a difficult and complex task. Without going into detail on the types of problems encountered in this area, suffice it to say that opportunities do exist for SME development through this vehicle. For example, in restructuring large industries, some activities might be spun off to be performed by SMEs through subcontracting arrangements, much like has been done in the auto industry in the U.S. or in the electronics industry in Asia. Another example is demonstrated by A.I.D.'s experience in Poland where government agents performing artificial insemination services for animal breeding were trained to become private entrepreneurs providing the same services for a fee.

A.I.D. officials expressed the opinion that smaller businesses run by government are considerably easier to privatize than larger industries. What is needed in this case is training on how to operate a small business in a profitable manner within a competitive, free market economy.

A.I.D.'s privatization efforts include extensive assistance to ministries and government agencies in assessing privatization feasibility of different industries, valuing the assets and financial position of industries, legal documentation, business plan development, restructuring of accounting systems, attracting international investment, encouraging joint ventures, structuring deals, conducting public awareness campaigns on privatization issues, arranging for privatization finance including employee buyouts, designing voucher systems for share purchases, establishing mutual funds for share purchases, etc.

Assistance has been provided in the areas of finance, law, engineering and other technical advice to specific industries, marketing, and other specialized topics. Implementing organizations include Coopers & Lybrand, Crimson Capital, Development Alternatives, Inc., Deloitte Touche, Chemonics, IESC, KPMG Peat Marwick, and Price Waterhouse.

Funds obligated to date for privatization activities total approximately $81.7 million. The principal recipient countries include Poland with $23.1m (28%), Czech Republic with $19.2m (23.5%), Hungary with $12.2m (15%), Slovakia with $7.2m (9%), and Bulgaria with $5.4m (7%).

C. Review of Other U.S. Non-Governmental Organizations Implementing A.I.D.-Financed SME Development Activities

The following summaries of programs run by U.S. NGOs involve SME development but have been financed by other A.I.D. offices outside of the 1800023 portfolio. This list is provided to show the array of SME development activity in which various NGOs are engaged. Although it is quite comprehensive, a few specific activities may have been unintentionally overlooked. Many of these activities are agriculture or agribusiness-related and are financed as part of the agriculture development activities of A.I.D. Others have received funding from central grants or through other channels. The NGOs are presented in alphabetic order, not in order of importance. Information on these programs was received from interviews in Washington, D.C. with representatives of these organizations and from various documents.

1. Agricultural Cooperative Development International

Agricultural Cooperative Development International (ACDI) was established in 1963 as a non-profit training, technical and management assistance organization created by leading U.S. agricultural cooperatives and farmer organizations. It has 47 organizational members from across a broad spectrum of the agricultural sector in the U.S. Its mission is "to improve commercial and credit services to developing country farmers by responding to the needs of agribusinesses, agricultural cooperatives, farm credit systems, and supporting government agencies."

ACDI's program areas include agribusiness and trade promotion, credit systems, agricultural resource management, food for development and training and exchange programs.

Most of ACDI's activities in CEE began in 1991. A considerable amount of their work has involved extensive training of CEE farmers both through visits to farms and agribusinesses in the U.S. and through visits of farmers and technical experts to CEE countries. Much of this has been done in conjunction with Volunteers in Overseas Cooperative Assistance (VOCA).

ACDI has concentrated in Poland and Hungary in the past, although it is now broadening its activities to other countries. It recently established a regional office in Romania and has field offices in Albania, Macedonia, Romania, Hungary, Poland and Bulgaria. It has three principal projects financed by A.I.D. -- a Cooperative Bank Development Project in Poland, one of the Restructuring Agriculture and Agribusiness Private Sector (RAPPS) programs in Hungary, and the Agriculture Business Exchange Program for CEE (which it administers with VOCA). In addition it is assisting the World Bank to establish a rural cooperative bank in Romania to provide credit to rural areas through the privatization of the Bank for Agricultural Development.

- Cooperative Bank Development Project: This project in Poland involves a national network of over 1600 rural cooperative banks. ACDI has provided a model for rural bank privatization and the establishment of regional clearing house banks. This project reflects ACDI's extensive expertise in rural coop banking (the major farm credit and cooperative banks in the U.S. are members of ACDI). This four year project (1991-95) has funding of $2.4m.

- RAPPS/Hungary: This program attempts to match private Hungarian agribusinesses with similar U.S. enterprises in order to facilitate linkages between the firms and to provide management training and technology transfer to the Hungarian firms. During the first year, 26 Hungarian firms were matched with 26 American companies. The project pays for transportation and per diem, but salaries and fees are not paid. This program has funding of $4.5m for 3 years (1992-95).

- Agriculture Business Exchange Program: This program involves extensive visits by CEE farmers and agriculturalist to view agriculture and agribusinesses in the U.S. as well as visits by U.S. agricultural experts to CEE countries to advise on businesses there. Topics have included agricultural credit, management and marketing, and policy. About 120 agriculturalists from CEE have received training in the U.S. under this program and more than 700 persons have attended in-country training workshops. This project has been funded for $12m over the three years since it began in 1991. It is currently being renewed with VOCA as the prime contractor and ACDI as subcontractor for the next four years and will be funded with $27m.

Although the support of SMEs is not an explicit objective of these programs, it is implicit in their implementation, particularly as regards agribusiness activities.

2. CARESBAC

CARESBAC is the acronym for CARE Small Business Assistance Corporation which was established as a non-profit subsidiary of CARE in 1989, largely to explore the potential of debt-for-development exchanges. Over the years, CARESBAC has moved on to develop a mechanism for supporting SME development, particularly in CEE. It has also broadened its board membership to include the Citizens Democracy Corps (CDC), the Citizens' Network for Foreign Affairs (CNFA), the Environmental Enterprises Assistance Corps (EEAC), the International Executive Service Corps (IESC), Volunteers in Overseas Cooperative Assistance (VOCA) and CARE.

CARESBAC-Polska was the first tangible product of CARESBAC's efforts when it was set up in Warsaw in December 1991 as a Polish investment company with financing from a direct, draw-down loan facility from OPIC for $2.3m. This was supplemented in March 1992 with a A.I.D. grant of $750,000 in local currency resulting from sales of U.S. food aid. With these funds, CARESBAC-Polska began its operations. Since that time CARESBAC offices have been established in St. Petersburg in Russia and in Sofia, Bulgaria. CARESBAC also has submitted a proposal to A.I.D. for funding the establishment of three regional offices in Poland.

CARESBAC's objective is to assist in the development of SMEs through the provision of finance and technical assistance. It does this primarily with infusions of equity capital (although some loan credit is used as well) through joint venture arrangements and with extensive technical assistance to the local partner in CEE. This assistance assures the effective functioning of the

enterprise through management, production technology, accounting, marketing and other related business skills training.

Most of the results of CARESBAC's efforts are evident in Poland since the other two offices have been functioning for less than a year. According to a publication prepared by CARESBAC, CARESBAC-Polska has had the following results between its inception in March 1992 and January 1994:

- Completed investments in 9 Polish SMEs and approved four more investments now in the process of closing.
- Invested a total of $1.8m (including zloty equivalents) in completed investments with an additional investment of $1.05m in approved investments.
- Created or saved a minimum of 296 jobs.
- Raised an additional $2.5m from EBRD in additional investment capital for Polish SMEs.
- Engaged or directly complemented the services of various U.S. volunteer and other NGOs.
- Trained 7 young Poles in financial analysis and venture capital investing.

3. Land 'O Lakes

Land 'O Lakes (LOL) is a very large, well known, multi-state, dairy cooperative in Midwestern U.S. LOL had participated in technical assistance to developing countries to a limited extent prior to its work in CEE. Now it is one of the principal U.S. NGOs working in the agricultural sector in CEE and the NIS. Officials of LOL said that 80% of their work to date has been in CEE and, of that, 80% has been in Poland. Its activities are all based on agricultural production or processing. LOL has been active in Poland since 1989. It had some activities in the Czech Republic, Slovakia and Hungary for a couple of years, but is no longer there since A.I.D.'s priorities have shifted away from agriculture in those countries, according to a LOL representative. They have other programs in Bulgaria, Romania, Albania and the three Baltic States, and will soon be starting a program in Macedonia.

LOL's entire portfolio amounts to approximately $23m worldwide in active multi-year grants received from A.I.D.. Of that, it has disbursed about $12m on its Poland program. A country-by-country description of LOL's work in CEE follows:

- Poland: LOL started working with dairy producer coops, then moved to milk processing and business management, and is now concentrating on feed and seed and other agricultural inputs. This is part of the RAPPS program. Over 34 training courses have been given for approximately 1000 participants. Over 60 Polish agribusiness leaders/farmers have served internships in U.S. agribusinesses

and farms. Other aspects of LOL's program include work with three Polish universities to strengthen their dairy curriculum, development of market information systems, and providing guidance to the dairy industry on government policies.

- Bulgaria: LOL's activities in Bulgaria are closest to the Polish model. They are focussing mainly on business development there rather than production and are working with coops or pre-coops. The World Bank is planning to collaborate with LOL to help develop a dairy production policy for Bulgaria. The Bulgarian-American Enterprise Fund has provided a loan to Milkway (a local dairy product distributor) to be onlent to farmers to purchase quality genetics to improve production.

- Albania: This program is on a different scale than the rest of CEE. LOL is focussing 100% on women dairy producers to improve dairy production, both quantity and quality. Ten Albanian field agents have been trained to conduct multiple training sessions for Albanian women across the country. By December 1994, it is expected that 3000 - 3500 women will have been trained. This system of private production will replace the former State dairy production system and help to increase the incomes of rural women and their families. A key problem to be resolved is to get the milk from the rural north to the urban areas in the south.

- The Baltics: LOL is working with a handful of processing plants in Estonia to improve operational efficiencies and marketing. In Latvia, LOL has settled on an approach similar to its Albanian program and is working to help develop the capacity of rural women to produce dairy products. The Lithuanian program is concentrating on assistance to the government on which dairy plants should be closed down and how to develop linkages between private producers and processors and between processors and government.

- Other Countries: LOL's work in Hungary, the Czech Republic and Slovakia entailed mainly training to milk producers in better production techniques and marketing.

4. National Cooperative Business Association

The National Cooperative Business Association (NCBA) was founded in 1916 as the Cooperative League of the U.S.A. (CLUSA) as the national trade association and membership organization representing the cooperative business community in America. Membership is open to cooperatives of all types as well as to individuals and other organizations interested in cooperatives. Cooperatives of all sizes are represented, from Fortune 500 companies such as the large producer cooperatives in California and the Midwest to small consumer cooperatives. Cooperative members are credit unions, housing coops, insurance companies, rural utilities, state associations, agricultural coops, etc. Over 100 million Americans and 45,000 businesses are members of NCBA.

The mission of NCBA is "to represent, strengthen, and expand the cooperative form of business and to link its members with organizations in the United States and around the world for mutually beneficial relationships." NCBA accomplishes its mission through membership conferences, educational programs, publishing books and documents, lobbying government at all levels for favorable cooperative legislation, and promoting cooperative development in the U.S. and around the world. NCBA also works through four affiliated organizations -

- The Cooperative Development Foundation (CDF) supports cooperative education and development in the U.S. and abroad.

- Cooperative Business International (CBI) helps cooperatives benefit from commercial trade opportunities around the world.

- The Consumer Cooperative Management Association (CCMA) provides a forum for discussion of industry trends and techniques.

- The Cooperative Action for Congressional Trust (Co-Act) is a political action committee which assists candidates for public office who support cooperatives.

NCBA's work in CEE has been mostly trade and investment related and has been managed by CBI. In 1991, NCBA, with the financial assistance of six U.S. cooperatives, created the American Cooperative Enterprise Center (ACE). Each of the six cooperatives committed to invest $25,000 per year for five years. A matching grant of $2.5m was received from A.I.D. to support the facility over the same five year period. The ACE Center opened its Prague regional headquarters in September 1992, with satellite offices in Slovakia, Hungary and Poland.

The ACE Center's purpose is to promote the sustainable success of agricultural business, particularly cooperatives, in the market economies of the Czech Republic, Slovakia, Poland and Hungary. This is to be accomplished through the development of joint ventures and trade among U.S., Polish, Hungarian, Czech and Slovakian cooperatives and small businesses while also providing cooperative training, technical assistance, marketing information, and development services. We were informed that a key aspect of these activities is to assist in providing access for U.S. cooperatives to the agriculture markets in CEE. Many of the cooperatives with which ACE works are former state-run cooperatives which are being privatized.

The objectives of the ACE Center are:

- To improve the marketing skills and profitability of ACE agribusiness clients by providing them access to markets, information and technical support.

- Develop client alliances which promote U.S. goods in Europe and increase regional trade among Central European countries.

- Improve the management abilities of ACE agribusiness customers by providing expertise in business planning, feasibility studies, finance, and organizational audits.

- Enhance the business opportunities of ACE agribusiness customers by linking them to the resources, staff, and distinctive competence of ACE partners in the U.S.

Examples of accomplishments to date include the following:

- Four joint ventures between U.S. coops and CEE coops are nearly established. The joint ventures underway will provide both equity capital and technical assistance to the CEE cooperatives.

- A U.S. agricultural coop is in the process of establishing a high quality, competitive animal nutrition system through a private coop in Hungary. When operational, it will provide on-going technical assistance and training to their farmer coop members.

- The ACE Center is assisting in marketing products from U.S. cooperatives in Prague, e.g., fresh fruits, juices, popcorn and processed products in Prague. Using a wholesale distribution center and a promotional display, these products are being test marketed.

- In cooperation with a U.S. genetics organization, the ACE Center is currently establishing a farmer-controlled artificial insemination cooperative from a core group of leading Polish farmers. They are focussing on products, prices and services that increase genetic choices for herd improvement.

- An American agricultural inputs cooperative has provided short-term credit to farmers in CEE to purchase their products in order to introduce these inputs to the market in CEE. Payment will be made at harvest-time.

The ACE Center expects to become financially sustainable through equity income, service fees, trading commissions and training fees.

5. Opportunity International

Opportunity International is a Chicago-based American PVO which has promoted microenterprise lending worldwide since it was created in 1970. It emphasizes an approach where it works with local partner organizations to develop revolving funds to provide small loans to microentrepreneurs. According to its 1993 Annual Report, Opportunity International operations made 16,797 loans for a total of $8.2m in 19 countries in 1993 (for an average loan size of $488). It claims that it has a 94% payback rate and that 66% of the loans go to women. Opportunity International also conducts training seminars in small business operations. It conducted 1,429 seminars for 23,624 participants in 1993. It received $4,3m in contributions and $535,000 in government grants in 1993.

Opportunity International started operations in Bulgaria and Russia in 1993. These are the only countries in which it is currently working in CEE and the NIS. Its program in Bulgaria was

established in July 1993 with funding of $500,000 from the Bulgarian American Enterprise Fund (BAEF) to set up a window for micro-lending. Subsequent commitments from BAEF now provide approximately $1.5m in loan funds over five years. Funds for operating costs have been received from various sources including general funds from Opportunity International and the British Know How Fund. The local organization formed to manage the loan funds is called the "Nachala Foundation," which translates into "Beginnings Foundation" in English. The fund is managed by a local board of directors and is directed by an American employee of Opportunity International.

During the first quarter of 1994 Nachala made over 50 loans totaling over $250,000 for an average loan size of $5000. They expect to make over 200 loans for a total of $1m in 1994. It currently operates out of three offices and targets people who are too small or too poor to borrow from financial institutions. The long-term goal is to provide a national credit program in Bulgaria with six to ten regional offices.

Proposals for similar programs in Albania and Macedonia have been submitted to A.I.D..

6. Volunteers in Overseas Cooperative Assistance

Volunteers in Overseas Cooperative Assistance (VOCA) was founded in 1970 as an international people-to-people volunteer organization committed to strengthening democratic institutions, enhancing economic opportunities of cooperatives and agriculturally-based enterprises, and improving the environment of rural communities.

Over the past twenty three years, VOCA volunteers have provided policy, technical and management advice and have worked in 104 countries in Africa, Asia, Latin America and the Caribbean, Central and Eastern Europe and the NIS. Types of projects include agriculture production, food processing and marketing, cooperative formation and strengthening, agribusiness development, farm management, agriculture extension and environment and natural resource management.

VOCA is headquartered in Washington, D.C. and has five regional recruiting offices in the U.S. and 25 overseas offices. Its principal source of funding is A.I.D.. It received a total of $10.6 million in program grants in 1993, of which most came from A.I.D.. The donated services from volunteers is estimated at 37% of VOCA's revenues ($6.4m). VOCA also receives program grants and contributions from U.S. corporations and foundations, overseas contributors and gift/donations from individuals in the U.S.

With the collapse of the communist governments in CEE and the NIS, VOCA's operations expanded dramatically. Prior to the early 1990's, VOCA placed about 100 volunteers per year in assignments around the world. In 1993, 600 out of a total of 763 volunteers served in CEE/NIS. Activities in the CEE/NIS now represents about 80% of VOCA's total program.

VOCA's efforts in CEE began in late 1989 with a field mission to Poland to assess agricultural development needs and opportunities in the emerging free market economy. Subsequently, VOCA received a $1.4m grant from A.I.D. to initiate a farmer-to-farmer program there. In April

1991, the program was expanded to include several other countries including the Czech Republic, Slovakia, Hungary, Bulgaria, Romania, Macedonia and the Baltic States. Funding was increased to $9.5m with the program to run until March 1994.

An evaluation of VOCA's activities in CEE under that grant was performed for A.I.D. by Management Systems International (MSI) in late 1993. Much of the description which follows was received from the report on that evaluation.

Under the grant from A.I.D., VOCA emphasizes five areas:

- Creation of new, commercially viable private agricultural cooperatives, producer associations and other agribusinesses.
- Enhancement of commercial performance of existing private agribusinesses, principally in marketing and processing.
- Privatization of state agricultural enterprises.
- Creation of agricultural credit institutions to provide credit and banking services for farmers and agribusinesses.
- Redirection of the government extension services toward the private farming sector.

VOCA follows a demand-driven approach by working with clients who have existing operations and who are making initiatives to improve their productivity and profit. Projects are identified through an in-country staff that pays frequent visits to rural areas, networks with other development organizations, and investigates "walk-ins" who seek out VOCA's assistance. In CEE countries, VOCA is well known, and receives several referrals for technical assistance and training. Most of VOCA's clients are small and medium-scale enterprises.

Clients share some project costs by providing co-workers, translators, and local ground transportation. VOCA covers major expenses such as international travel, housing and meals. The average cost per assignment in CEE for FY 1993 was $16,708. This represents all direct as well as indirect costs, including expenses for spouses who accompanied volunteers on 27% of CEE projects. As of January 1994, VOCA changed its policy and no longer covers the expenses of accompanying spouses, except in special circumstances.

Between 1990 and September 1993, VOCA projects in CEE were distributed among the various countries as follows:

Country	Volunteers
Poland	225
Czech Republic	90
Bulgaria	71
Albania	55
Latvia	51
Hungary	45
Estonia	39
Slovakia	35
Lithuania	26
Romania	12
Macedonia	12
Total	661

The evaluation performed in 1993 found that in all but a few of the 177 assignments reviewed, the clients had high praise for the skill and dedication of the VOCA volunteers. Recommendations made to clients by volunteers affected demonstrable changes in the operations of the client assisted, e.g., improved productivity, increased sales, larger profit margins, and improved services.

A.I.D. is currently renewing its grant to VOCA for an additional four years for a total of $27 million. ACDI will serve as a major subcontractor under this upcoming grant.

D. Lessons Learned and Their Implications for Future Program Directions

The following are lessons learned on A.I.D.'s experience to date in providing technical assistance to enhance the development of the SME sector in Central and Eastern Europe. These lessons are the result of over 230 interviews in ten countries throughout the region with A.I.D. grantees, volunteers, entrepreneurs, A.I.D. staff, government officials, local NGOs, business associations, and other donor representatives, as well as through document reviews.

Many A.I.D. grantees and other donors have been active in the region since 1990 and have established programs in most CEE countries. Their extensive field experience has provided the team a substantial core of knowledge on which to base these lessons learned. In addition, through field interviews, the team learned how grantees and other practitioners have adjusted or improved their programs based on their own lessons learned, through assessing their programs' successes and limitations in an environment of economic and political transition.

Some of the following lessons concern the needs and experiences of entrepreneurs at the enterprise-level. Others pertain to the role and effectiveness of institutions that serve the business community such as public sector institutions, financial intermediaries, and business advisory centers. Other lessons involve strengthening the policy, legal, and regulatory framework that

impacts private businesses. Each lesson is worth consideration as A.I.D. plans its future programming for SME development in Central and Eastern Europe.

1. Effectiveness of Various Forms of Assistance

Firm-Level Technical Assistance

At least half of the ten A.I.D. grantees in the 1800023 portfolio have provided technical assistance to individual firms, either private or privatizing. These grantees mainly provide technical assistance on a volunteer basis through industry or business specialists, whether retired executives, mid-career professionals, or recent MBA graduates. These grantees include Citizens Democracy Corps (CDC) and IESC, which provide short-term volunteers for an average of 2-3 months; and MBA Enterprise Corps and the Peace Corps, which provide long-term volunteer advisors from 15 months to two years respectively. The Polish Business Advisory Service (PBAS) also assists individual firms among its other activities in building a local consulting industry.

The following provides some insight as to the magnitude of firm-level assistance provided by these grantees to date[8]: 1) Since 1990, IESC volunteers have completed over 800 technical assistance projects to private and privatizing firms throughout the region; 2) approximately 75% of CDC's volunteers have participated in business or business-related assignments totalling over 260 in five countries since 1991; 3) over 200 MBA Corps volunteers have been assigned mainly to private or privatizing firms since 1991 in five CEE countries; 4) since 1992, the Peace Corps has fielded over 250 Small Business Advisors mainly to EC-Phare sponsored Enterprise Support Centers through the region.

Technical Assistance Needs of Entrepreneurs

Entrepreneurs throughout Central and Eastern Europe generally have strong technical skills, are well educated, and are experienced producers. This is partly due to the legacy of the communist era, given the social emphasis on training, education, and mass production. Despite their ability as capable producers, these entrepreneurs generally lack experience as managers and innovators. They also lack the necessary tools for running a business in a free-market economy such as financial management, pricing, and marketing strategies. Yet marketing and management skills are vital for entrepreneurs to succeed in the newly competitive marketplace. While firm-level assistance programs have promoted development of these skills, future programs need to continue to provide additional assistance in this area to ensure the continued growth of private enterprise.

The experience of A.I.D. grantees and other practitioners also indicates that firms in different stages of development have different technical assistance needs. While start-up firms need more basic business management tools, established firms have more specific needs in order to grow and compete, such as skills in organizational development, distribution, and information systems. In

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[8] For sources and more details on each grantee, see Volume Two Attachments, "Summaries of 1800023 Grants and Contracts."

addition, firms increasingly need more industry-specific information to upgrade technology and production methods.

This suggests that today, as more firms become established, firm-level assistance needs to be focussed and specialized, rather than general in nature.

Need for Information

Entrepreneurs constantly expressed the need for more information on markets, financial resources, potential investors, as well as technology and other industry-specific information. This information is crucial for firms to make financial projections, determine potential market share, design competitive strategies, and make other plans for modernization, expansion, or restructuring.

Some donor programs, local NGOs, and universities are actively mobilizing such information through local resource centers, libraries, and training programs. These programs serve an important role in the transition process by helping improve the capability of entrepreneurs. Yet many programs have limited resources and are unable to meet the demands of entrepreneurs. Such programs are often based only in the capital cities or available during business hours when entrepreneurs are busy with day-to-day business activities.

As information is crucial in the making of informed business decisions, additional resources should be allocated to help meet the information needs of entrepreneurs in the future.

Private vs. Privatizing Firms

Initially, A.I.D. grantees found few private entrepreneurs to work with given a newly emerging private sector. As a result, the privatizing state-owned enterprises (SOEs) were the key recipients for technical assistance. To date, many SOEs targeted for privatization which received technical assistance have not actually been privatized, nor are much closer to privatization than before. Many external factors outside the program's control has hindered the privatization process, such as cumbersome government policies and lags in the development of bankruptcy laws. With high debt burdens, inefficient production methods, and outdated equipment, many of these SOEs have little likelihood of future survival.

Now that the private sector is developing, grantees throughout the region have been able to assist a greater share of private firms. These firms are often more receptive to technical assistance and have a greater potential for continued long-term growth. These reasons suggest the need for A.I.D. to consider prioritizing assistance to fully private rather than privatizing firms.

Trading vs. Production Activities

In the earliest stage of economic transition, entrepreneurs have often first engaged in trading activities. Trading has been a fast way for entrepreneurs to meet new demands for consumer goods. Trading has also allowed easy entry into the marketplace. Most importantly, trading has enabled entrepreneurs to earn quick profits and accumulate savings for future business ventures.

For example, many entrepreneurs in Albania are actively involved in trading activities given the lack of local production capability.

In countries which are farther along in the transition process such as the Czech Republic, Poland, and Hungary, many entrepreneurs are now investing their accumulated capital from years of trading in new or expanded production activities. This is a positive sign, since long-term sustainability depends greatly on the ability of the private sector to produce marketable goods. Many entrepreneurs are also actively managing multiple enterprises and are providing new local jobs.

Trade has therefore been a good short-term strategy to generate capital for longer-term economic development.

Credit Issues

Bank credit, while important, has not always proven to be a key need for initial SME development in the region. The team found this to be true in each of the ten CEE countries visited. Many firms in the CEE have been started with limited, private capital and have now grown into multiple ventures. For example, in Albania, significant amounts of capital are remitted from nearly two million Albanians working abroad, and these funds are commonly used for business startups. As mentioned above, entrepreneurs throughout the region have also used savings mobilized through initial cross-border trading activities to fund additional enterprises.

While lack of credit does not appear to have been a key hindrance to start-up businesses, the need for credit or other financing is much greater for established firms seeking to expand or modernize. Yet, grantees throughout the region have found that capital infusion alone does not address a firm's fundamental need for sound business management, good planning, and financial control. With the help of appropriate technical assistance, many established firms requesting credit have been able to resolve cash flow shortages through improved collection of receivables, better financial management, and higher productivity. By imparting these important business management skills, grantees have provided entrepreneurs with useful long-term tools, and have often saved firms from taking on an unnecessary debt burden.

A more detailed discussion of lessons learned on financial issues in the CEE is provided later in the section entitled "Financial Sector Development."

Business Support Services

Throughout the world, an established service industry that can meet the needs of the business community is a major component of a thriving private sector. Such business support services help other businesses to solve problems, meet special needs, and stay competitive in the marketplace. These include consulting, accounting and market research firms, industry specialists, attorneys, as well as printing, photo-copying, communications, and other business services. Few business support services currently exist in Central and Eastern Europe.

One A.I.D. grantee, the Polish Business Advisory Service, recognized the need for local business support services after initially starting its operations in Poland as a public finance facility. After working with many private businesses, PBAS realized Polish firms were not yet ready to handle large new sources of funding. Firms still needed basic business management tools such as planning, cost accounting, and marketing. PBAS believed that a cadre of local trained business consultants could help provide businesses with these tools. As a result, PBAS changed the focus of its program to help develop an indigenous business consulting industry in Poland. By training local consultants, they are providing improved services for the growing business community. To date, dozens of new consulting firms of qualified Polish consultants have been established.

Training and technical assistance to the SME sector must continue to help build an indigenous supply of, and demand for, these and other business support services in the marketplace. This suggests an important target area for future A.I.D. assistance programs.

Long-term vs. Short Term Assistance

Several A.I.D. grantees, notably IESC and CDC, originally provided technical assistance to individual firms on a short-term basis. These assignments, with durations of two to three months, were designed to tackle specific problems at the firm level. It was believed that short-term interventions would give an initial boost to firms, and would allow A.I.D. to quickly gain an understanding of the constraints faced by SMEs.

After several years of working in the region, these grantees have learned that the needs of firms are more long-term in nature than originally anticipated. Many firms face multiple constraints at the firm-level as well as in the legal and policy environment in which they operate. Programs which initially worked with privatizing SOEs found they had complex management problems, given their large size, history of mismanagement, poor allocation of resources, and production inefficiencies. Given these long-term constraints, long term technical assistance is most appropriate to address them.

In response to these longer term needs of firms, several A.I.D. grantees have modified their approach to include more long-term interventions. For example, IESC has placed a long-term resident "mentor" in several countries to provide follow-up advice for prior clients and to train local advisors. CDC has also complemented its short-term assistance program by also providing "Entrepreneurs in Residence" in five countries who volunteer on a long-term basis.

Based on the lessons learned in the region to date, a long-term approach to technical assistance is still appropriate, and has a greater likelihood of achieving impact than shorter term technical advice.

Legal, Policy, and Regulatory Reform Efforts

Improving the policy, legal, and regulatory environment is critical for long-term success of SME development throughout Central and Eastern Europe. Several A.I.D. grantees in the 1800023 portfolio have been active in these reform efforts, such as CIPE, which operates in seven CEE countries, and WOCCU, GEMINI and IRIS in Poland. Their activities in this area include

GEMINI's involvement with Polish legislators in adopting an SME bill; IRIS's efforts in forming Polish collateral law; CIPE's work with local policy institutes and other advocacy groups; and WOCCU's efforts to adopt a credit union law in Poland.

These programs have mainly been active in policy and other reforms at the national level. Yet through their experience in the region, they have learned the importance of also focussing reform efforts towards municipalities and local government entities for potentially greater impact. In addition, they have learned the value of working with local business advocacy groups to affect policy change from the ground up. These and other lessons in legal, regulatory, and policy reform efforts in the region are detailed below.

Need for Improvements

Much progress has been made throughout the region in the development and/or revision of laws that support the development of private business and set the foundation for democratic society. These laws are being formed or updated with the help of A.I.D. grantees, advisors from the U.S. Treasury, ABA/CEELI, and the U.S. Commerce Department, among others. Their efforts have helped form laws which include civil and commercial codes, personal and corporate income taxes, property taxes, and laws on bankruptcy, collateral requirements, and foreign investment.

Yet, despite the progress made in the legal arena, there is still a need for continued improvement in the legal, policy, and regulatory environment to enhance the development of SMEs. Laws which ensure ownership of private property and right of sale must still be developed or clarified.[9] In many CEE countries, legal and enforcement procedures are not yet fully in place. Throughout the region, experience with due process is still limited, court procedures are still being developed, and legal jurisdictions must still be clarified. Also, several CEE governments have adopted an assortment of laws from different countries, reflecting the varied nationalities of foreign advisors. These laws must be better coordinated to reconcile possible conflicts due to their diverse origins.

Foreign assistance can continue to make a valuable contribution in forming the legal foundation for a free market economy, and improving the operating environment for SMEs.

Tax Policy

In order to generate needed revenues, CEE governments have adopted new taxes on licensed, private businesses. While taxes are a key requirement of civil society, many governments have adopted tax policies that are too burdensome for the emerging business sector. In addition to facing disproportionally high taxes, SMEs often receive few tax holidays or other pro-business incentives.

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[9] For example, right of occupancy in state-owned housing units in Poland has been granted to individual tenants. However, laws are not yet in place to ensure true ownership through legal title and right of sale.

High taxes are not only a financial burden especially for new businesses, but can cause inefficiencies as business owners misallocate time and resources to evade taxes.[10] As a result, businesses suffer, governments lose vital tax revenues, and firms undervalue their financial records, limiting their future accessibility to bank credit. Burdensome tax policies therefore can create a disincentive to business growth and an unhealthy environment for future business development.

A.I.D. programs can play an important role in helping policy makers to (a) understand the benefits of adopting tax policies more favorable to SMEs, and (b) implement needed changes to realize these benefits.

Approaches - National/Local Policy and Grassroots Advocacy

In the early stage of the transition process, foreign donors and others working to affect policy change in Central and Eastern Europe often worked with policy makers at the national level. This "top down" approach to policy reform was a logical starting point given the legacy of centralized government control and the lack of grassroots initiatives which could advocate for the interests of private business. Now that the transition process is underway and new advocacy groups are emerging, lessons learned to date suggest that lasting policy reform can best be achieved by a combination of approaches: through dialogue between grassroots organizations and policy makers at the national level.

Based on this understanding, the GEMINI Project in Poland, for example, has shifted its focus to incorporate this dual approach. Originally, GEMINI worked with government officials within ministries to support the development and adoption of pro-SME legislation. The program effectively brought the interests of SMEs into the national spotlight, and SME concerns are now included in national policy debate. However, Poland has since undergone several changes in national government, and some policy makers sympathetic to SME concerns are no longer in office. GEMINI learned that the implementation of policies at the national level can be jeopardized by relying on key individuals with uncertain political futures.

With this knowledge, GEMINI has made new efforts towards policy change in Poland through a "bottom-up" approach, by working at the grassroots level. Currently, GEMINI is working with a network of local enterprise clubs in ten outlying areas to encourage the development of grassroots SME advocacy initiatives and provide follow-up assistance on effective lobbying techniques. This work complements their continued reform efforts at the national level.

In Hungary, CIPE has also demonstrated the benefits of a grassroots approach to policy reform. CIPE has supported five local associations and research institutes that are striving to represent and voice the interests of private business. These organizations gather data on the contribution of SMEs to the overall economy, and share this information through publications and conferences. During the last national election, these organizations prompted political parties to adopt pro-SME

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[10] Tax policies in Bulgaria for example, create a disincentive for business owners to reinvest revenues into the enterprise.

stands in their official party platforms. These platforms were printed in major newspapers. Voters were then able to take them into consideration during the election process.

As a result of the lessons learned to date in the region, future programs should help strengthen the important dialogue between grassroots organizations and government policy makers at the national level to ensure lasting policy reform.

Relationship Between SME Development and Privatization

The slow pace of large-scale privatization in most CEE countries is contributing to an uncertain operating environment for SMEs. This uncertain climate makes it difficult for entrepreneurs to make informed business decisions or plan for the future. For example, unresolved ownership disputes continue to limit the availability of retail shopfront property for private firms; the doubtful future of many large SOEs which now supply crucial production inputs is a cause for concern; and entrepreneurs are unable to predict the potential market share of their firms given the uncertain future of SOEs which dominate their industry.

Many governments entangled in the privatization process are unable to focus needed attention on the emerging SME sector. Their own political agendas are often highly focussed on privatization, and they take little concentrated interest in private business development. Private entrepreneurs are often viewed by government officials as either insignificant economic players, a threat to government control, or able to solve their problems with their own resources. In addition, the current pressures of reform and budget maintenance make it difficult for governments to focus on building a stronger revenue base through the long term development of an independent business sector. By continuing to support inefficient state enterprises, governments are also restricting the availability of capital for private sector investment.

Several countries have economies based on industries in need of conversion, technological upgrading, or total liquidation such as the defense industry in Slovakia. As these former state-owned firms close and restructure, excess labor is shed and incomes are reduced. Despite the climate of uncertainty created by the slow pace of privatization, many entrepreneurs have started small private businesses as alternative sources of income. As a result, the SME sector is slowly beginning to absorb labor shed from the state-owned sector. The ability of SMEs to provide even more jobs in the future will be an important element of successful transition to an open market economy.

SMEs are beginning to play an important role relative to the privatization process. Foreign assistance can help encourage CEE governments to provide greater support for the development of SMEs as an element of their privatization efforts.

Relationship Between Information and Policy Reform

Policy makers throughout the region are in need of information on the SME sector, its role and contribution to the overall economy, and constraints to its development. Yet the collection and distribution of this information is lacking throughout the region. This inhibits the ability of

government and the private sector to carry on a meaningful dialogue about policy and regulatory reforms which affect SMEs.

To address the need for more information to encourage policy reform, GEMINI/Poland is developing an SME database and Research Foundation for a future SME Advocacy Bureau within the Ministry of Industry. GEMINI expects the database will encourage information sharing and advocacy activities for SMEs.

A better understanding of the important contribution and role of SMEs in the economy can help policy makers create a more beneficial operating environment for private firms. Future A.I.D. programming should continue to support efforts at data collection and information exchange in order to advance favorable policy reforms.

Institutional Strengthening and Development

AID activities to promote SMEs in Central and Eastern Europe have also included the development and strengthening of institutions. These include the public sector at both national and local levels, NGOs, universities, chambers of commerce, various business associations, and business advisory centers.

Grantees in the 1800023 portfolio active in these areas include CIPE, GEMINI, IRIS, and WOCCU. The Peace Corps also provides Small Business Advisors to EC-Phare sponsored Enterprise Support Centers throughout the region. To some extent, other grantees have provided institutional strengthening in addition to their firm-level activities, such as CDC through their work with local municipalities; IESC through their Public Administration program; and the MBA Corps in their assistance to the Enterprise Funds in Bulgaria and the Czech Republic.

Build on Local Institutions

The consensus among grantees, entrepreneurs, and others working throughout the region is that foreign assistance programs must help build on existing institutional structures to ensure the successful transition to a market economy. They stress that building local institutional capacity is important to ensure local ownership of change. Individuals in the CEE recall how communist structures were artificially superimposed onto their pre-existing institutions. Resentment towards this external meddling still runs high in many countries. Not surprisingly, many individuals are now concerned about the imposition of new institutions and organizations by foreign donors, even if set up under the aegis of "free market reform."

Additionally, there are many well-trained, committed individuals throughout the region capable of organizing and staffing their own organizations to meet their own needs. Several local organizations have begun to emerge throughout the region. These include trade associations, research institutes, chambers of commerce, business advisory centers, and regional development agencies. Many of these organizations are at an early stage of development and will need continued assistance to strengthen organizational and membership development, leadership, financing, and public relations in the future. If strengthened, these institutions will be better able

to meet the needs of SMEs by providing business services or helping to advocate SME interests to government.

Public Sector - National and Local Levels

Foreign donors working throughout the region recognize the important role of public sector institutions in supporting SME development. To date, most assistance to the public sector has occurred at the national level, an approach which made sense in the early transition period. Initially, it was important for foreign donors to work with government officials at the national level who had the strongest mandates to carry out needed reforms.

At the national level, foreign advisors have assisted government ministers, parliamentarians, and others in policy making and institutional strengthening. Many programs supported the efforts of particular government officials who seemed to represent the best interests of the private sector and the economic transition process. Unfortunately, there was high risk inherent in basing programs on liaison with individual political figures. As the past four years in the region have been marked by political instability, many changes have occurred in government personnel and institutional structures. As mentioned earlier, some programs found that key government contacts were lost, and their activities had to be redirected as a result.

During the communist era, local governments had little if any autonomy from central authorities, and these institutions were often weak and ineffective. Today, after several years of transition, there is evidence throughout the region of growing dynamism at the local government level. In several countries, notably Bulgaria, local governments at the municipal, district, or regional levels have established independence from the national government and have demonstrated greater willingness towards reform. Regional economic development agencies have emerged in the Czech Republic and Romania, and municipalities in Bulgaria are the most active government players in the privatization process.

While the development of local government institutions varies among countries, their ability to function as independent entities with their own revenue base is still generally limited. In many countries, municipalities have the legal right to collect local taxes, yet must remit all tax revenues to central authorities in the capital. Many local governments throughout the region are eager to make positive changes that enhance the potential for SME development, but need help in planning and implementing private sector support programs.

In order to help meet these needs, several A.I.D. grantees have adapted their programs towards strengthening these public institutions. For example, IESC has begun assisting local government initiatives through its Public Administration Program. In Estonia, IESC has helped local communities identify alternative sectors to generate new jobs as old industries fade, and is working with the Ministry of Finance to encourage more favorable tax laws at the local level. In Bulgaria, CDC has been working with municipalities to form local privatization plans in health care, construction, and other targeted industries.

By working to strengthen local public sector institutions, grantees have often found greater political will than at the national level to make needed reforms which enhance private business

development. This suggests that targeting assistance to municipalities and other public institutions at the local level is an important opportunity for future A.I.D. programming.

NGOs, Associations, and Chambers of Commerce

Due to the communist legacy, entrepreneurs throughout the region have been reluctant to join organizations such as chambers of commerce and business associations that claim to serve the interests of SMEs. This is understandable since during the communist era, entrepreneurial activity was unallowed or undertaken in secrecy. While many chambers of commerce have now been established in the region, they are often government-run. For this reason, some businesses hesitate to join them, as they negatively associate them with state-dominated institutions of the past. In addition, several CEE countries such as Poland and Hungary are considering adopting laws which would require chamber membership for all licensed business, based on the German chamber model. Since many entrepreneurs are adverse to the idea of mandatory membership, they are especially wary of these business organizations.

Aside from chambers of commerce, several NGOs and business associations have also emerged throughout the region. Many are opportunistic efforts, or platforms for individuals seeking national political influence. Yet, there are many other organizations which are intent on serving the business community. As the transition process continues, businesses are slowly beginning to recognize the benefits of associating with colleagues on common issues. As a result, they have begun to seek out and join some of these organizations.

It is important that these organizations be supported so they can effectively advocate for policy changes that support SMEs and provide improved services to the business community. It is also important that only those organizations which have open, voluntary membership be supported in order to promote democratic principles throughout the region.

Educational Institutions

Assistance to the educational system in the CEE has mainly occurred at the university level. With the help of foreign assistance, several MBA-type programs have been established through local universities. To support SME development, advisors have also helped to upgrade curricula, develop new specializations, establish business libraries, and retrain professors.

For example, through the University of Delaware's program sponsored by A.I.D. in Bulgaria, the University in Sofia has instituted a new SME sub-specialization within its undergraduate level business administration degree. The IRIS project in Poland has been active in commercialization of university-based scientific research and development technology. This area has future potential for private sector development in many countries.

These activities provide useful examples of how educational institutions can be targeted in supporting private sector development. There is also a great need in many CEE countries to educate the public on the mechanics of the free market system. This could be addressed by developing basic courses at all school levels to foster greater understanding of market economics, competition, and international trade.

Today's students are tomorrow's entrepreneurs, professors, and policy makers. They need to be supported now in order to be better prepared for a future in a market economy.

Small Business Development Centers (SBDCs)

Several international donors have established advisory centers in the region to support the development of small business. These include the European Community, the U.N., and the U.S. government, based on congressional appropriation through the SEED Act.

The European Community, through its EC-Phare Program, has committed substantial resources to private sector development efforts in CEE. To this end, EC-Phare has established a network of small business development centers, entitled "Enterprise Support Centers," located throughout the region. Through these centers, EC-Phare provides medium and long-term loans for SMEs and microentrepreneurs at below market rates with preferential terms. The centers help entrepreneurs apply for loans, identify business opportunities, and prepare business plans. They also aim to provide ongoing business and financial advice through consulting services, training, and seminars. Throughout the region, the Peace Corps is providing Small Business Advisors to these centers to offer management, organizational development, and technical expertise.

The EC-Phare approach differs in several aspects from lessons learned by the team. First, the services of these centers are targeted mainly to startups or young firms.[11] Yet, experience suggests that established firms have greater prospects for long-term survival. Most practitioners agree on the importance of supporting existing institutions to ensure long-term sustainability. However, the EC-Phare model is based on the creation of new bureaucratic structures. These include new government-to-government institutions such as local foundations which provide technical assistance and loan funds to the support centers.

In Poland and Hungary, the U.S. has established several SBDCs based on the experience of the American SBDCs. U.S. advisors have provided on-site assistance to support their operations, build client bases, and package their services to suit local business needs. One center in Pecs, Hungary has received local government commitment for office space and on-going financial support. The center recently hosted a town meeting on small business development which was attended by the Hungarian President and received national publicity.

An advantage of both programs is that these centers are a major source of information and assistance to SMEs outside the capital cities. In many countries, they are the sole service providers to entrepreneurs in secondary cities and rural areas. However, implementers are still struggling to link the centers into an integrated network through which they can share information and lessons learned, make cross referrals, and leverage successful activities.

While sustainability is a key goal of these programs, the centers have not yet reached a critical mass of entrepreneurs who are willing and able to pay for services. As a result, service fees do

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[11] For example, enterprises applying for EC loans through the LEAs (Local Enterprise Agencies) in Hungary must not exceed two years of age.

not generally cover operating expenses, and many centers must rely on host governments or other donors for continued funding. This approach is similar in the U.S. where SBDCs are not usually self-sustaining institutions: most are subsidized by state or local public funds. Sustainability of donor-sponsored business centers in the CEE might require long-term resource commitment by the state sector, combined with service fee revenues.

In any case, these centers will need to concentrate on providing services that entrepreneurs need and are willing to pay for in order to survive in the long-term. For example, a UN-sponsored center located outside of Bucharest, Romania, successfully covers its costs through preparation of business plans alone. By excelling in this service, the center's team of local consultants has carved out a competitive market niche. To date, experience has shown the more successful centers are offering specialized services that meet the demand of local SMEs.

Financial Sector Development

The tasks of reforming the financial sector and overhauling the banking system are monumental in a post-centrally planned economy. Given the enormous challenges and limited A.I.D. resources, the 1800023 portfolio of programs can have limited impact in this area. Yet, important lessons have been learned regarding the role and success of foreign assistance in improving the financial sector.

WOCCU is the only 1800023 grantee focussed mainly on financial sector issues, in its efforts to establish a local credit union movement in Poland. IRIS, another A.I.D. grantee, has been active in improving the lending environment in Poland through its efforts to develop a collateral law. Other A.I.D. participants outside the portfolio include CARESBAC in Bulgaria and Poland, Opportunity International in Bulgaria, the Enterprise Funds throughout the region, and numerous advisors from the U.S. Treasury, U.S. Commerce Department, and the Federal Reserve, among others.

Need for Improvement

A.I.D. grantees and other foreign donors have assisted financial sector development in the region through policy reform, management and credit training, banking supervision, and technical assistance to improve banking operations. Through their assistance, many improvements have been made in these areas. After several years of the transition process, there are signs that the financial sectors of many countries are beginning to restructure to suit the needs of a market economy.

In Poland for example, London Club bank creditors signed an agreement giving Poland a 42.5% reduction on its $13.2 billion commercial bank debt. Recently, the Czech Republic achieved an investment-grade rating for its government debt (higher than Greece's, an E.U. member). This will allow the country greater access to capital in the international financial markets.

Despite improvements, most SME needs for financial services are still not being met. This is mainly due to continued deficiencies in the banking system. Banks are still unfamiliar with the concept of risk-based lending, and are unaware of the special needs of SMEs. Few consumer

banking services such as checking accounts and credit cards are available or convenient; few banks offer transactional services such as letters of credit; and availability of bank credit is limited and generally offered on restrictive terms.

Many improvements in the banking sector still need to be made throughout the region. These include: 1) increased bank solvency, achieved through debt relief, recapitalization, improved credit policies, updated accounting systems, and better management practices; 2) fully-functioning branch networks with trained loan officers; 3) improved payments clearing systems; 4) developed money markets; and 5) fully convertible currencies.[12]

Some of these improvements will take place through government initiatives, such as adoption of non-inflationary monetary policy and new bank supervisory rules. Others can be achieved through programs which provide technical assistance to improve bank operations and train managers, loan officers, and other bank personnel.

Risk-Adverse Behavior of Banks

Many newly reformed banks throughout the region are striving to become responsible commercial lenders. With the help of foreign advisors, loan officers throughout the region are now being trained in credit analysis and other basics of risk-based lending. As a result, these banks are beginning to exercise new financial prudence. This, on the one hand, is a positive development.

Yet this prudent behavior by banks is resulting in new bank lending policies that are often too cautious. For example, many banks attempt to cover their credit risk by making excessive demands for collateral -- often up to 150-200% of the loan value. These terms are highly restrictive for borrowers, and fewer loans are made as a result. In addition, many banks prefer to invest in safe, government securities instead of taking a risk on loans. [13]

Given the inexperience of banks and the huge constraints still inherent in the banking system, this risk adverse behavior by banks is not entirely irrational. The irony is that while banks are trying to become better banks -- and are lending cautiously as a result - entrepreneurs are trying to seize new opportunities -- and are demanding more bank financing. Such caution by banks results in limited access to financing by entrepreneurs at precisely when their demand is greatest.

Besides the continued need to strengthen the banking system, this suggests the need to promote non-bank alternative sources of financing. More discussion on these non-bank alternatives is provided in the following section.

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[12] Except for Latvia, the only country in the CEE with a fully convertible currency.

[13] This has become common practice in Poland, and other countries with functioning money markets.

Non-Bank Financial Alternatives and Savings Mobilization

Given the inadequacy of the banks to meet the financial needs of a growing SME sector, it is important to consider some non-bank financial alternatives to meet those needs. For example, WOCCU has established over 120 credit unions throughout Poland representing over 100,000 primary members.[14] Credit unions encourage mobilization of local savings, provide a non-bank source of credit, and can target activities to local needs.

Other non-bank financing alternatives have emerged which are beginning to serve the SME sector but are not adequate to satisfy demand. CARESBAC has been able to serve the financial needs of SMEs outside the constraints of the banking system through its venture capital programs in Poland and Bulgaria. Other financial services which need to be explored include leasing and factoring[15] arrangements. Since many new firms require capital equipment, leasing arrangements could suit this need without the high interest or collateral required for a traditional bank loan. This could be particularly helpful in CEE countries with weak banking systems and where new equipment needed for business startups is unavailable, such as Albania.

In addition, greater savings mobilization must be encouraged throughout the region. Increased commercial bank deposits, for example, would provide a greater capital base for future lending. WOCCU has encouraged savings by working to convert former employee savings and loan associations into modern credit unions. To achieve this within the commercial banking system will require greater confidence by depositors. This can be accomplished through improving underlying bank soundness, as well as through national deposit insurance.

Even in the U.S., commercial banks are unable to sufficiently meet the financial needs of SMEs. Regardless of improvements which take place in the banking system in the CEE, foreign assistance must devote more resources to develop other, non-bank financial services. In addition, assistance programs can encourage the formation of a larger savings base to enhance overall economic stability.

Different Growth Stages, Different Financing Needs

Start-up firms often need credit for working capital and purchase of inventories and equipment. As firms become established and need to grow, they will have new financing needs. Yet credit is not always their best means of obtaining capital for expansion. Established firms are often better candidates for venture capital, joint venture partners, or other forms of equity investment. Yet, very little equity financing is available throughout the CEE.

CARESBAC, supported by A.I.D., is one type of program that provides a combination of equity investment and debt financing through its venture capital programs in both Poland and Bulgaria. CARESBAC is one of the few sources of venture capital financing in the region which focuses

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[14] Source: WOCCU Project Goals Comparison, April 1994.

[15] Factoring occurs when one firm sells another firm outstanding receivables which need to be collected. The second firm buys these liabilities at a discount and then undertakes the collection process.

particularly on SMEs. While conventional wisdom implies that smaller firms without track records pose higher risk for investors, CARESBAC has demonstrated that with proper research, targeting, and technical assistance, SMEs can be potentially good investments.

Experience shows that the ability of firms to carry out needed growth is critical for their long-term survival. Thus, there is a vital need to encourage more provision of venture capital or other investment resources to growing firms.

Micro-Lending Programs

Some lending programs in the region are targeted to start-up microenterprises. These micro-loan programs are usually based on subsidized lines of credit from international donors, and include micro-loan components of the Polish-American and Hungarian-American Enterprise Funds. These programs offer loans with preferential terms, including below-market interest rates, lengthy grace periods, and few collateral requirements.

While micro-loan programs strive to meet certain needs, they have some inherent disadvantages. Micro-loan programs usually target entrepreneurs with little previous business experience and few assets with which to collateralize their loans. This inexperience can lead to business failures and high loan default rates. For these reasons, micro-loan programs are inherently riskier than other lending programs. In addition, micro-loan programs can seldom cover their operating costs from interest income or service fees. Given this reality, and the potential for high loan defaults, micro-loan programs are also costlier than other lending programs. As a result, their underlying capital base can erode quickly, ending the possibility of future loans.

Foreign donors need to consider these disadvantages when implementing micro-loan programs. In addition, given the evidence of ventures having started with private capital throughout the region, the need for micro-loans may not be as great as originally anticipated.

In the event that implementers do decide to continue micro-loan programs in the future, lessons can be learned from existing programs. For example, Opportunity International, an A.I.D. sponsored program, is providing micro-loans of $2000 on average to entrepreneurs in Bulgaria. To date, their program has experienced high payback rates. They attribute their success to several factors: technical assistance in forming business plans, careful analysis of those plans, appropriate collateral requirements and loan size, clear payback conditions, and close loan supervision. These are valuable lessons for foreign assistance providers to keep in mind for future micro-loan programs.

Need for Training

Bank loan officers are generally unfamiliar with credit analysis, and bank policies often discourage them from considering SME proposals. As a result, SMEs complain they are unable to access bank credit on reasonable terms. Bankers, on the other hand, commonly state they receive few well-presented, bankable projects from SMEs. To ease bottlenecks in the lending process, both borrowers and lenders need further education about their respective roles, rights, and responsibilities in supplying and receiving financial services.

Lenders need to understand the special needs of SMEs and set their credit policies accordingly. Borrowers need to better understand the credit process and how to improve their business plans. Some programs, notably EC-Phare's Enterprise Support Centers are assisting borrowers in this process.

Yet borrowers also need to improve the underlying "bankability" of their enterprises. This is not just achieved by creating a good business plan document, but by having the skills needed to run a sound business. For example, new businesses often seek more financing than they actually need due to lack of financial planning skills. This implies the need for further business management training as well.

The Peace Corps, for example, has helped improve banking skills through training provided by its Small Business Advisors. One advisor, working through a local Enterprise Support Center in Bulgaria, has provided credit training to over 150 bankers in 60 different banks. Other donors including the World Bank, EBRD, and the E.U. are devoting resources towards training bank personnel in these areas.

Given the constraints in the banking system and the enormity of the task, this training process will require continued interventions over the long-term.

Linkage - Financing and Technical Assistance

Grantees commonly stated the need to link the process of applying for credit with technical assistance in improving business management skills. For example, EC Phare's Enterprise Support Centers now provide this linkage throughout the region on a limited basis. These centers have learned that simply helping entrepreneurs to complete loan applications and make business plans is not enough. Entrepreneurs must also be able to evaluate the soundness of their business ideas, and to assess if credit will really meet their needs. This can be achieved by providing business management training as part of the credit application process.

CARESBAC in Poland, for example, has learned the value of linking with other A.I.D. grantees such as ACDI and VOCA. These programs agree to provide ongoing technical assistance to selected Polish firms as a condition for CARESBAC's provision of venture capital financing. Such coordination has proved beneficial for recipients, who gain the advantage of both technical and financial resources. CARESBAC also gains the assurance that increased technical assistance will help the long-term viability of their investments.

Training Activities

While training is an important technical assistance area, it has not been a key focus of the SME support program under the 1800023 portfolio. The exception is PIET, which provides in-country training for entrepreneurs and fields host country nationals for participant training and internships in the U.S. To date, PIET has sent over 190 entrepreneurs, business owners, and firm managers from seven CEE countries to the U.S. for training.

Several other A.I.D.-sponsored training providers are active in the region. These include: ORT, which provides vocational training to former political prisoners in Albania; and a region-wide program which partners U.S. universities with local counterparts to upgrade curricula, build business degree programs, and provide resources for SME development.

The following are lessons learned on the content of training programs, their local applicability, participant training programs in the U.S., and the training of trainers. Lessons on the targeting of training to specific recipient groups are covered in the next section, "Targeting of Assistance."

Training Content

Market Economics: Many firm-level technical assistance programs have helped promote the concept of market economics to some extent. Although these programs have proved valuable to recipients, most entrepreneurs still need a greater understanding of competitive markets, international trade, and the cause and effect of business cycles. This suggests an opportunity for more training to reach a critical mass of entrepreneurs. In addition, free market concepts are still unfamiliar to many individuals throughout the region. Students, teachers, professors, and others in the general public could benefit from more training in this area. Curricula must be updated at universities and all school levels to help meet this need.

Business Management: In the early years of reform, the key objectives of training were to reorient individuals towards a free-market system and to improve business management skills. Training in these areas is still needed by many entrepreneurs throughout the region who lack managerial skills and tools to run a business in a free market context. Without these skills, enterprises may suffer from operating inefficiencies or costly mistakes. Such skills are needed for entrepreneurs active in all sub-sectors, whether in agriculture, manufacturing, or service industries. They are also useful for public administration officials, hospital administrators, managers of business associations, heads of educational institutions, and others who work in a management capacity.

Industry-Specific Training: General management training is still appropriate for many individuals as mentioned above, but now many entrepreneurs have more sophisticated needs. Practitioners and entrepreneurs throughout the region expressed the need for more industry-specific training and information. This will be particularly important as entrepreneurs move into production-oriented activities such as light manufacturing, electronics, and construction. Specialized training will be needed to improve production methods, quality control, and market competitiveness. Future programs need to provide an appropriate mix of general and more specialized training.

Marketing: Marketing ability and access to information are key to long-term economic viability of firms. To date, some marketing training has been provided as a part of more general business management training. Yet, lack of marketing information is a repeated complaint among entrepreneurs. More resources are needed to teach entrepreneurs how to get and use information in order to conduct market research, target customers, and upgrade products and services.

Local Applicability

U.S.-sponsored training programs in several CEE countries had to make early adjustments to be applicable to local conditions. In some cases, program content did not fit with local laws and procedures. For example, training on the U.S. accounting system was attempted in countries such as Bulgaria where traditional accounting standards are notably different than in the U.S. Now that training programs have had more local country experience, training content is being adjusted, and the training needs of the SME sector are better served as a result.

Participant Training Programs in the U.S.

Entrepreneurs which participated in U.S.-based training programs generally found these programs enriching. Yet, the usefulness of the technical assistance they received is less clear. Participants seldom cited increased technical knowledge as a major benefit received through U.S. training. Instead, many participants expressed the key values of these programs were exposure to western business practices and the opportunity to seek investors and trading partners.

U.S.-based training programs have several limitations. First, given the requirement for strong English language ability, these programs tend to reach a limited and already advantaged audience. In addition, participant training programs usually require a three to four week time commitment. It is often difficult to find appropriate entrepreneurs who can leave their businesses for this duration. Since these programs are tailor-made for each participant, they are also costly. For example, PIET estimates the average total cost of fielding each participant for up to four weeks of training is roughly $11,000. In contrast, the estimated total cost for an MBA Corps volunteer is approximately $38,000 for a 15 month assignment.[16]

Given scarce A.I.D. funds, training resources might be better utilized by providing in-country training of business managers, bank personnel, and policy makers, and by helping to build in-country capacity to provide quality training services to local SMEs.

Training of Trainers

Practitioners throughout the region agree that training of trainers should be a priority in order to build local capacity in the future. Experience has shown that there are already many individuals qualified to become good trainers. Some government institutions and banks are also beginning to realize the need for in-house trainers.

In Bulgaria, for example, the Ministry of Industry and Trade and the Foreign Trade Bank have instituted "training coordinators" with the help of foreign advisors. These initiatives demonstrate useful examples of how training resources can be leveraged to build the capacity of local institutions.

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[16] Based on data supplied by PIET and MBA Enterprise Corps. For more details on each grantee, refer to Volume Two Attachments, "Summaries of 1800023 Grants and Contracts."

2. Targeting of Assistance

This section reviews lessons learned on targeting assistance to various firms, institutions, and trainees, in various geographical locations, to support SME sector development in Central and Eastern Europe. To date, A.I.D. grantees have achieved varying results working with different target groups.

Types of Firms Assisted

Private vs. Privatizing Firms

As detailed earlier, technical assistance was initially provided to firms undergoing privatization. This was necessary as there were few private firms to work with in the early transition stage. Unfortunately, privatization was expected to proceed more quickly than it has to date. Many firms have not actually been privatized, nor are much closer to privatization than before. This is due to a host of external factors outside the control of assistance programs.

As the transition process continues, more private firms are emerging which are in need of assistance. Many of these new firms have been created from much larger SOEs which were divided into smaller production units. New start-up businesses have also been created based on private initiatives. These firms have greater future potential than many of the privatizing firms which must overcome considerable operating constraints.

Based on these lessons learned to date, future A.I.D. programs need to focus more on these private businesses with greater prospects for long-term growth, and provide assistance to privatizing firms only a case by case basis.

Trading vs. Production Firms

Many entrepreneurs in the early stage of transition started enterprises based on trade-oriented activities. As discussed earlier, trading enabled quick entry into the marketplace and allowed entrepreneurs to gain quick profits. In the future, it will be increasingly important for traders to begin to utilize their saved capital to invest in production-oriented firms.

Yet, restrictive tax laws and other policies in many CEE countries provide few incentives for entrepreneurs to engage in production. As a result, many SMEs have not made the important transition from trade to production of local goods. The ability of SMEs to successfully make this transition will be key for long-term sustainability of the private sector.

Future technical assistance needs to be targeted more towards production-oriented rather than trading firms. An exception could be made in lesser developed economies in the region such as Albania, where trading can allow entrepreneurs to quickly generate needed capital.

Firm Size

Most grantees are assisting small and medium-sized firms, whether private or privatizing. The size of firms appears to have much less bearing on the impact of assistance than other factors such as management ability or stage of growth. Smaller start-ups can be well served through standardized technical assistance, training, educational materials. Larger firms however, have more specific and more long-term assistance needs.

Growth Stage

Stage of growth appears to be an important determinant in tailoring appropriate technical assistance. It may also be a key factor in the success of assistance. Initially, grantees targeted start-up firms needing help in seizing new market opportunities. Many of these firms are no longer operative. Yet, others have grown into established businesses with proven capability. Grantees agree that it will be important to identify and assist these companies moving into a vulnerable phase of growth and delegation.

Given their potential and demonstrated ability, attention should be focussed on existing firms. New SMEs and micro-enterprises could continue to be supported through basic business management training and business manuals.

Sub-Sector Focus

Initially, most 1800023 programs did not target assistance towards a particular sub-sector or ethnic group, except for the stated goal of encouraging women entrepreneurs. As a result, most programs have been demand-driven with the requests of entrepreneurs driving the focus of assistance. This strategy may have been most appropriate at first and allowed flexibility in targeting assistance. Grantees agree that flexibility was key for successful programs in the early stage of economic transition.

Although a sub-sector approach may be appropriate for some countries in the future, more importantly, programs must focus on supporting good businesses of all types, and help to create an environment in which businesses in all sub-sectors can grow.

Selection of Geographic Locations - Focus Outside Capital Cities

Since the fall of communism, most capitals throughout the CEE have advanced much more rapidly than the rest of the region. Initially, it was natural for international donors to congregate their programs in the capital cities, since this is where access to local resources is greatest. In contrast, areas outside the capital cities in most CEE countries still have limited foreign assistance or other resources to support private business development. In addition, many local governments have established new autonomy from the central government and are eager to support the development of SMEs in their communities. For these reasons, experienced practitioners throughout the region strongly emphasized the importance of locating programs outside of the capitals for greater impact and to better meet local needs.

In several countries, historical centers of entrepreneurial activity are found outside the capitals. These towns along traditional trade routes and near international borders include: Pecs (Hungary), Korce (Albania), Timisoara (Romania), Plovdiv (Bulgaria), and Plzen (Czech Republic). In Korce, for example, the local environment for SME development is considerably more favorable than in the capital, based on the historical trade ties and professions of town residents. Support to these secondary towns could yield excellent results for the overall business sector in the future.

Some grantees have begun to provide advisors to secondary cities and areas of high unemployment. In Poland, the MBA Enterprise Corps has chosen four areas outside of Warsaw in which to focus its programs: Gdansk, Poznan, Lodz, and Krakow. CDC has selected four secondary cities of high business potential outside of Bucharest in which to base its activities in Romania. IESC has begun a new approach called the "Small City Package," to provide technical assistance and business development services to enterprises in economically depressed areas of rural Hungary. Future activities will be targeted to agricultural producers, food processing services, vocational training programs, and new industries targeted by the government to relieve high unemployment.

Given these lessons learned by grantees, it is important that future A.I.D. programs be targeted to appropriate areas outside the capitals. This can ensure a better distribution of SME development throughout the CEE countries.

Selection of Institutions

For additional background in lessons learned on institutional-level assistance, refer to the previous section entitled "Institutional Strengthening and Development."

Build on Indigenous Institutions

Many local institutions are at an early stage of development and are in need of technical assistance to enhance their organizational development, financing, and other tools to ensure their long-term viability. These institutions include trade associations, research institutes, chambers of commerce, business advisory centers, and regional development agencies, which are discussed in more detail below.

The key point for targeting assistance to these various institutions is that they be indigenous and independent. Practitioners and entrepreneurs alike throughout the region expressed the importance of supporting such local entities, rather than receiving newly imposed structures created by foreign donors.

Public Sector - Local Level

The experience of grantees working in the region indicates that in many countries, specific policy reforms which are favorable for SMEs might be more easily implemented at the local level than at the national level, where reform efforts may be at a standstill. While some municipal, district, or regional level governments have achieved new autonomy from central government control, more assistance is needed to help them. With assistance, local policy makers could improve the

operating environment of SMEs by supporting measures such as tax incentives and tax holidays, favorable land use planning, and development of commercial property for shopfronts.

An example of this approach is underway in the town of Plzen in the Czech Republic. IESC has assisted the Mayor's office in a renewal project of the major town square now littered with kiosks. After renovation, vendors will be able to move to shopfronts on the square. A cleaner, renovated square is expected to attract tourists and additional tourist-related commerce.

This demonstrates how, with some technical assistance, local governments could be supported to create a more favorable operating environment for SMEs in their communities.

Indigenous Associations and NGOs

Based on lessons learned in the region, future programs should support the development of local associations and groups which could effectively advocate for SME interests. For example, indigenous policy institutes could be supported and encouraged to publish relevant data to influence adoption of laws and policies favorable to SMEs.

It is also crucial that only organizations which have voluntary participation be supported, in contrast to mandatory membership requirements that many countries are trying to adopt for local chambers of commerce. Assistance programs must help build democratic principles as well as stimulate private enterprise by working to strengthen an independent business sector.

Educational Institutions

Several donor programs are helping to strengthen university curricula and management training centers throughout the region. Their work is crucial for preparing the next generation in the principles of democracy and free enterprise. As mentioned earlier, these programs have been valuable in supporting SME development, yet have only been available on a limited basis.

Additional programs are needed at all levels of education, including primary schools. This could take place through developing new courses, updating educational materials, and hosting special school programs. These programs will help students prepare for their roles as future entrepreneurs, taxpayers, and policy makers.

Targeting Foreign Trade and Investment Activities

In most CEE countries, the internal markets are too small to support an SME sector of significant size. As such, trade linkages must be strengthened within the region and elsewhere as appropriate. The region can utilize its many comparative advantages in the global marketplace such as low labor costs, rich natural resources, and a location at the crossroads of east and west.

Trade should be considered a long-term economic goal for sustainability of the CEE countries. This is especially important since most CEE countries will ultimately join the European Union. International trade and investment efforts will comprise a substantial segment of private sector

activity in the future as a result. Foreign assistance providers should therefore encourage these efforts as part of their SME support programs.

Target Groups for training

Training of Trainers: Practitioners throughout the region agree that training of trainers needs to be supported in many areas. Potential target groups include local business advisors, consultants, commercial bank personnel, government officials, university professors, and designated individuals in other institutions where training resources can be utilized. Training of trainers has proven to be a useful way of supporting the provision of technical assistance while leveraging training resources.

Government Officials: Policy makers and administrators in government need to be better educated about the benefits of instituting legal, regulatory, and policy reforms that allow businesses to form and develop. They also need to understand the important role and function of SMEs in a free market economy. Government officials at both national and local levels could be enriched by training in these areas, and SMEs would benefit as a result.

Established Firms: Established firms which have demonstrated capability need to be supported in their continued growth. While start-ups need more basic business management tools, established firms have more complex needs in order to grow and compete. Established firms should be targeted for these more advanced tools in organizational development, market research, distribution methods, information systems, and customer service.

Financial Sector: As discussed at length earlier, there is a need to further educate both borrowers and lenders in their respective roles and responsibilities. Bank personnel need continued training in credit analysis, central bank supervision, customer service, and general bank operations. Potential borrowers need education in preparing business plans and tools for running sound businesses. More focussed training is needed in all these areas to support development of the financial sector and ultimately improve the financial services available to SMEs.

Schools and Universities: Even after several years of economic transition, many individuals still need a better understanding of free market economic principles. To reach a broad spectrum of society and leverage training resources, teachers and university professors should be targeted for retraining in order to update curricula. Courses which help to inform students about the workings of a market economy need to be introduced into schools at all levels.

3. Ensuring Sustainability of Benefits

Central and Eastern Europe has seen extreme contrasts in economic and political orientation in only a few years. While recent reforms have created opportunities for some, it has also created new hardships for many. These hardships have raised social concerns which could threaten the reform process, evidenced by the recent election of former communists in Poland and Hungary.

While the CEE countries appear to be solidly on the path of market-oriented, democratic societies, the future is still uncertain. For this reason, foreign donors working in Central and

Eastern Europe must choose programmatic approaches which best ensure the sustainability of their assistance efforts.

The following are lessons learned on ensuring the long-term benefits of assistance to the SME sector. These lessons concern the selection of program performance indicators, the provision of long-term assistance, local involvement, leveraging benefits, and the timing of project interventions.

Selection of Performance Indicators

After the fall of communism in Central and Eastern Europe, there was an immediate opportunity for foreign assistance to contribute to the new economic transition. It was believed that urgent response was needed to help assure the transition's success. Yet, donors had little if any experience in the region, nor in assisting transitional economies. Under these new circumstances, it was initially difficult to determine what performance indicators programs should use.

To date, few performance indicators have been used to track the impact of the 1800023 programs in the field.[17] Generally, the indicators used tend to track activity levels, not performance results. For example, commonly used indicators include the number of businesses or organizations assisted; the number of volunteers fielded; the number of trainees trained; the status of legislation or policies in the process of being adopted; and the number of requests for assistance received. Instead, better indicators of actual program performance need to be implemented such as firm-level changes in sales revenues, production techniques, or employment. These new indicators will be most effective if used after appropriate baseline data is initially established.

It should also be noted that while the economies of some countries are improving greatly, grantees expressed concern that program performance indicators alone do not capture many important elements of sustainable development. Other factors should be considered such as the level of institutional development, the ability of the private sector to absorb labor shed through privatization, capacity of social safety nets, and development of the financial sector. These factors could also be used as "exit indicators" to determine when critical benchmarks have been reached in the transition process.

Short-Term vs. Long-Term Interventions

Many programs under the 1800023 portfolio have focussed on short-term, firm-level interventions to private and privatizing enterprises throughout the region. Providing assistance on a short-term basis allowed A.I.D. to tackle a number of specific firm-level constraints. Yet, after several years of experience in the region, grantees have found the needs of firms are more long-term in nature. This implies that firms will require more long-term technical assistance to meet these needs. In addition, the long-term success of firms will be measured by factors not now monitored systematically. This also suggests the need for useful performance indicators which are

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[17] See Volume I, Section III.E. "Measuring Performance and Impact" for a discussion and recommendations concerning performance indicators in the SME program.

consistently tracked over the long-term, as mentioned above.

At the policy level, measuring the impact of technical assistance in the short-term is extremely difficult. Political instability in the region has led to numerous changes in government personnel and restructuring of public institutions. Several programs which were based on key government contacts have encountered setbacks as a result. Legal, regulatory and policy change is a slow process even under the best of circumstances. This suggests that policy reform in the CEE is also a long-term process which will take more time and commitment than originally anticipated.

The development of institutions such as grassroots advocacy groups and the ability of governments to respond to the demands of the private sector will also take time. The long-term needs of the SME sector can be assisted by helping to build local service delivery capacity through business associations, NGOs, and other indigenous institutions. Many businesses still operate in isolation from each other and deeply distrust government. Building a sense of trust among fellow business owners, an awareness of the importance and need to associate, and an understanding of the role and function of "lobbying" are long-term efforts. This points to the continued need for a long-term approach towards institutional development.

In summary, building a strong, independent SME sector is a long-term process. It will therefore require long-term interventions to build institutional capacity, enhance the legal and policy environment for SMEs, and increase the abilities of entrepreneurs to succeed as independent producers.

Local Involvement, Ownership, and Capacity Building

In order to ensure the long-term success of economic transition in the CEE, an independent SME sector must be created which can effectively compete in the marketplace. To this end, A.I.D. can help support local involvement in the transition process and build the service delivery capacity of local institutions. Lessons learned on how A.I.D. programs could help meet these objectives are discussed below.

Build on Existing Organizations/ Institutions: As mentioned earlier, the consensus among practitioners is that foreign assistance programs must build on existing, local institutions to ensure a successful transition to a market economy. Experience suggests that economic transition will have a higher likelihood of success when local individuals and organizations are actively engaged in the transition process. For this reason, future A.I.D. programs must focus on supporting local institutions to the extent possible, rather than create new, temporary structures.

Target Municipalities and Local Government: Many economic, institutional, legal, and technical factors affect the success of SMEs in the CEE. Tackling these on a national level with limited resources can yield limited results at best. As discussed above, some governments at the municipal, district, and/or regional level have newly established autonomy from the national government and have demonstrated interest in promoting the local development of SMEs. For example, local or regional development agencies have been created in some countries to seek alternative income sources for those who have lost jobs due to privatization of state-owned firms.

The development of local SMEs could help provide new economic opportunities for the unemployed.

While many municipalities and other local government institutions are eager to make the needed policy changes to enhance the environment for SMEs, they are in need of assistance in planning and implementing private sector support programs. A pilot or demonstration project could be designed in which a few municipalities in secondary cities are targeted for development, and several impact indicators are examined.

Improve the Flow of Information: Information can be a critical catalyst for stimulating changes in the SME enabling environment, namely policy, legal and regulatory reforms. The availability and use of appropriate information can be encouraged through several elements: 1) a strong grassroots base for SME advocacy; 2) good data and analysis on the role and importance of SMEs in the economy; and 3) forums for debating issues, voicing concerns, and proposing change which involve key players in government, academia, and the private sector.

In addition, entrepreneurs need market research, technical, and other industry-specific information in order to modernize, plan marketing strategies, and stay competitive. Assistance could be targeted to meet these needs by supporting local advocacy groups, research institutes, and national conferences on SME issues.

Improve the Operating Environment for SMEs: In many countries, the SME sector survives by avoiding government and sidestepping the privatization process. The operating environment will need to improve so SMEs can function at their best, not only without government interference, but with government approval and support. Lessons learned suggest this will require a dual approach: mobilizing advocacy at the grassroots level, as well as providing technical assistance, training, and education to policy-makers at the national level.

Build the Supply of Business Support Services: Improvements in local service delivery capacity can be achieved by promoting the growth of business support services for SMEs. These services include accountants, attorneys, and business consultants. They could be supported through direct technical assistance and appropriate training of trainers. Other activities could include development of yellow pages directories, market research firms, non-bank financial services, and the establishment of international franchises.

Leveraging Benefits

Given limited resources, foreign assistance programs throughout Central and Eastern Europe have learned valuable lessons about leveraging their resources for maximum results. The following are several approaches to help leverage benefits based on the experience of programs to date.

Focus on Local Level Interventions: In several countries, notably Bulgaria, local governments at the municipal, district, or regional levels have established autonomy from the national government and have demonstrated greater willingness to adopt needed reforms. These areas have limited foreign assistance or other resources to support private business development.

In order to leverage the impact of assistance, A.I.D. needs to focus its resources on selected municipalities, secondary cities, and other target areas outside capital cities where there is potential for successful SME development.

Grantees and contractors should be encouraged to operate programs on a regional or municipal basis. Selected localities could be used as models to demonstrate the value of SME development to other regions and nationally. Lessons learned from these local level interventions could be highlighted in national, public forums for discussion and debate. This will help to promote the important role of SMEs in the economy, and help national policy makers recognize the benefits of encouraging SME development.

Support Public Forums - Media: The donor community could build on the successes of its programs by sharing success stories. This could be accomplished through seminars or public information campaigns that promote positive examples of entrepreneurial activity and provide constructive role models. By sharing positive lessons learned, the media can promote the importance of private business to the overall economy. Several grantees also suggested the establishment of an annual conference on small business development. Workshops could be provided for SMEs, and local entrepreneurs and counterpart organizations could prepare case studies to share successes and lessons learned.

Encourage Dialogue Between Business and Government: Policy reform efforts can be leveraged through continued, effective dialogue between grassroots organizations which represent SME interests and policy makers at the national, regional, and municipal levels. As detailed earlier, such dialogue could be encouraged through public forums and task forces attended by both policy makers and members of the business community.

Enhance Curriculum Development: Curriculum development at all school levels and universities is an area of opportunity for A.I.D. to leverage its resources in the future. In this way, a broad spectrum of recipients can gain a greater understanding of the workings of a free market economy. Teachers and university professors should be targeted for retraining in order to update and introduce these new concepts into their classrooms.

Promote Training of Trainers: Building an experienced cadre of trainers is a valuable method of enhancing local capability while leveraging assistance resources. Target trainees could include local business advisors, commercial bank personnel, government officials, university professors, and designated individuals in other institutions where training resources can be leveraged.

Continue Donor Coordination: A.I.D. can leverage the impact of its assistance through multilateral coordination with other A.I.D. grantees and donors. By coordinating resources, programs can eliminate duplication, encourage economies of scale, and build greater resource and referral networks.

The GEMINI project in Poland has provided an excellent model of multi-lateral coordination at the policy level through formation of the "G-24 Task Force." Formed in partnership between government and the G-24 donors, its mission is to coordinate local efforts in SME development. By providing Small Business Advisors to EC-Phare's Enterprise Support Centers, the Peace

Corps has demonstrated the ability to leverage benefits through coordinated multinational efforts. While EC-Phare provides the financial and administrative basis for development of the Centers, the Peace Corps volunteers provide long-term technical expertise to support ongoing management and operations in the field.

A more detailed discussion on donor coordination and collaboration is provided in the following section on "Program Management Issues."

Timing and Sequencing of Project Interventions

Programs under the 1800023 portfolio have been generally funded on a year to year basis. While this may have been initially prudent, this process has been cumbersome for grantees. Program managers often face the uncertainty of continued funding at year end, and spend time and energy preparing for possible phase out of their programs. Once more funding is secured, they must expend additional resources to gear up again for continued activities.

Multi-year funding of programs would allow more effective planning and more efficient use of limited resources. It would also enable management to spend less time and energy on administration and allow more time for project activities.

4. Program Management Issues

While the team's research primarily focussed on program activities, the team also learned some valuable lessons on program management worth noting. These include issues on staffing, factors for successful programs, host-country contribution, monitoring and evaluation, long-term vs. short-term interventions, donor-coordination, and programmatic approach. Lessons learned on each of these issues are discussed briefly below.

Volunteer Advisors

Most programs under the 1800023 portfolio have provided technical assistance through volunteers. These grantees include CDC, IESC, MBA Enterprise Corps, and the Peace Corps. Grantees have been able to recruit qualified short and long-term volunteers with relative ease to work in the CEE. Many Americans have been willing to volunteer because of family background in the region, or are eager to participate in the historical changes taking place.

Some individuals in the region expressed resentment towards foreign advisors who receive U.S. level salaries in-country. In contrast, volunteers have high credibility among government officials, clients, and others. Volunteers are perceived as being genuinely committed to serving the needs of the business community. This has been a key advantage of the ability of volunteer-based programs to successfully provide technical assistance.

Field Office Staffing

Debate exists as to whether or not host U.S. nationals should continue to head programs. U.S. nationals are sometimes hampered by language barriers and unfamiliarity with local business

practices. However, they can operate independently from local patronage systems, can avoid favoritism, and often have strong managerial and technical skills. Host country nationals tend to lack managerial experience but benefit from familiarity with local culture and language.

Experience suggests that a good combination is achieved with a U.S. national program director, supported by a professional staff of host country nationals.

Success Factors

Based on the last four years of experience, the success of foreign assistance programs throughout the region has depended on several factors. These include: 1) appropriate matching of advisors/ volunteers and clients; 2) good project definition; 3) capability and cooperation of host counterparts; 4) managing expectations of clients, advisors, and local counterparts; 5) timely method of getting feedback from all program participants; and 6) the ability to incorporate lessons learned into continued program improvements.

Through experience, A.I.D. grantees have been able to make programmatic adjustments in all of these areas based on their lessons learned since first implementing their programs. For example, in the first stage of programming, A.I.D. grantees worked eagerly with almost any firm seeking assistance. Now that there are more private firms from which to choose, and many with demonstrated experience, grantees can be more selective in choosing the best projects. Through their local experience, grantees now have greater familiarity with local business culture, a better grasp of the skills needed by advisors, and improved understanding of the assistance needs of private firms.

Host Country Contribution

Some grantees have discovered that the financial contribution required by host country firms to support a resident volunteer is prohibitive to smaller-sized businesses.[18] In addition, programs which try to assist SMEs outside of the capitals find firms have even fewer financial means. As a result, assistance tends to be skewed towards larger firms with greater resources. This may become less of a problem as firms grow and develop over time. Meanwhile, programs should reevaluate the amount of contribution required by recipient firms to ensure that their needs can realistically be met.

Monitoring and Evaluation

A.I.D. programs need better feedback mechanisms from the field to enable constant improvement of activities. Most grantees working at the firm-level conduct an initial evaluation after project completion, with some additional follow-up six to twelve months later. Beyond that, longer term follow-up is not widely undertaken, and often the information gathered is not reviewed critically.

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[18] For example, MBA Enterprise Corps volunteers are considered as local employees in most countries. Host companies must pay their social security, health insurance, and other taxes which can total 60% of salary. This cost burden might be relieved by classifying volunteers as "consultants," yet legal and programmatic implications would need to be examined.

The initial evaluation usually captures the level of client satisfaction with the advisor. Follow-up evaluations are often insufficient to capture key information such as how business performance improved as a result of assistance. To make this determination, performance data would need to be collected on a longer-term basis. For example, it may have been impossible for a firm to implement an advisor's recommendation in the short run, due to lack of management ability or capital. The design of future programs should include long-term monitoring and evaluation methods, as well as a way of incorporating lessons learned into program improvements.

Evaluation of programs which are trying to affect policy change is much more difficult. Can a program be considered unsuccessful if a particular piece of legislation was not adopted as intended? There are too many external factors affecting the policy arena to evaluate the effectiveness of a policy reform program solely on this basis. Policy reform is a process. As such, incremental steps along the way could be monitored to assure that reform efforts are at least headed in the right direction. Such steps might include monitoring debate of key issues affecting SMEs at the national level, the extent to which these issues factor into local or national elections, or the quality of media coverage on these issues.

Long-Term vs. Short Term Interventions

As detailed earlier, the use of long-term advisors is still appropriate given the long-term nature of the constraints hindering the operating environment for SMEs. Firms will continue to require long-term mentoring and follow-up as they grow and adapt to changes in the marketplace. Long-term technical assistance at the policy level is still required given the complexity of issues and the time needed to address them. Institutional capacity building is also a long-term effort which will require long-term commitment of resources.

Coordination and Collaboration

Grantees believe there is an opportunity for greater collaboration among A.I.D. grantees and other donors throughout the region. Through better coordination, assistance agencies can pool resources, share ideas, and exchange information, which would enrich all program participants. Coordination should also take place at a regional or municipal level to help ensure local impact and demonstration effects.

With Other A.I.D. Programs

The team saw many examples of how collaboration among 1800023 grantees produced excellent results. In addition, many activities under the 1800023 portfolio relate to other A.I.D. programs and priorities. For example, the MBA Enterprise Corps is working closely with the Enterprise Funds in both Bulgaria and the Czech Republic to provide finance and marketing assistance. A.I.D.'s privatization efforts in the region are enhanced by SME support activities, as SMEs are beginning to absorb labor shed in the privatization process. Grantees under 1800023 have also been active in democracy enhancement, and have coordinated with Treasury, ABA/CEELI, and other advisors to improve the legal environment for SMEs.

With Other Donors

A.I.D. grantees have learned that by knowing more about other donor programs they can leverage the impact of assistance, such as making appropriate referrals. A good example of multilateral coordination is demonstrated by Peace Corps providing Small Business Advisors to EC-Phare Enterprise Support Centers throughout the region. In Poland, the GEMINI project has formed the "G-24 Task Force," which aims to coordinate donor activities in SME development. Such multilateral coordination efforts should continue to be a focus for the future.

With Local Organizations

Many foreign assistance programs are working with local organizations to support their continued development. These organizations such as policy and research institutes, business associations, and advocacy groups can become important local resources for private businesses in the future. It is therefore important for assistance programs to support this local talent and work to strengthen these indigenous institutions.

A Strategic Approach to Programming

The lessons learned in this section suggest that many issues still need to be addressed to ensure long-term development of SMEs in Central and Eastern Europe. Moreover, the success of A.I.D.'s efforts hinges on the ability to meet those needs. To this end, A.I.D. must aim for an assistance strategy which is greater than the sum of its parts: by combining several types of interventions at different levels, greater synergy can be created to meet the needs of the SME sector with limited resources.

As discussed earlier, a significant portion of the 1800023 resources to date has provided technical assistance at the firm-level. Initially, this was a good strategy for practitioners working to improve the SME sector. Firm-level assistance not only provided SMEs needed training, but provided A.I.D. with an understanding of micro and macro-economic constraints facing SMEs.

The lessons learned by grantees and information gained over the past several years indicate there is now a need for more focus on problems that cannot be adequately addressed through firm-level assistance alone. This implies the need for a combined approach to future programming. Additional focus is needed in developing local public and private institutions which can serve the needs of SMEs, policy reform efforts directed at both the local and national levels, and targeted training programs.

While A.I.D. could consider many different combinations of programs, it also needs an approach which is *strategic* -- that is, based on strategic objectives such as those detailed in Volume I. Through such a strategic approach to programming, appropriate interventions could be selected for various countries within a common framework. As the transition process continues, the mix of interventions could be adjusted based on the same set of strategic objectives. This allows for a consistent approach despite differences between countries and differences in their pace of economic transition.

5. Summary Examples - Grantee Applications of Lessons Learned

The following are examples of how A.I.D. grantees in the 1800023 portfolio have adapted their programs based on lessons learned in Central and Eastern Europe. Briefly summarized here are examples which have been cited earlier in this "Lessons Learned" section. These changes illustrate not only the importance of what has been learned, but provide insight into how lessons can be incorporated into future programming. The examples below are not listed in any particular order of importance -- they are all equally important lessons to consider.

Policy Reform through Grassroots Advocacy: In Poland, GEMINI initially began working on policy reform efforts through policy makers at the national level. As Poland has since undergone several changes in national government, GEMINI has learned the importance of also affecting policy change through a "bottom-up" approach, by working at the grassroots level.

Currently, GEMINI is working with a network of local enterprise clubs in outlying areas to encourage the development of grassroots SME advocacy initiatives and provide follow-up assistance on effective lobbying techniques. This work complements continuing GEMINI policy reform efforts at the national level.

Targeting Municipalities: Initially, IESC's activities in the region were focussed on providing technical assistance to privatizing SOEs. After becoming aware of numerous political and policy constraints in the privatization process, IESC determined it should be providing assistance directly to local government officials. As a result, IESC has begun to target technical assistance to municipalities through their Public Administration Program.

These projects include regional economic development, privatization, community development, urban planning, and municipal finance. For example, IESC has assisted the Mayor's office in Plzen, Czech Republic in a renewal project of the major town square. Retail shop fronts are being prepared for vendors now selling from kiosks in the square. When free of kiosks, the square will be renovated and will attract tourists and more businesses. Local tax revenues are expected to increase as a result.

Strengthening Business Support Services: After starting as a public finance facility, PBAS in Poland realized firms were not yet ready to handle large new sources of funding. Firms still needed basic business management tools such as planning, cost accounting, marketing. As a result, PBAS shifted its focus and now provides training to enhance the skills of Polish business management consultants. This new cadre of trained consultants will provide services to support the needs of growing SMEs.

Building Institutional Capacity: In Hungary, CIPE currently supports local research institutes which examine the SME sector and present findings through publications and national conferences. During the last election, CIPE sub-grantees encouraged each Hungarian political party to print their national platforms in the newspaper. Each platform included a policy statement on that party's stance towards SME development. As a result, the business community was able to consider these positions when casting their votes.

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Enhancing Information Flow: Based on an understanding of the importance of information on SMEs to encourage favorable government policy, GEMINI/Poland is developing an SME database and Research Foundation for a future SME Advocacy Bureau within the Ministry of Industry. GEMINI expects the database will encourage information sharing and advocacy activities for SMEs.

Using a Focussed Approach: An initial objective of the IRIS project was the enormous task of enhancing the legal environment for SMEs in Poland. IRIS approached this task strategically, by carefully researching the range of constraints facing SMEs in Poland and pinpointing which were priorities to address. IRIS identified a key constraint hindering SME access to credit -- lack of a collateral law -- and designed its program to particularly address this issue. This has proven to be an effective way of concentrating resources on a well-defined objective.

A.I.D./Donor Coordination: Several A.I.D. grantees are actively coordinating with other donor programs in the region. The Peace Corps is providing Small Business Advisors to EC-Phare supported Enterprise Assistance Centers to offer management, organizational development, and technical expertise. This multilateral effort enables both donors to leverage its resources in promoting local SME development. The MBA Enterprise Corps is now providing long-term volunteers to the Enterprise Funds in Bulgaria and the Czech Republic. In this way, the MBA Corps is helping build institutional capacity as well as providing firm-level technical assistance. Based on the need to coordinate donor resources in Poland, the GEMINI Project has helped form the "G-24 Task Force." Formed in partnership between government and the G-24 donors, its goal is to coordinate local efforts in SME development.

Long-Term Focus: As a result of three years experience providing short-term advisors in the region, IESC plans to provide a long-term "Resident Mentor" in several countries. This individual will provide long-term follow-up assistance to new and prior clients. In the future, a typical client may expect several follow-up interventions to help them carry out the recommendations of advisors in a step-by-step process.

Geographic Targeting Outside Capital Cities: CDC has begun to strategically target their short-term technical assistance to firms located outside the capitals in order to provide assistance in areas with few business development resources. In the Czech Republic, CDC is focussed on creating jobs in areas of high unemployment such as northern Bohemia and southern Moravia. In Romania, CDC is targeting four diverse secondary cities to build local capacity in areas of business potential.

Fees for Service: Through its experience in Poland, PBAS has learned the concept of user fees is prohibitive to many smaller businesses. Instead, they charge a "success fee," which is based on a benchmark such as percentage increase in sales resulting from technical assistance received.

Chapter III. Other Donor Programs Supporting SME Development in Central and Eastern Europe

The information in this section was obtained either from documents or interviews with persons responsible for the programs. A visit was made to Brussels and Paris to interview officials of the EC and OECD. Other interviews took place by telephone.

A. European Community

The EC is one of the largest (if not the largest) donors for SME development in CEE. It has allocated 210 million European Currency Units (ECUs) (approximately $210 million) for SME activities in eleven countries in CEE. The single largest recipient is Poland (91m) followed by Hungary (36m), Bulgaria (25m), Czech Republic (22m) and Slovakia (14m). EC-PHARE is the name of the EC's program for aid to the CEE countries. PHARE is an acronym for "Poland and Hungary Aid for Restructuring the Economy", but the program now includes all of the countries in CEE. (EC-TACIS - "Technical Assistance to the Commonwealth of Independent States" - is the name of its aid program for the Newly Independent States of the former Soviet Union.) The EC-PHARE program provides funding for activities in five categories,

- Privatization and Restructuring
- Management Training
- Tourism and Investment Promotion
- Banking and Finance
- SME and Regional Development

EC-PHARE engages in three broad areas of SME development activity -- (a) SME support institutions, (b) financial instruments, and (c) policy advice. EC-PHARE contends that their emphasis in each area varies from country to country. The SME activities tend to be tied to a regional development emphasis in each country, i.e., trying to decentralize program activities outside of the capital cities. There also seems to be a strong bias toward working to support institutional development.

SME support services are generally provided through business centers (called by different names according to the country) which provide training and technical assistance to SMEs. In some cases, they have utilized a business incubator approach. EC-PHARE documents state that when feasible, they operate through a national institution, e.g., Hungary, Czech Republic and Slovakia. In other cases, they operate through regional or local centers. In some cases, they operate through a combination of national and regional centers. General opinion voiced by EC-PHARE staff was that the business advisory services components were working well.

Financial services have been provided either through credit lines for small loans (generally to microenterprises) through banks or through loan guarantee programs. In some cases, EC-PHARE is establishing equity funds to assist entrepreneurs to either establish new businesses or expand. These funds are in the early stages of development and may very well be used in tandem with loan funds or guarantee programs as well. The STRUDER regional development initiative in Poland was mentioned by Mr. Pierre Mirel, Deputy Head of Unit, Directorate General for External Relations - PHARE Operational Service. He stated that the program is based upon a Portuguese model which provides grants to entrepreneurs who qualify for loans from banks. Dissatisfaction was expressed about the limited success of the financial services components. Problems with the banking sector or overall financial sectors in CEE were often linked to problems with financial services components to operate effectively. A total of ECU 125 has been committed by EC-PHARE to financial services components in CEE, mostly for small and microenterprise credit.

The general opinion of EC-PHARE officials was that there was considerably more work to do in the policy development area. It was expressed by both persons interviewed and in EC-PHARE documents that more emphasis needs to be placed on reforms in this area.

Persons interviewed also felt that many of their country programs tended to reflect the biases of the consulting firms that designed them and that a more strategic, regional approach was required. This observation reflected a similar viewpoint to that expressed by some officials of A.I.D., i.e., that the persons/organizations receiving the money for SME development in CEE often tend to design programs which reflect their own biases toward SME development. This is no real surprise. What is needed is for the government agency providing the aid funds to have a better internal vision of what they wish to accomplish.

A second observation by EC officials regarding the slow absorption rate of EC-PHARE aid funds by CEE institutions was creating criticism of the program. There have recently been criticisms of A.I.D. on this same score. It is interesting that this is a common problem to both agencies. Persons with experience in foreign aid have seen similar problems before, e.g., in Egypt in the 1980s.

A key problem mentioned by some EC-PHARE officials was that government ministries tended to be reluctant to allow private trade associations to create alternative power bases. This was often reflected in the attempt to control the SME support institutions in the country. EC-PHARE officials felt that, although the government obviously had a role to play in SME development (e.g., through the implementation of a supportive environment), the private sector must lead the way in providing services to SMEs.

Conversations with Peter Smith of Directorate General XXIII (DG23) revealed that DG23 was established to assist SMEs within the EC member countries. DG23 serves in a consultative role to EC-PHARE. It assists in the definition and conception of the EC member country programs. Its role in SME development in CEE is limited to assessments of EC-PHARE programs and helping to forge linkages between SME support institutions in EC member countries and SME support institutions in CEE.

Mr. Smith likened DG23 to the SBA in the U.S., except that DG23 works through the SME support institutions in the EC member countries. He viewed the policy environment as the most important area to work on in CEE, particularly property rights and bankruptcy laws. He felt that country programs were given considerable latitude to formulate their approaches to match local conditions. In regard to the comparative advantages of EC aid versus A.I.D., he felt that the EC had the advantage regarding trade issues, since SMEs tend to market their goods near to their production. On the other hand, he felt that the U.S. had much to offer in terms of financial services and legal frameworks for SMEs, since the U.S. could provide alternatives to the relatively more rigid and conservative systems found in Europe. He felt that the American bent of constantly challenging government regulations might have some applicability to the current situation in CEE countries.

B. European Bank for Reconstruction and Development

The European Bank for Reconstruction and Development (EBRD) was established in May 1990. Its stated purpose was to "foster the transition toward market-oriented economies and to promote private and entrepreneurial initiative in the countries of central and eastern Europe, including the former Soviet Union, thereby helping their economies to become integrated into the international economy." Its initial members consisted of Western European countries, Japan and the U.S. It now has over 20 members including many of the countries in CEE and the NIS. All members must be committed to and apply the "fundamental principles of multiparty democracy, the rule of law, respect for human rights, and market economics."

The EBRD completed its first full year of operations in 1992. Mario Sarcinelli, Vice President of the Development Banking Department, described the difference between EC-PHARE and the EBRD as follows (from an article entitled "PHARE and the European Bank" in the publication Action for Central and Eastern Europe:

> PHARE is basically a "know-how" program -- it aims at restructuring by providing the knowledge and skills to enable the local people to understand and solve their economic problems in the context of the transition to a market economy. The majority of funds are spent on the services of experts and consultants whose knowledge and skills are applied mostly in the eastern European countries themselves....This assistance is provided in grant form as a gift to the country involved. Although project benefits are carefully assessed in advance, there is no need for a direct financial return on the technical assistance provided.
>
> Essentially, the European Bank (EBRD) operates an "investment" programme. Its objective is to encourage investment in central and eastern Europe in both public and private sectors....In its operations, the Bank is required to apply "sound banking principles", that is, it should undertake projects which are calculated to give a sufficiently high return on the investment mode....In order to make infrastructural improvements or significantly affect efficiency, the Bank's projects frequently involve the purchase of large amounts of hardware. Technical assistance is normally a small percentage of the total project value.

The EBRD approved 54 projects totalling ECU 1.2 billion in 1992. An EBRD representative in Slovakia stated that most of their projects are $15 million and above. Of the 70 projects approved between 1991 and 1992, 12 were equity investments, 40 were loans and two were agency lines of credit.

Most of the EBRD's efforts in SME development involve banking reform and attempts both to improve banking methods and procedures and to free up lines of credit for SME financing. The 1992 Annual Report states that the EBRD has attempted to address "the problem of "transforming financial institutions from passive instruments for centrally planned allocation of credit into agents capable of performing the crucial function of the market-based direction of resources in a free economy." It goes on to say, "Throughout the region, the Bank combines advisory services aimed at overall rehabilitation programs and policy establishment with directed investment in institutions capable of acting as banks in a free-market economy." Agency credit lines involving international and local banks have been established in some countries to enhance banking services to SMEs. However, the EBRD concedes that its experience in this regard has not been very successful and that more must be done to encourage partners in these ventures if the problems of SME finance are to be resolved.

EBRD sources stated that the single initiative dealing with a special fund for SMEs undertaken by the EBRD is the Russia Small Business Fund. We were informed that the EBRD has committed $300 million to this fund for credit to small enterprises if the pilot phase proves successful. This fund is currently operating in three sites and with success, will be expanded to about 150 locations throughout Russia. No special funds of this nature have been established in CEE.

C. Organization for Economic Cooperation and Development

The OECD operates as a research and coordination vehicle for the OECD member countries. It does not implement any SME development activities, but rather produces reports on various issues relative to SME development and serves as a coordinating body for donor activity in specific instances when member countries desire OECD services.

There are three sections of the OECD which are dealing with CEE relative to SME development. Their activities are described below.

1. The **Center for Cooperation with the Economies in Transition (CCET)** is a division of the OECD established to deal with issues relative to countries in CEE and the NIS. They have produced a number of helpful reports dealing with various issues, including SME development in the CEE. (Note titles in section below.) The CCET maintains a Register of OECD country activities in CEE and the NIS, including A.I.D. activities. The EC, which has been charged by the various donors active in SME development in CEE to coordinate SME development activities has delegated most of its record-keeping responsibility in this area to the CCET. As such, the CCET serves as a central database for G-24 activities in CEE. A.I.D. personnel have access to the CCET database through their computer linkups in their offices.

2. The **Directorate of Science, Technology & Industry (DSTI)** has worked on SME activities over the past four years. It has a division composed of three persons lead by Madame Marie-Florence Estime. It has concentrated on analyzing country policies toward SMEs and comparing different country approaches toward SME development. It seems to generate its activities through conferences. Conferences have been held each year since 1990 in Paris, Lisbon, Montreal and Australia. It has conducted two conferences in CEE and the NIS in 1992, one in Poland and one in Russia. At the 1993 conference, a Working Party was established composed of representatives from various OECD countries. An officer of the Small Business Administration (SBA) serves as the U.S. representative on the Working Party. The Working Party has decided to conduct the following activities regarding SME development over the next few years:

- Review of best practices in business environment, management capability, finance and access to markets.

- Creation of an international database on SME policies in member countries; four topics would be developed - policies & programs, institutions providing services to SMEs, facts and trends, and calendar of events. A statistical database would be kept by the OECD Statistical Division and Eurostat.

The Working Party will hold a conference in Seville in September dealing with SME finance. Madame Estime stated that they are interested in forming an institution to serve SMEs in member countries which would serve as a secretariat for the Working Party and would be funded by the private sector. She stated that they plan to target multinational corporations and banks for funding.

3. The **Local Initiatives and Employment Creation (ILE) Program** was created in 1982. Its approach appears to be more socially oriented than the DSTI approach. One gets the impression that its focus is on job creation and social equity issues rather than economic growth issues, per se. A few years ago, it was decided to try to export the lessons learned under the ILE program to CEE. A conference was held in Poland in March 1994 on credit guarantee funds for small and microenterprises. Latin American examples were used as a model. ILE is interested in forming partnerships between credit programs operating in Latin America and CEE. ILE is also working with Women's World Banking and the South Shore Bank to help develop small and microenterprise credit programs in CEE. It is also trying to replicate an Italian program in CEE countries which encourages larger companies to mentor smaller companies. The idea is to pair companies in Western Europe with smaller companies in CEE, starting with countries bordering Western Europe.

It has been proposed that the ILE Program be transformed into the LEED Program (copy of proposal in documents cited below) which would provide activities in the following three areas:

- Development of entrepreneurship and small and medium size enterprises.
- Managing the social costs of transition at the local level.
- Territorial employment development.

The proposal states that approximately 70% of the principle activities would be implemented in the Partners in Transition (PIT) countries (Poland, Hungary, Czech Republic and Slovakia) and the remaining 30% in other countries. Regional projects would take precedence over country-specific projects.

D. World Bank (including the IFC and IMF)

Discussions with World Bank representatives revealed very little activity in SME development by Bank programs. The flagship program appears to be Polish Business Advisory Service (PBAS). It was established in 1991 by the International Finance Corporation (IFC)[19] and the EBRD and has received subsequent support from other donors. Its funding commitments to date total $11.4 million, of which $4.6 million had been disbursed by the end of the third quarter of 1993. (See a discussion of PBAS, which has received some assistance from A.I.D., in Chapter II.)

The second project mentioned by World Bank sources is a microenterprise project entitled the "Rural Poverty Alleviation Project" in Albania. This project started in 1993 and is currently in the pilot stage and has two components: (1) a rural works component emphasizing infrastructure development and employment and (2) village credit funds which utilize a Grameen Bank type of methodology. The loans are for $500 or less and given to farmers. World Bank officials are pleased with the success of the pilot phase to date and are currently searching for co-financing of the full-scale phase. The pilot phase was joint financed by IDA and the EC for a total of $4.5m. The full-scale phase will amount to approximately $22m over 3 years and would extend the program to all villages in the country.

Although the World Bank has financed a number of country studies on SMEs in CEE, these appear to be the only two interventions in which they have engaged.

E. United Kingdom

1. Know How Fund

The British Know-How-Fund (KHF) is a central part of the British Government's assistance to CEE and the former Soviet Union. Its main objective is to assist those countries to move toward democracy and free market economies through the provision of advice and expertise.

The KHF was launched in 1989 to provide funds to Poland in the amount of £25 million. Over the years it has been broadened to cover all CEE countries as well as some of the NIS.

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[19] Funding also has been provided under A.I.D.'s 1800023 portfolio.

Disbursements for 1989/90 were £2.3m, for 1990/91 - £15m, 1991/92 - £36m, and 1992/93 - £49m. The expected expenditures for 1993/94 is £53m.

The KHF is managed out of the Joint Assistance Unit (JAU) of the Foreign and Commonwealth Office. In June 1992, the JAU was split into two divisions - JAU (Eastern European) covering the Baltic States, Russia, the Ukraine and the rest of the former Soviet Union and JAU (Central European) covering Albania, Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovak Republic and Slovenia. An advisory board composed of representatives of political parties, business, industry, trade unions, journalists and British specialists on the region provides guidance to the administrators of the KHF.

KHF assistance is designed in collaboration with each of the governments involved in order to come up with specific country programs which are tailored to their needs. The main priorities in CEE have been assistance to the financial services sector, co-operation between the respective employment services, advice on the establishment of small businesses, management training, and the training of civil servants and local government officials. Secondary priorities have included energy, environment and the industrial sectors. Agriculture has not received much assistance except for Romania and in the context of the separate Polish Agriculture Development Fund. The four targeted sectors in the Baltic States and the former Soviet Union have been energy, small business creation, financial services and food processing and distribution.

Other, related programs include the following:

- Investment Support Schemes: These involve grants to British businesses contemplating investment in the region. Two different programs exist - a Pre-Investment Feasibility Studies (PIFS) Scheme and a Training for Investment Personnel (TIPS) Scheme. 89 applications for PIFS grants totalling £2.47m and 34 applications for TIPS grants totalling £.87m were approved between April 1992 and March 1993. Greatest interest under these programs has been shown for investments in Poland, Russia, Hungary and the Czech Republic.

- Joint Industrial and Commercial Attachments Program (JICAP): This program provides internships for middle managers of CEE and NIS firms with UK firms to gain management experience.

- Environmental Know How: This is a specific fund for responding to the threat of environmental damage within the region. It will spend £5m between 1992 and 1995 on projects dealing with this problem.

- Charity Know How: This was a response of various charitable trusts in Britain to provide support and assistance to the emerging voluntary sector in CEE and the NIS. Its total expenditures in 1992-93 were about £700,000 on 303 grants in 20 countries.

- Technical Twinning Scheme: This provides funding for technical projects carried out jointly by a UK local authority and a partner in the region. This scheme has just gotten underway and has committed funds in the neighborhood of £400,000.

2. Eastern Poland Enterprise Fund

A special project was formulated for Eastern Poland subsequent to a visit by Prime Minister John Majors to Poland in 1991. This was a part of a commitment of £50 million made during that visit. This project was designed with four components:

- A business development program to provide support for networks of business services organizations and incubators.

- An equity investment fund to address the under-capitalization of SMEs by providing medium term finance in the form of low cost equity participation.

- A loan guarantee scheme to help resolve the problem of collateral for SMEs when applying for loans.

- A market development program to help train and equip SMEs to secure new markets locally and abroad.

This program was approved by the UK government in late 1993 with funding of £12 million.

Attachment A:

Summaries of 1800023 Grant and Contract Activities

180-0023 Activities Summary for CIPE Center for International Private Enterprise

The following is a summary of activities for CIPE in Central and Eastern Europe. The information was obtained through personal interviews with the headquarters and field staff, clients, and document reviews. The discussion below is based on the best information available for each country. Section I describes the program, Section II details the lessons learned based on experience, and Section III discusses future directions and needs as determined by research interviews.

I. Program Overview

Description of Program

Founded in 1983, CIPE is an independent foundation affiliated with the U.S. Chamber of Commerce, and mainly funded by the National Endowment for Democracy. CIPE has been active in the CEE since 1989, supporting local entrepreneurs, business organizations, and public policy institutes to advocate for better business laws and market oriented reforms. CIPE aims to encourage the growth of private enterprise principles and organizations as vital elements in the process of democratic development.

In 1992, CIPE received A.I.D. funds to promote business and entrepreneurship development in the Baltic States (Estonia, Latvia, Lithuania) and a better legal and regulatory environment for SMEs in Hungary. To this end, CIPE provides direct grant support to indigenous business organizations and public policy institutes in these countries who are potential advocates for legal and regulatory reforms. The average grant amount to CIPE sub-grantees is $35,000.

CIPE's objectives are carried out through two main approaches. Legal/regulatory reform and structural adjustment efforts are carried out through research, lectures by foreign experts, policy papers, newsletters, and mass media in coordinated advocacy campaigns. Policy papers and meetings with government policy makers are then used to shape upcoming elections and emerging legislation. CIPE's other approach is through public and media support to educate the public, businesses, and policy makers to promote a positive image of private entrepreneurs and to build support for market economic reforms.

Targeted Group and Criteria for Selection

To achieve its program objectives, CIPE first forms an Advisory Board in-country, which then helps select subgrantees for CIPE funding. The Advisory Board is a formal advocacy group for the business community comprised of influential members of government and major organizations. The Advisory Board also discusses project issues and hosts foreign experts in the areas of legal and regulatory reform.

Subgrantees are selected on their ability to conduct advocacy programs and build upon existing capacity, as well as their established track record and reputation. These organizations are existing and indigenous, and are usually aligned with a particular party, or cause. CIPE strives for balance of political orientation, and promotes the concepts of advocacy and teamwork.

Funding by Country

CIPE received $1,500,000 for CEE programs in FY 1992 under the 1800023 portfolio as detailed in the chart below.

CIPE - Central & Eastern Europe
1800023 Funding Levels - FY 1992
Source: SEED ACT 1993

FY	EST	HUN	LAT	LIT	TOTAL
1992	$167,000	$1,000,000	$167,000	$167,000	$1,500,000

CIPE's original Grant Agreement was obligated 9/30/92 for $1,000,000 for programming in Hungary. In September 1992, CIPE was awarded $500,000 to promote enterprise development in the Baltic countries.

Activities

In FY 1992, CIPE began its activities in Hungary and the three Baltic countries, Estonia, Latvia, and Lithuania. Since then, CIPE expanded its activities in 1994 to include Slovakia, Romania, and Bulgaria.

Hungary: In Hungary, CIPE has developed an interactive Hungarian Legal and Regulatory Reform program which has supplied grants directly to five local organizations to support policy change. These include the following:

- The Foundation for Market Economy is undertaking a research and advocacy project to study incentives for doing business in the informal sector (such as burdensome taxes, and lack of access to credit).

- The Institute for World Economics is examining the privatization process.

- Financial Research, Ltd. analyzes and makes recommendations for financial sector reforms.

- The National Federation of Craftsmen's Associations is focussing on tax policies as impediments to SMEs. The Federation's large constituency of over 130,000 members comprises a substantial advocacy group for the government to recognize.

- The Public Policy Institute is working to identify ways for local governments to provide incentives for private sector development, such as a land-registry system.

In the recent Hungarian election, CIPE-subgrantees encouraged each political party to develop a stand on SME development. Each of these positions was published in the newspapers prior to the election. As a result, the business community was able to consider these positions when casting their votes.

In addition, CIPE is publishing a monthly newsletter and research papers on issues such as privatization and the informal sector. Through this information, CIPE can help the government realize that tax increases push many businesses towards the informal sector, resulting in reduced tax revenue, the opposite of the intended effect. Circulation of about 10,000 newspapers is expected, with partial publication in English. Policy papers will be compiled into a research volume and circulated to about 400 policy makers, academics, and others interested in private sector issues.

Estonia: The Estonia Small Business Association (EVEA), a sub-grantee, is promoting small business development in cooperation with the Estonian Privatization Agency.

Outputs by Country

During CIPE's 1992 tranche of funding, CIPE completed the following number of projects (funded sub-grantees) for each country: Estonia (1); Lithuania (1); Latvia (2); and Hungary (6). In 1994 to date, the following number of projects were underway: Estonia (1); Lithuania (1); Latvia (1); Slovakia (3); Romania (1); and Bulgaria (3).[1]

II. Lessons Learned

Based on CIPE's experience working to affect policy change in the CEE since 1992, the following lessons are worth noting.

Information is an important tool for policy change: As mentioned above, during the last election in Hungary, CIPE sub-grantees encouraged each Hungarian political party to print their national platforms in the newspaper. These platforms included each party's stand on SME development. Voters were able to consider these positions when casting their votes. Information proved to be an important element in the process of electing government officials who encouraged SME development.

Focus on Indigenous Organizations: CIPE has found this to be a key element in helping to ensure successful transition to a free-market economy. Since much local talent exists, CIPE can help to support continued professional development while building on existing structures, rather than imposing, new artificial ones.

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[1] Source: CIPE Report, July 14, 1994.

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Compulsory Chamber Membership Laws is Cause for Concern: In Hungary and several other CEE countries, the government supports new legislation which would require mandatory membership in local Chambers of Commerce. This is based on the Chamber model common in Germany. All licensed businesses would be required to join a Chamber and pay the required fee. CIPE anticipates several adverse affects of these mandatory membership laws: increase of non-licensed (i.e. informal) businesses; dissolution of alternative, community-based associations; increased ill-will towards government; and distrust of entrepreneurs towards Chambers of Commerce. In the future, foreign assistance organizations should be encouraged to only support those organizations with voluntary, open membership, in order to promote democratic principles throughout the region.

Other Accomplishments of Program

Through CIPE's Advisory Board, research by sub-grantees, and resulting publications, CIPE helped to highlight issues for policy debate in the Hungarian elections which greatly concerned the growing business community.

As a result of a joint venture with the U.S. Information Agency, CIPE initiated a new magazine in 1991 entitled "Economic Reform Today." The magazine provides decision makers and opinion leaders in CEE and other developing and transitional economies with information needed for making informed economic policy decisions. Worldwide circulation in first quarter 1994 was around 26,000 readers. In addition, CIPE has produced a series of monographs called "Prosperity Papers" specially for use by the U.S. Information Service. These serve as educational primers on economic topics important to policy makers. The papers have been printed in Hungarian and other CEE languages.

Impacts and How Measured

Gaging impact of policy reform efforts is difficult, given the long time frame required and complexity of the task. Aside from tracking outputs, CIPE mainly measures its impact by the accepted credibility of work produced.

III. Future Needs and Directions

From CIPE's perspective, key priorities for promoting SME development in the future should be in the areas of tax reform and financial intermediation.

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180-0023 Activities Summary for Citizens Democracy Corps (CDC)

The following is a summary of activities for CDC in Central and Eastern Europe. The information was obtained through personal interviews with the headquarters and field staff, clients, and document reviews. Field research was conducted in each of the five CEE countries of operation: Bulgaria, Hungary, Poland, Romania, and the Czech Republic. The discussion below is based on the best information available for each country. Section I describes the program, Section II details the lessons learned based on experience, and Section III discusses future directions and needs as determined by research interviews.

I. Program Overview

Description of Program

CDC, a private, non-profit NGO, was founded in May 1990 to provide voluntary assistance from the U.S. to the emerging private sector in Central and Eastern Europe. Senior-level business managers and technical experts provide management assistance to private and privatizing firms on a voluntary basis. Volunteers typically serve for two months. Headquartered in Washington, CDC has field offices in Bucharest, Budapest, Prague, Sofia, and Warsaw.

CDC aims to strengthen SMEs as an important source of growth and income generation in the transitional economies of the region. To this end, its key objectives are: 1) to provide technical and management assistance to SMEs and privatizing businesses to increase their ability to operate profitably and competitively; and 2) to assist public sector and non-profit organizations to increase their ability to support the development of SMEs and privatizing firms.

The program's first activity was to establish an information Clearinghouse on U.S. non-profit assistance programs in CEE and the NIS. In addition, CDC has developed three assistance programs in response to the needs of the region. These have included the Corporate Assistance Program (CAP), the Business Entrepreneur Program (BEP), and the Citizens Volunteer Program (CVP). Due to funding limitations and shifting A.I.D. priorities, the BEP is currently the only program in operation. Below are brief descriptions of each of these program activities:

- The Clearinghouse collects and disseminates this information through its Databank, Volunteer Registry, and regional conferences. CDC has published a Compendium of U.S. Nonprofit Assistance to Central and Eastern Europe and the Commonwealth of Independent States, as well as over twenty country-specific Assistance Directories.

- The Corporate Assistance Program enlists U.S. corporations to provide pro bono assistance to build managerial, technical, and financial skills of public and private sector institutions in CEE. Corporate Advisors volunteer for six months to a year working with top managers of host institutions. CDC no longer continues to operate this program due to funding limitations.

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- The Citizens Volunteer Program (CVP) provides skilled U.S. volunteers to strengthen public and private institutions for a minimum of two months. The program has mainly focused on assisting municipal governments, NGOs, and educational institutions. CDC helps local or regional authorities to institute new policies and programs to improve the operating environment for SMEs. CDC no longer operates this program. However, elements of the CVP have been incorporated into the present BEP program.

- Initiated in June 1992, the Business Entrepreneur Program (BEP) matches experienced U.S. entrepreneurs with SMEs in the region to provide direct firm-level technical assistance to help companies compete in a free market economy. Entrepreneur Advisors (EAs) volunteer for a minimum of two months.

- In April 1992, CDC began assigning "Entrepreneurs in Residence" (EIRs) to CDC offices in Bulgaria, Czechoslovakia, and Hungary. These long-term volunteers assess companies and develop assignments for the EAs. In addition, they share advice and ideas with numerous companies in the business community. The EIR program was expanded to Poland in October 1992 and to Romania in January 1993. Currently, this is the main program focus of CDC in the region.

Countries & Dates of Operation

CDC began activities in the region in 1990, and the expected PACD of the original contract agreement was July 1994. The Business Entrepreneur Program was initiated in mid-1992 in Bulgaria, Hungary, Poland, and the Czech Republic, and not until 1993 in Romania due to the slow pace of privatization. CDC stopped sending volunteers to the CEE in October 1993 because of fundraising difficulties. The BEP Program was later restarted in April 1994. The dates of the first BEP volunteers are as follows:

Citizens Democracy Corps - Central & Eastern Europe
Business Entrepreneur Program - Starting Dates of Operation
Source: CDC Report, July 1, 1994

	BUL	CZECH	HUN	POL	ROM
START DATE	June 92	July 92	June 92	July 92	June 93

Targeted Group and Criteria for Selection

CDC has developed a specific set of criteria for selecting firms to receive technical assistance. As guidelines, these criteria are consistently used in all countries of operation in the region:

1) Small to medium firms (10-1500 employees) which are private or actively privatizing.
2) Preference on production-oriented companies (particularly manufacturers).
3) 100% local ownership (if possible).
4) Well-established firms (preferably in business at least one year).

5) Firms with high potential for success given their operating environment.
6) Stable management willing to devote time and resources to support an advisor, including local accommodation, translation services, and administrative assistance.

Based on experience working in Bulgaria since 1992, CDC/Bulgaria has added other specific criteria to the selection of firms. These include: 1) Firms with viable products that can be improved and exported mainly to Eastern markets; 2) No firms active in the arms/defense industry are to receive assistance; 3) No firms in the tourism industry, as the necessary interventions are too large and costly for limited CDC resources; 4) No small traders will be assisted since CDC tries to support firms in productive sectors.

No particular sub-sector has been targeted in the region except where noted. Geographically, CDC has begun to target secondary cities and other areas outside of capital cities. For example, in Romania CDC initially targeted the Transylvania region. Now CDC is targeting four cities for geographic diversity: Cluj, Bresov, Iasi, and Constanta. They were selected due to the existence of regional centers in the cities; their openness to and potential for business development; and the limited local assistance resources available. In the Czech Republic, CDC is focussed on creating jobs in areas of high unemployment such as northern Bohemia and southern Moravia.

Funding by Country

In 1991 CDC received funding for three years of activity in CEE under the 1800023 portfolio. A recent proposal has been submitted to A.I.D. for extension for the period August 1994 - September 1995.

Citizens Democracy Corps - Central & Eastern Europe
1800023 Funding Levels FY 1991 - FY 1992
(in $000's)
Source: SEED Act Report, 1993

	ALB	BUL	CZE	EST	HUN	LAT	LIT	POL	RM	Total
FY91	$292	$292	$292	$16	$292	$16	$16	$292	$292	$1,800
FY92	$426	$426	$426	$0	$426	$0	$0	$426	$426	$2,557
Total	$718	$718	$718	$16	$718	$16	$16	$718	$718	**$4,357**

Activities by Country

The following are highlights of specific CDC program activities in different CEE countries of operation. This information is not a comprehensive look at each country program, but is intended to provide key examples of different approaches and activities based on lessons learned in different countries.

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Bulgaria: Initially, the key activity has been to prepare firms for privatization. It was difficult at first to find enough private firms to work with which met CDC's criteria. Of current projects, 80% are state or municipal-owned firms, 20% private. Since privatization is expected to continue at a slow pace in the near future, CDC/Bulgaria is now taking a new focus: on SMES, municipalities (to encourage privatization of local companies), NGOs, and other organizations that train business people. CDC is providing assistance to meet the key needs of entrepreneurs in the areas of marketing, management, and financial control.

Czech Republic: CDC is focussing on small and medium-sized manufacturers rather than service organizations or financial institutions. Their activities are concentrated on creating jobs in areas of high unemployment such as northern Bohemia and southern Moravia. According to the Country Director, their focus is on three types of clients. They mostly work with the "consciously incompetent," with the "unconsciously incompetent," and also with inexperienced individuals who are willing to ask for help.

Poland: CDC is working with a local foundation (FISE) to provide training to entrepreneurs, and is working in conjunction with other A.I.D. -funded programs such as the Polish-American Enterprise Fund, CARESBAC, and PIET.

Romania: This program started later than the others, in June 1993, partly due to the slow pace of privatization. The objective is to place advisors in SMEs which are private or privatizing, and in institutions which support the development of the private sector. After initially targeting assistance to Transylvania, now CDC/Romania is targeting new areas: Cluj, Brasov, Iasi, and Constanta. These areas were targeted since CDC wanted to concentrate activities to demonstrate successes and build a local contact base in diverse locations and larger cities which have fewer foreign assistance resources. Their industry focus is on manufacturing, the banking sector, private media, and the environment (as consistent with U.S. government priority sectors).[1]

[1] Source: CDC/Romania, Business Program Strategy.

Outputs

From 1991 through mid-1994, CDC has fielded 272 volunteers to five countries in CEE. These figures do not include 15 long-term Entrepreneurs in Residence. Of these, approximately 75% have been business or business-related assignments. The remaining 25% have been with universities, hospitals, and non-profit organizations.

Citizens Democracy Corps - Central & Eastern Europe
Number of Volunteer Assignments Completed, On-Site or Scheduled
1991 - June 1994
Source: CDC Report, July 1994

Program	BUL	CZECH	HUN	POL	ROM	TOTAL:
BEP	24	39	13	18	12	106
CAP	15	29	7	18	1	70
CVP	38	19	20	3	16	96
TOTAL:	77	87	40	39	29	**272**

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Cost Measurements

The chart below details the average cost to A.I.D. per week of a volunteer assignment for CDC. This is based on an average assignment length of 8 weeks.

CITIZENS DEMOCRACY CORPS - Central & Eastern Europe
Summary Data for A.I.D. Grant Funds Used and Volunteers Fielded
(figures rounded to nearest $10,000)
Source: CDC Report, July 1994

FY	FUNDS USED	TOTAL VOLS	VOLUNTEER WEEKS	
1992	$700,000	85	680	
1993	$2,400,000	170	1360	
1994	10/1/93 - 3/31/94 $700,000	0	480	
	4/1/94 - 9/30/94 (est) $780,000	60		
TOTAL:	$4,580,000	315	2,520	
			AVG COST TO A.I.D. PER WK PER VOLUNTEER	**$1,817**

In 1991, CDC received A.I.D. funds initially only for Clearinghouse operations. While direct Clearinghouse expenses have been excluded from the figures above, there are some indirect costs that could not be separated. In 1991, CDC used $290,000 to run Clearinghouse operations and to establish the CAP program. Volunteer based programs did not start until 1992.

Due to a funding freeze, CDC ceased its volunteer operations between October 1, 1993 and April 22, 1994. During this period, CDC underwent restructuring and renegotiated their grant with A.I.D. To enhance its cost-effectiveness, CDC reduced its Washington staff from 25 to 12 and moved to smaller offices. Field offices were also directed to sublet space or seek less expensive quarters. CDC restarted its program on April 22, 1994 and incurred the associated costs of recruiting advisors and marketing to potential clients.

CDC volunteers generally pay their own daily expenses except housing during their two months overseas assignment. Housing is usually provided by the local company, and is sometimes at substantial expense. In Romania, for example, even when a competitive local hotel rate has been negotiated, hotels in one of the four target cities cost roughly $10 per night. For a two month stay this totals roughly $600, higher than the average per capita monthly income.

Since only airfare and housing are provided by CDC and volunteers do not receive a stipend or

per diem, the CDC program is highly cost effective for A.I.D. Volunteers are willing to make their own financial contribution due to expected future benefits of personal and business relationships.

II. Lessons Learned

Need for Long-Term Assistance: Through the long-term assistance of Entrepreneurs in Residence (EIR), CDC has learned that these long-term advisors play an important role above and beyond assessing companies and developing assignments. While engaged in these activities, EIRs can share advice and ideas with many more companies than can directly benefit from a short-term CDC advisor. These long-term advisors can help build business contacts and support the development of a cohesive business community.

Regarding Volunteers: Volunteers are much better received than paid consultants would be given negative attitudes of many individuals in the region towards highly paid U.S. consultants. CDC also found it beneficial to concentrate volunteers in several cities to leverage expertise and share ideas. Volunteers also prefer to live near each other for mutual support, and it makes the program easier to manage.

Programmatic Lessons: After several years operating in the region, CDC has made programmatic adjustments based on lessons learned. CDC now emphasizes higher quality assignments, better project design, more specific objectives, and more careful assessment of results through assessment forms. CDC has learned that the best assignments are specific and well-defined. CDC is now more selective of clients, working less with start-ups, and more with established firms with market potential. In addition, CDC has recognized the need for better coordination between programs. To this end, they suggest establishing a central database of clients served by A.I.D. grantees to leverage resources and avoid duplication of effort.

Needs of Entrepreneurs: As transition has proceeded, the needs of entrepreneurs have changed. Instead of requesting financing, entrepreneurs are now asking for more specific technical assistance. For example, entrepreneurs need a better understanding of how to perform cash flow projections, negotiate contracts, and set up sales terms and conditions. CDC has found the larger the company, the more complex the assistance needs, and the greater the time needed for assistance. Previously, firms sought joint-venture partners and believed that an external source of know-how and capital would solve their problems. Now firms are more aware of their deficiencies and believe they can solve their own problems by adopting the necessary recommendations of advisors. Now that entrepreneurs realize the importance of assistance, there is increased demand for assistance. As a result, CDC can be more selective of clients with the greatest potential for success.

III. Future Needs and Directions

The following are several country-specific priorities for SME Development based on the experience of CDC in Central and Eastern Europe:

Czech Republic: Shift regional focus to areas of high or potential future unemployment such as

northern Bohemia; target technical assistance to the municipal level for greater impact.

Romania: Focus on improving available credit and management skills; promote a stable economic climate through encouraging consistent and favorable government policies, tax laws, and laws which encourage foreign investment; help to speed up the privatization process.

Approaches that Might be Transferred to Other Countries

Based on lessons learned, CDC believes it is important to focus technical assistance to local level interventions. For example, in Bulgaria CDC is working with the Association of Free Mayors for referrals and in order to privatize companies at the municipal level. This local intervention has greater likelihood of making the local environment more favorable for private sector development than would policies eventually adopted at the national level. This approach could be applied to other countries throughout the region to encourage the transition process.

180-0023 Activities Summary for GEMINI - POLAND

The following is a summary of GEMINI's activities in Poland. The information was obtained through personal interviews in Washington D.C. and Poland with GEMINI staff, government officials involved with the project, and document reviews. Section I describes the program, Section II details the lessons learned based on experience, and Section III discusses future directions and needs as determined by research interviews.

I. Program Overview

Description of Program

The GEMINI/Poland Small Business Project is a collaborative venture between the Polish Ministry of Industry and Trade (MIT) and A.I.D. In 1991, Development Alternatives, Inc. was contracted by A.I.D. to implement the project, which is a component of DAI's worldwide Growth and Equity through Microenterprise Investment and Institutions (GEMINI) program. Under the original work plan, the program's activities began in September 1991 and are focussed exclusively on Poland.

GEMINI is helping to build the capacity of the government to create and sustain an environment conducive to the formation and successful operation of SMEs in Poland. To this end, the project has two key elements: 1) to assess the financial needs of small business and 2) to assist in industry-specific reform in the construction and agri-business sectors.

GEMINI's goals as stated in their Scope of Work are as follows:

- Identification of policy-related constraints and opportunities affecting small enterprise development;
- Evaluation and prioritization of support programs and regulatory and procedural initiatives to accomplish specific small enterprise development objectives;
- Assistance in planning and coordinating small enterprise promotion and service activities within the GOP;
- Enhancement of the capability of the Ministry of Industry and Trade/SME Office to facilitate communication between the private sector and the GOP.

Funding by Country

The original buy-in to the GEMINI Project/ Contract Amendment was obligated in September

1991 for $1,355,000.[1]

Activities/ Outputs

GEMINI/Poland has been active in providing policy analysis and technical assistance advice to the Office for SME development within the MIT. Through these activities, GEMINI assists in design and implementation of policy reforms which enhance SME development. For example, GEMINI has actively assisted in the drafting of an SME Act, which includes provisions for the creation of a Bureau of SME advocacy within the Ministry of Industry. The Act is scheduled for review by Parliament, and GEMINI is working to help assure its future passage into law.

In early 1994, GEMINI published a report on SME needs in the Polish context entitled "Investing in the Future." This report details constraints facing the SME sector and plausible approaches to address them. Both the Prime Minister and the President of Poland formally confirmed their strong support for the SME sector by endorsing this report. It has been widely distributed in Poland, and is cited many by assistance organizations, local associations, and government officials as a key tool for enhancing the policy environment for SMEs in the future. These endorsements and ongoing activities within the Ministry have generated increased awareness within the public and private sectors of the role and importance of SMEs to the continued development of the Polish economy.

A key achievement of GEMINI to date has been its participation in establishing the "G-24 Task Force" in Poland under the aegis of the Minister for Small Business Development. The Task Force's mission is "to recommend measures aimed at sustainable increase of profitable investments by SMEs." The Task Force Secretariat is located in and managed by GEMINI on behalf of the Ministry. Membership includes representatives of ministries, donor agencies, and SME organizations, with the E.U. Ambassador and Minister for SME Development serving as co-Chairmen. By coordinating and leveraging donor resources, the Task Force is helping to coordinate local efforts in SME development.

Currently, GEMINI is working at the grassroots level with a network of ten PAECs (Polish American Enterprise Clubs) in outlying areas supported by the Foundation in Support of Local Democracy. GEMINI attends their regional meetings to support the development of grassroots SME advocacy initiatives, and to provide follow-up assistance on effective lobbying/advocacy techniques. In addition, GEMINI is developing an SME database and Research Foundation for the future SME Advocacy Bureau. GEMINI expects the database will stimulate sharing of information and promote the concept of advocacy to enhance private business development.

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[1] Source: GEMINI Contract Amendment, 1991.

II. Lessons Learned

After several years of working in Poland, GEMINI has learned some key lessons on the process of developing policy reforms favorable for SME development:

Policy Reform through Grassroots Advocacy: In Poland, GEMINI initially began working on policy reform efforts through policy makers at the national level. As Poland has since undergone several changes in national government, GEMINI has learned the importance of also affecting policy change through a "bottom-up" approach, by working at the grassroots level. As mentioned above, GEMINI is now working with a network of local enterprise clubs to encourage grassroots SME advocacy initiatives.

Enhancing Information Flow: Based on an understanding of the importance of information on SMEs to encourage favorable government policy, GEMINI/Poland is developing an SME database and Research Foundation as mentioned above. GEMINI has learned the importance of enhancing the flow of information on the SMEs in order to help stimulate favorable policies.

Lack of Access to Credit is not a Key Constraint: While there is a need for more credit on more favorable terms, GEMINI has found that lack of credit is not a key constraint in the development of SMEs in Poland. More critical is the lack of firm government policy in support of SMEs and the lack of small business advocacy initiatives at the local level outside of Warsaw.

Need for a Broad-Based Approach: Through its experience in Poland, GEMINI concludes that policy change needs a broad-based approach, including a combination of interventions at both the national and local levels in conjunction with assisting business organizations. These interventions include:

- legal and policy reforms at the municipal level, such as land use reform to ease ownership and operation of storefronts; local tax and revenue policies favorable to SMEs.
- information sharing on SMEs available outside Warsaw.
- development of grassroots advocacy activities.
- development of banking services at a branch level outside major cities.

Constraints to Achieving Goals and Objectives

Aside from the myriad macro-economic constraints and limitations of the financial sector, GEMINI highlighted two key legal constraints currently facing SMEs in Poland:

1) the instability of rules, regulations, and laws as they impact SME activities; changing laws prevent meaningful business planning;

2) the newly imposed lump sum taxation of small businesses with annual turnover of less than 1.2 billion zloty (approximately $50,000); this adversely impacts the smallest businesses.

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GEMINI is working to address these issues through their policy reform efforts.

Key Accomplishments of Program

A key achievement of GEMINI to date has been its participation in establishing the "G-24 Task Force" in Poland under the aegis of the Minister for Small Business Development. The Task Force is helping to coordinate local efforts at SME development.

The GEMINI report on SME needs in the Polish context entitled "Investing in the Future" is another key accomplishment. Endorsements of the report and ongoing activities within the Ministry have generated increased awareness within the public and private sectors of the role and importance of SMEs to the continued development of the Polish economy.

III. Future Needs and Directions

Based on the lessons learned in Poland, GEMINI sees the need for future programs to concentrate on promoting policy reform through grassroots advocacy initiatives, and to support information sharing on the role and importance of the SME sector to the overall economy. Both these initiatives can help influence policy formation and enhance the operating environment for local SMEs.

In addition, GEMINI sees the importance of improved coordination between donor programs. This has been demonstrated by the successful model of the "G-24 Task Force" in Poland. This could be accomplished in other countries through forming task forces or similar groups which meet on a regular basis to share information, ideas, and coordinate resources.

180-0023 Activities Summary for IESC

The following is a summary of activities for IESC in Central and Eastern Europe. The information was obtained through personal interviews with the headquarters and field staff, clients, and document reviews. Field research was conducted in each of the seven CEE countries as well as Estonia and Latvia. The discussion below is based on the best information available for each country. Section I describes the program, Section II details the lessons learned based on experience, and Section III discusses future directions and needs as determined by research interviews.

I. Program Overview

Description of Program

Founded in 1964, IESC is a volunteer organization based in Stamford, Connecticut which provides worldwide technical assistance through short-term advisors, mainly retired U.S. executives. IESC has a network of 13,000 volunteers with executive-level skills and experience, referred to as "Volunteer Executives". These "VEs" share their skills and experience on a volunteer basis ranging from two weeks to three months.

IESC activities started in the region through their Business Development and Support Program for Central and Eastern Europe. The program first began in Poland in October 1990 through a Cooperative Agreement with A.I.D. IESC has been active in all countries throughout the region. Beginning in 1994, IESC has refocused its program to target five countries: Hungary, Poland, Lithuania, Romania, and the Czech Republic.

The program's objective is to foster the successful evolution of the region's economies to a free market system. This is achieved by providing short-term technical assistance mainly to privatizing SOEs and to private firms throughout the region. In addition, IESC has implemented several other projects in the region to meet specific needs. These projects are detailed below.

- Technical Assistance Projects (TA): The vast majority of IESC projects are in providing technical assistance. VEs offer technical assistance to indigenous consulting and training organizations, business associations, and other groups which support private business development.

- Trade and Investment Services (TIS): Previously, IESC provided volunteer trade and investment specialists to survey potential business sectors, develop sectoral and firm strategies for enterprise growth, provide training, and strengthen local institutions. IESC also provided clients with market research and provided individual firms with information on potential U.S. partners and/or investors. This activity has lessened as a result of a refocussing of A.I.D. priorities.

- Defense Industry Conversion (DIC): As part of its activities in Slovakia and Poland, IESC

offers advisors to support joint venture or other investments which will result in conversion of defense production facilities to civilian production in the private sector.

- Public Administration Program (PA): Through this program, IESC has begun providing assistance to local municipalities, regional authorities, and mayors. In this way, the local conditions can be improved for the growth and development of SMEs in local communities.

- American Business Linkage Enterprise (ABLE): This program provides individual consulting services and business linkages with the U.S. Activities in this area have ceased due to shifting programmatic priorities at A.I.D.

Dates and Countries of Operation

IESC's operations in CEE began in Poland in October 1990 through a Cooperative Agreement with A.I.D. Subsequently, IESC started programs in 1991 in Bulgaria, Hungary, Czech Republic, Slovakia, Romania, Croatia, and Slovenia. In 1992, IESC added programs in Albania, Estonia, Latvia, and Lithuania, while ending programs in Croatia and Slovenia.

IESC's activities were temporarily suspended from December 1992 through June 1993 due to a funding freeze. IESC/Estonia will end its activities in August 1994 as part of A.I.D.'s general phasing out of Estonia. IESC activities are also being phased out currently in Latvia and Albania due to refocusing of A.I.D. and IESC priorities.

Targeted Group and Criteria for Selection

General criteria for selection of clients is similar across countries:

1) private or privatizing firms.
2) locally owned firms.
3) firms that demonstrate financial/management support, and viable work plans for Ves.
4) firms with growth potential.

Other country-specific selection criteria are noted below where applicable.

Bulgaria: IESC began assisting SOEs in the privatization process, and is now working with an increasing number of private businesses. Priority industries are agri-business, electronics, and tourism, while geographic focus is on areas of high unemployment. Future projects will be more specific and targeted to a few high priority areas where IESC has experience. These sectors include food processing and franchise development. Since municipalities are very independent in Bulgaria, IESC is providing them assistance to enhance the operating environment for SMEs. In this way, IESC can help to encourage the growth of private enterprises at the local level, even if they face constraints caused by policies adopted at the national level.

Czech Republic: The first project activities were in defense conversion and assistance to state-owned industrial firms. As the private sector has grown, IESC is now working with more private,

small companies. Regionally, the program targets Northern Moravia and Western Bohemia, prime industrial areas with growing unemployment. Other target areas include regions where unemployment is high, industry needs restructuring, or potential for tourism exists.

Estonia: The program originally focussed on northeastern Estonia, a needy region lacking in private business activity. However this region was remote and had few comparative advantages for entrepreneurial development. Geographical focus is now on southern Estonia and Tartu, a secondary city with large medical facilities, health care sector potential, and other resources for private business development. Other priority sub-sectors include wood processing and tourism.

Hungary: IESC's client base has ranged from small entrepreneurs to major enterprises including educational institutions, municipal governments, regional associations, and chambers of commerce. Through its new "Small City Package" program, IESC is now targeting 15 small cities in disadvantaged areas throughout Hungary. In addition to the firm selection criteria noted above, IESC/Hungary's other criteria include: 1) firm must be located in one of 15 targeted geographical areas; 2) firm must not be receiving assistance from other sources; 3) preference for firms which would have the most positive impact on the local economy.

Poland: IESC/Poland aims to work with firms with good business potential. IESC notes the following indicators, among others, which typically demonstrate a firm's business potential: 1) visible improvements and modifications, as determined by site visits; 2) firms which ask the "right" questions; and 3) firms with coherent plans for marketing or improving production quality.

Romania: This program focuses mainly on small manufacturing and service firms.

Slovakia: Geographic focus is on areas of high unemployment and regions with greatest development potential. Sub-sector focus includes tourism, currently 15% of projects, and light manufacturing.

Funding Levels

For fiscal years 1991 - 1993, IESC received funding of $15,137,000 for Central and Eastern European programs under the 1800023 portfolio. The following two tables provide breakdowns of IESC funding by program and by country, where applicable, for fiscal years 1991 - 1993.

IESC - Central & Eastern Europe
1800023 Funding Levels, FY 1991 - FY 1993
Source: SEED Act Report, 1993

FY 1991	FY 1992	FY 1993	TOTAL
$6,315,000 (PE)	$5,355,000 (PE)	$2,267,000 (PE)	
	$1,200,000 (DC)		
			$15,137,000

PE = Private Enterprise DC = Defense Conversion

IESC - Central & Eastern Europe
Country-Specific 1800023 Funding Levels, FY 1991 - FY 1993
(amount in $000's)
Source: SEED Act Report, 1993

FY	AL	BUL	CZE	EST	HUN	LAT	LIT	POL	RM	SLO	YU	TOT
91	24	231	778	317	1549	316	316	1975	14	334	461	6315
92 (PE)	303	0	896	374	756	334	0	1025	655	384	628	5355
92 (DC)	0	0	0	0	0	0	0	600	0	600	0	1200
93	140	89	195	152	216	145	89	260	199	109	594	2267
TOT	467	320	1869	843	2521	795	405	3860	868	1427	1683	**15,137**

Activities/ Key Accomplishments by Country

This information is not a comprehensive look at each country program, but is intended to provide key examples of different approaches and activities based on lessons learned in different countries.

Albania: Given enormous constraints to private sector development, IESC Albania has been able to provide technical assistance to only two private clients. Volunteers have assisted SOEs, public works, and other public sector facilities such as the national airport.

Bulgaria: VEs have provided technical assistance in the areas of financial services, postal security, and telecommunications. IESC was helpful in assisting in the sale of a major SOE, the Magnetic Heads Company to a U.S. company, Design Review International. The U.S. company bought 80% of the shares of the Bulgarian firm in exchange for assuming the SOE's substantial old debts.

Czech Republic: As of April 1994, ten volunteers have assisted in municipal finance and planning through the new Public Administration Program. These activities include assistance at the municipal level in community development, urban planning, economic development, municipal finance, and urban renewal. Volunteers have been placed in seven locations including Jicin, Plzen, and Pribram. For example, a former Mayor of Battle Creek Michigan was a volunteer to the Mayor's office of Plzen to assist in redevelopment of the major town square. The team visited the site, where retail shop fronts will be renovated for vendors now selling from kiosks in the square. Once the square is uncluttered by kiosks, it will be renovated and will be more attractive to tourists. The local tax base is expected to improve through new tax revenues and tourist receipts.

Other activities include assistance to financial institutions such as the Czech-Moravian Guarantee Bank to improve bank operations and loan officer training. Volunteers also work with clients of the Czech-American Enterprise Fund to provide assistance in finance and marketing. IESC has successfully leveraged their impact through liaison with the Czech Management Center (CMC) and their ENSUS (Entrepreneur Success Program).

Estonia: Technical assistance projects have helped SOEs reorganize, improve management and production, and promote market development. The objectives of the Public Administration projects are to create jobs, increase local tax revenues, and build local capacity rather than just improve the operating efficiency of firms. IESC has helped local communities identify potential alternative sectors for new job creation as old industries fade, and is working with the Ministry of Finance to encourage more favorable tax laws at the local level.

Hungary: IESC is providing firm-level technical assistance to entrepreneurs and is now beginning to work at the institutional level with chambers and local associations. According to the Draft Country Specific Action Plan dated March 21, 1994, VEs have completed over 170 technical and managerial assistance projects, mainly in rural areas. IESC has also begun a new approach, its "Small City Package" to provide technical assistance and business development services to enterprises in economically depressed areas of rural Hungary.

Future activities will be targeted to agricultural producers, food processing services, vocational training programs and start-up industries targeted by the government to relieve high unemployment. Other new target sub-sectors include banking (loan analysis and management), energy and environmental planning, newly licensed broadcast companies, economic development of municipal institutions, research institutions and other local organizations which promote private enterprise.

To date, three Economic Development Councils have been created in local communities as a direct result of IESC intervention. New linkages have been created between local government, the business community and entrepreneurs. Eight shipments of U.S. goods valued at about $100,000 have been imported by Hungarian companies. Hungarian goods and services to the U.S. as a result of IESC assistance have totalled $319,000 (including trial orders of apple juice concentrate and polypropylene bags, and four research contracts.)[1]

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[1] Source: Interview with Ross Sawtelle, Country Director, IESC/Hungary.

Latvia: The program has been active in assisting both SOEs and private firms. Initially, about 30% of companies assisted were private; now that there are more private firms to work with, this has increased to 50%. The project has focussed on the pharmaceutical industry (80% of projects) and has also worked with private wholesalers. Its activities are currently being phased out due to refocussing of A.I.D. priorities.

Poland: To meet the need of firms for post-intervention follow-up, IESC is now providing several volunteers as long-term mentors in Poland. IESC is also active in assisting business associations, local consulting firms, and other groups such as the Polish Franchising Association.

Romania: IESC assisted in the establishment of a Mercantile Exchange which now has over 100 listed companies and employs 30-40 brokers.

Slovakia: IESC is now beginning to provide assistance to local mayors in municipal finance, planning, and economic development. The number of private SME clients is growing as the private sector develops.

Outputs

The following chart details the number of IESC projects completed throughout the CEE from 1991 projected through June 30, 1994, for a total of 933 projects. These figures include IESC's activities in technical assistance, plus TIS, PA, and DIC projects (excluding four projects in Slovenia in 1991). Completed projects include those several days in length to several months, depending on the type of intervention, and "piggyback" projects in which one advisor completes several successive assignments while in the field.

IESC, Central and Eastern Europe
Number of Projects Completed
FY 1991 - Projected through June 30, 1994
Source: May 16, 1994 Report - IESC

FY	ALB	BUL	CZE	EST	HUN	LAT	LIT	POL	ROM	SLO	TOT
91	0	5	18	0	53	0	0	55	0	1	132
92	25	46	70	5	64	23	8	63	29	33	366
93	5	19	25	26	40	19	33	34	23	28	252
6/94	2	13	24	14	33	16	23	16	20	22	183
TOT	32	83	137	45	190	58	64	168	72	84	**933**

Cost Measurements

IESC has calculated its net total A.I.D. reimbursable expenses per 30 day project to range from $12,345 for Slovakia to $15,140 for projects in the more costly Czech Republic. This is based on client contributions which range from $3,000 in Lithuania and Albania, to $9,250 in the Czech

Republic.[2]

Based on the actual amount of A.I.D. funds expended from 1990 projected through June 30, 1994, the following chart details the average cost to A.I.D. per week of a volunteer assignment for IESC.

IESC - Central & Eastern Europe
Summary Data for A.I.D. Grant Funds Disbursed and Volunteers Fielded
FY 1991 - June 30, 1994
(based on FY from January - December)
Source: IESC Report, July 1994

FY	FUNDS USED	TOTAL VOLS	VOLUNTEER WKS	
1990	$ 59,691	9	66	
1991	$3,658,539	137	728	
1992	$6,574,732	346	1,209	
1993	$5,275,782	197	1,551	
1994 (thru 6/30)	$ 721,545	150	887	
TOTAL:	$16,290,289	839	4,441	
			TOTAL AVG COST TO A.I.D. PER WK PER VOLUNTEER	**$3,668**

The above figures include IESC's Technical Assistance (TA) and Trade and Investment Services (TIS) activities only from FY 1991 through June 30, 1994. IESC normally tracks outputs in terms of projects completed, but for consistency, the information in this table was compiled to represent actual numbers of volunteers sent to the field. These numbers are the best proxy for numbers of individual volunteers completing assignments. This was calculated by excluding "piggy back" or repeated projects from each country per year. IESC's activities were temporarily suspended from December 1992 through June 1993 due to a funding freeze. Thus, the 1993 figures appear low. In addition, IESC has been phasing-out in several countries since March 1994.

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[2] Sources: IESC Report, May 13, 1994 and IESC 1994 Annual Plan, based on "Regular Project" information. The figures do not pertain to TIS Projects; includes transportation and recruiting costs; and excludes administrative costs.

II. Lessons Learned

Targeting of Assistance

Privatizing v. Private Firms: In the early transition stage, few private entrepreneurs existed which could be assisted. Now that a critical mass of new enterprises has started to be reached, it has become easier to find private clients to work with throughout the region. In addition, many SOEs which were originally targeted for assistance have not privatized due mainly to economic and political factors outside IESC's control. For these reasons, IESC is beginning to work more readily with private firms.

Focus on Areas outside Capitals: IESC has found it important to target specific regions outside of major urban centers. In this way, IESC can reach a greater range of firms which need assistance.

Focus on Municipal-Level Assistance: IESC has found that strong political will at the municipal level can compensate for constraints at the national level. This is especially true in Bulgaria and the Czech Republic, which have demonstrated new autonomy at the municipal level.

Nature of Assistance

Need for Long-term Focus: Firms need to receive follow-up assistance to build on previous short-term interventions. As a result, IESC sees the need for long-term advisors in-country with a portfolio of companies to be assisted on a rotational basis. These volunteers can serve as long-term mentors. To this end, IESC is now taking a longer term focus to assist local associations and businesses which need help on an on-going basis. IESC has proposed a new initiative, entitled "LIFE" (Long-term Intensive Focus on Enterprises), which will provide volunteers on a one-year basis to advise enterprises.

Build Capacity of Institutions and Public Sector: Another new focus, IESC is assisting public sector reforms through their new Public Administration program. This is a change of emphasis from firm-level to institutional capacity-building based on the need to enhance the local environment for entrepreneurs. IESC has discovered the value of establishing linkages between local government, entrepreneurs, and the business community.

Need for More Industry-Specific Assistance: Future training must be more industry- specific. Recipients are now reaching higher level of sophistication in their entrepreneurial development, and training must be revised to meet these new needs.

Lack of Capital: Many firms lack capital with which to implement recommendations of IESC advisors. This is especially true for debt-ridden SOEs in the process of privatizing.

Country-Specific Lessons

Bulgaria: There are more private firms to work directly with now than earlier, given greater development of the private sector. For example, in FY92, 30% of the firms IESC assisted were

private companies. In FY93, private firms comprised 70% of their projects. IESC is now working successfully with local individuals who are influential in their local business communities, such as mayors of several large cities and directors of regional development centers.

Czech Republic: IESC has learned that capacity building at the municipal level is a long-term process which requires greater resources than assistance at the enterprise level. Training needs to be specific, and requires longer assignments and better preparation. Given the enormity of the task and its long-term nature, the impact of assistance to municipalities is very difficult to gage.

Estonia: PA programs have made a greater impact on improving the SME environment than TA to specific firms. The advantage of PA is that it is focussed on creating jobs, whereas TA focusses on only one enterprise. Thus, PA projects are a good way to leverage limited assistance resources.

Hungary: Businesses in Hungary tend to be either of small or large size. The lack of many medium-sized firms in Hungary stems mainly from the logjam of privatization, where large SOEs have not yet been divided into smaller production units. Assistance to medium-sized firms does not require different programmatic content, but a greater degree of detail and commitment of time than to smaller firms.

Poland: Polish entrepreneurs have a need for marketing familiarization and specific industry experience. IESC could possibly help meet this need through arranging appropriate short-term training in the U.S. for entrepreneurs.

Slovakia: IESC has worked in close liaison with other A.I.D. grantees and other bi-lateral assistance programs. For example, in Slovakia, the MBA Enterprise Corps and EC-Phare sponsored BICs (local version of regional Enterprise Support Centers) are helping to make client referrals to IESC.

Programming/ Management Issues

Staffing: As one of the first service providers in the region, IESC aimed to adapt quickly to local conditions. To this end, they selected host country nationals as Country Directors. Their local knowledge, contacts, language ability, and familiarity was beneficial in the earliest stage of IESC's projects. However, local directors lacked the necessary foundation in free market economic principles and familiarity with A.I.D. programs. IESC has discovered that the training and experience of U.S. nationals as Country Directors can compensate for their lack of familiarity with the local business environment. The best management combination is possibly a long-term U.S. advisor who can support a local country director as needed, to provide on-going follow-up advice to companies which have received prior technical assistance.

Volunteers: The volunteer nature of IESC's program is viewed favorably by recipients as it demonstrates commitment. This is especially important as many individuals in the region disapprove of paid foreign consultants.

Follow-on Assignments: According to IESC's Draft Country Specific Action Plan dated 3/21/94, IESC in the future will concentrate more on high quality and sustained projects as a result of lessons learned during the past three years in Central and Eastern Europe. In this way, a typical client may expect several volunteer executives, arriving in planned sequence, to help achieve the recommendations of prior advisors.

Coordination between A.I.D. Programs: IESC believes there is a need for better coordination between A.I.D. programs to avoid overlap and to leverage resources.

Leveraging Impact of Assistance

Training: Programs can increase impact and leverage resources by providing technical assistance and seminars at the institutional level, such as to chambers and trade associations, and to encourage training of trainers.

Combine Short and Long-term Assistance: Long-term assistance needs can helped be met through several short-term interventions. Initial short-term assistance can be followed up over time in a step-by-step process as firms become able to incrementally implement recommended changes. As mentioned above, this also suggests the need for a long-term resident advisor who has a portfolio of companies to assist on rotating basis as needed.

Key Accomplishments of Program

Throughout the region, many clients believe that the IESC intervention helped demonstrate a changed way of thinking within a free market context. SOE managers agreed on this point, even if SOEs have not actually been privatized to date. Recipients also found U.S. contacts helpful, especially through the ABLE program where potential U.S. joint-venture partners have been introduced to many firms. Thus, the biggest impact of IESC assistance on entrepreneurs appears to have been a "reorientation" towards market-oriented business practices.

Other examples of country-specific program accomplishments are detailed earlier in the "Activities/ Key Accomplishments" section above.

Impacts and How Measured

A Project Review Report is completed at the end of each project. Nine months later, a follow-up Post Project Review Report is completed by the Country Director with a representative number of clients. Clients complete an evaluation form at project completion and six months later.

IESC's "indicators of success" include the following:

Financial Impact: (on profits, sales, unit costs, capital investment).

Human Impact: (on jobs created, skills improved, productivity increased).

Marketing/Operations Impact: (on plant operations, production quality, new products,

new marketing programs).

Other Impacts: (on management systems, U.S. business ties, use of local supplies, foreign exchange earnings/savings, exports/ imports with U.S. or other countries) .

In addition, other impact indicators include the implementation of recommendations provided, and repeat requests by firms for additional assistance.

III. Future Needs and Directions

Based on the important lessons learned by IESC in the region, future priorities for promoting SME development noted by IESC staff and volunteers are summarized below. Country-specific recommendations for future programming are also mentioned where appropriate.

- Continue to provide technical assistance at the firm level.
- Target assistance towards established firms that have demonstrated ability and are now in a critical stage of growth and delegation.
- Develop local institutional infrastructure such as Chambers of Commerce and Business Advisory centers. These could be chambers created by SMEs which provide a flow of information, and which advocate the needs of the business community to local and national government.
- Work outside capitals and major cities to broaden the scope of assistance.
- Provide technical assistance in conjunction with credit.
- Assist in speeding up the privatization process, such as working with government privatization agencies to find potential investors.
- Assist in development of local services. For example, develop yellow pages directories.
- Work with chambers and private owners associations in small towns. Provide advisors who can assist them with operations and organizational development.
- Use local country staff to the extent possible, rather than U.S. expatriates to help build local capacity and orient programs towards local business culture.
- Continue to provide training to: 1) change thinking; 2) exchange information; 3) inform on how to operate a business in a free market economy; 4) educate on how to function in a global marketplace; and 5) provide a range of management and technical skills.

Estonia: Public Administration projects should be continued for biggest impact. This program focusses on creating jobs and building local capacity rather than just improving efficient operation of firms via firm-level technical assistance. In the future, local think tanks could be supported

such as the Institute of Future Studies and the Institute for Industrial Policy through the Ministry of Economy. These indigenous policy institutes should be supported and encouraged to publish studies which could influence legislation and policy creation.

Hungary: A new aspect of IESC's Hungary program, will be to ensure long term sustainability of services by enhancing the ability of several local institutions to deliver "IESC-type" services to local constituents in the future. For example, IESC has begun providing training and technical assistance to the National Association of Bakers, the Polish Franchising Association, a furniture maker's association, dairies, slaughterhouses, and the Association of Mayors. Similar groups could be assisted in other CEE countries as well.

Romania: The need exists for a multi-level approach to political lobbying with grassroots efforts through local chambers linked with national government bodies like the Regional Development Agency.

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180-0023 Activities Summary for IFC - Polish Business Advisory Service (PBAS) - Poland

The following is a summary of activities for PBAS in Poland. The information was obtained through personal interviews with IFC and PBAS staff in Washington D.C. and Poland, clients, and document reviews. Section I describes the program, Section II details the lessons learned based on experience, and Section III discusses future directions and needs as determined by research interviews.

I. Program Overview

Description of Program

At the request of the Government of Poland, the Polish Business Advisory Service was established in 1991 by the International Finance Corporation with the EBRD as its co-sponsor. PBAS's objective is to promote the development of SMEs in Poland, with a focus on enterprises with assets between US$1 and $10 million and 50-1000 employees. It provides training and technical assistance for the development of Polish business consultants, while assisting firms to prepare for joint venture partners, business investors, and future capital infusion.

Targeted Group and Criteria for Selection

PBAS targets Polish businesses based on the following criteria. Firms assisted must:

1) be international in nature.

2) be active in sectors other than real estate, insurance, or the financial sector; these are excluded since they are beyond the scope of resources available to PBAS.

3) have 50-1000 employees; originally the target was based on value of assets, but this criteria was difficult to gage due to unreliable balance sheets of firms.

4) have future potential.

5) be privately owned.

6) be medium sized; since typical funding requests are for $100,000 - $500,000, these amounts are better handled by medium-sized firms.

Funding / Cost Measurements

PBAS's original budget included expected total expenditure over five years of US$25 million. Of this amount, it was anticipated that PBAS could raise up to US$7 million through cash fees for service from companies it assisted. Given the limited liquidity within the Polish private sector, inherent riskiness, and limited experience of entrepreneurs, it was recognized that PBAS would need additional grants funds for start-up. A total of US$10.7 million was committed in 1992 by eight countries to initially support PBAS activities.[1]

A $2 million SEED grant to the IFC's Polish Business Advisory Service was obligated by A.I.D. in 1991. An additional amount of $500,000 was granted in 1993 as detailed below.

PBAS
1800023 Funding Levels - FY 1991 - 1993
Source: SEED Act Report, 1993

FY	AMOUNT
1991	$2,000,000
1993	$500,000
TOTAL:	**$2,500,000**

According to the Country Director interviewed, each intervention assignment in Poland costs the equivalent of $50-000 - $70,000. PBAS must earn this minimum in fees to cover costs. Through its experience in Poland, PBAS has learned the concept of user fees is prohibitive to many smaller businesses. Instead, they charge a "success fee," which is based on a benchmark such as percentage increase in sales resulting from technical assistance received.

Activities/ Outputs

Originally, PBAS intended to help develop bankable investment proposals for SMEs which needed additional financing yet were unfamiliar with how to prepare these proposals. The idea was to help these enterprises present their proposals to financial institutions with donor-sponsored credit lines targeted for SME development. PBAS would provide management and technical advice as needed. In reality, PBAS has had quite a different experience. PBAS discovered managers had little information on markets, competition, and even in their own true financial condition. Lack of information also made the necessary task of due diligence almost impossible, much to the dissatisfaction of financial institutions.

As a result of this experience, PBAS has changed its focus and more attention is being given to preparing firms for technical assistance and future financing through implementing new marketing and management approaches. To achieve this, the key aspect of the PBAS program is now the

[1] Source: PBAS,Report on Operations for the 18 months Ended 31 December 1992, p. 11.

training of future business consultants. PBAS utilizes local Polish consulting firms and individuals on each assignment as appropriate. Consultants have the opportunity to gain additional experience by working as part of an international team on individual assignments. PBAS has also set up training seminars for local consultants on specific topics such as financial analysis and accounting, especially geared to the context of SMEs.

Since 1991, PBAS has trained about 250 Polish individuals who are now working as local business consultants.

II. Lessons Learned

Focus on Consulting Services: As mentioned earlier, PBAS made an important conclusion based on its initial experience assisting firms in Poland: it is not lack of project financing per se that is constraining the growth of the SME sector. Instead, businesses need support to realize their long-term potential without making unnecessary investments or taking on excessive debt burdens. More needs to be done for individual companies to make them capable of absorbing capital required in the most effective way.

To address this need, PBAS is focussing attention on preparing firms for future financing by helping them implement new marketing and management approaches. To this end, PBAS is now providing business training to enhance the skills of Polish consultants. These consultants will be able to provide local firms the technical assistance they need to grow and develop in the future.

Needs of Entrepreneurs: PBAS staff reiterated that lack of credit is not the key constraint to entrepreneurs; instead the key issue is lack of marketing skills. PBAS is helping to meet this important need by supporting local consulting services. There is also a need for smaller amounts of credit and/or financing than is typically available.

User Fees are Prohibitive: Through its experience in Poland, has learned that charging clients user fees is prohibitive to many smaller businesses. Instead, PBAS has initiated a "success fee," which is based on a benchmark such as percentage increase in sales resulting from technical assistance received. This appears to be more equitable for the firm, and provides a success-oriented incentive for local consultants who provide the technical assistance. This charge can amount to the equivalent of $1000-$5000 depending on the benchmark achieved.

Need to Change Image: PBAS learned that its Polish name is similar to a Polish word for "first aid." PBAS has since changed its Polish name in order to not project the wrong image for the program.

Constraints to Achieving Goals and Objectives

While there are still many constraints to SME development in Poland, PBAS has identified the following key constraints impacting PBAS objectives.

Constraints of Entrepreneurs: These include risk adverse banks which are unable or unwilling to loan small amounts needed by SMEs; lack of information on how to prepare business plans; need

for better management skills; and lack of marketing information.

Other Constraints: These include the difficulties of banks and firms in collecting receivables; deterioration of net worth of Polish companies due to outstanding payables; Poland's future need to comply with ISO 9000 standards set by the E.U. which would require additional scarce resources; and the need for most SOEs to either restructure or liquidate.

Programmatic Constraints: Due to limited resources, PBAS can only reach about 40-60 firms out of a potential 10,000 which are worthy of assistance. Due to higher than expected costs, PBAS adjusted their target from 80 firms to about 40 a year. This is due mainly to greater time needed to perform due diligence, and hesitation by firms to pay the required fee. Since their fees are success-based, there is little guarantee that firms will succeed nor that they will pay the required fee if they are successful. PBAS sees the potential overlap with other donor programs, which could be avoided through better coordination to prevent competition for the same clients. Since Polish firms are unfamiliar with the concept of or need for consultants, PBAS must also address these this educational constraint in the operation of their program.

III. Future Needs and Directions

Based on the important lessons learned working in Poland, future priorities for promoting SME development as noted by PBAS are summarized below.

Promote the Concept of Business Advisory Services: PBAS has selected five successful former clients to be highlighted in a video for television. The video will not advertise PBAS, but will explain the general concept of what consultants can do for local companies.

Reduce Costs: To keep costs low, PBAS has begun working in conjunction with the MBA Enterprise Corps, utilizing their MBA volunteers to assist in their SME assignments.

Provide Industry-Specific Training: In the future, PBAS aims to develop a program which provides industry specific technical assistance and training services. PBAS refers to this shift in focus from a "two-dimensional to a three-dimensional program."

Coordinate Donor Programs: Better coordination between A.I.D. grantees and other donors can encourage cross referrals and pool resources. For example, PBAS has received referrals from IESC and MBA Corps. This should be encouraged in the future to leverage assistance resources. At the same time, competition among service providers could be reduced through better coordination and information sharing. PBAS currently attempts to avoid unnecessary competition with other agencies by concentrating its activities in areas not served by other donors. Coordination of resources can enrich all program participants.

Need for Long-Term Focus: A.I.D. could provide a longer time-frame for programming, as the constraints faced have been greater than anticipated. Entrepreneurs have long-term needs and should continue to receive on-going assistance over the long-term. Donor programs should ensure that both donor and local resources are available for on-going assistance.

Approaches that Might be Transferred to Other Countries

- Make the funding process for A.I.D. programs less cumbersome; less time and energy on administration will allow more time for project activities.

- Encourage "twinning" between local and U.S. agencies which provide resources to better serve the local community and stimulate greater impact.

180-0023 Activities Summary for "IRIS" - Institutional Reform and the Informal Sector Poland Small Business Legal and Regulatory Project

The following is a summary of IRIS's Small Business Legal and Regulatory Project activities in Poland. The information was obtained through personal interviews with the project director at the University of Maryland, field staff in Poland, and document reviews. Section I describes the program, Section II details the lessons learned based on experience, and Section III discusses future directions and needs as determined by research interviews.

I. Program Overview

Description of Program

IRIS-Poland is an A.I.D.-funded project of University Research Corporation International, a non-profit corporation affiliated with the University of Maryland's Department of Economics. According to its Scope of Work, IRIS's objective is "to benefit the formation and development of Polish small business through reform of the institutional framework under which small businesses operate." This is being accomplished through 1) administrative and regulatory simplification; and 2) legal reform. The emphasis is not on benefiting specific small businesses, but rather through improving the institutional and regulatory environment in which SMEs must operate. The project start date was September 26, 1991 with an initial anticipated completion date of June 30, 1994.

Targeted Group and Criteria for Selection

An initial objective of the IRIS project was the enormous task of enhancing the legal environment for SMEs in Poland. IRIS approached this task strategically, by carefully researching the range of constraints facing SMEs in Poland and pinpointing which were priorities to address. IRIS identified a key constraint hindering SME access to credit -- lack of a collateral law -- and designed its program to particularly address this issue. IRIS's activities are therefore targeted to addressing this well-defined constraint.

In addition, IRIS targets other areas of policy and legal reform consistent with its objective of improving the operating environment for SMEs in Poland.

Funding

For FY 1991 through 1994, IRIS received A.I.D. funding of $1,447,098 for their Poland program under the 1800023 portfolio as detailed in the chart below. The funding was arranged through buy-ins to the centrally funded IRIS project.

IRIS - Poland
1800023 Funding Levels - 1991 - 1994
Source: IRIS Grant Agreement and Amendments

DATE	DESCRIPTION	AMOUNT
9/25/91	IRIS Small Business Project Agreement	$643,487
9/25/92 (for 10/92 -6/93 extension)	IRIS Center, Univ. of Maryland Grant	$125,000
7/1/93 - 6/39/94	Extension	$678,611
	TOTAL:	**$1,447,098**

Activities

The IRIS Project has three key activities in Poland as follows:

- Collateral Law Reform: Through its research, IRIS identified excessive bank demand for collateral as a key constraint hindering SME access to credit. To assist in relieving this constraint, IRIS is working with officials from the Commission for Reform of the Civil Code, the Polish Ministry of Justice, the National Bank of Poland, and Polish legal scholars to draft a collateral law for future adoption by the Polish Parliament. The project is also active in establishing a new central ownership registry to track pledging of collateral.

- Insolvency Law Reform: IRIS is working with the Ministry of Justice and the Polish Lawyer's Association to affect bankruptcy law reform. The project has sponsored conferences on bankruptcy, insolvency, and enterprises in financial difficulty.

- Intellectual Property and Technology Commercialization: Activities in this area include working with the State Committee for Scientific Research, the Institute for Intellectual Property Law, and Jagiellonian University, to set rules on written commercialization policies, develop new model intellectual property contracts, and develop new copyright laws. The goal is to have results of government-sponsored scientific research develop into commercial private sector activity. An English version of Polish intellectual property law is being produced for American investors interested in Polish high-technology SMEs.

In addition, IRIS is active in these other relevant areas:

- Related Legal Reforms: IRIS is working with the Polish government in consultation with entrepreneur clubs and Polish lawyer groups to improve selected areas of legal reform important to SMEs. These include bankruptcy, company registration law, law of sales, and arbitration.

- Institutionalization of Legal Reform Process: This involves carrying out an Assessment Report recommendation to "institutionalize " the process of civil law reform.

II. Lessons Learned

Legal Reform - a Long-Term Process: After working for several years in Poland, IRIS has learned that addressing legal and regulatory issues takes time, and requires flexibility in programming. The reform process is more long-term in nature than originally anticipated due to constraints outside the program's control. These include several changes in national government, and shifting political agendas.

Programmatic Lessons: IRIS has found it beneficial to not be affiliated with a government Ministry, since their activities can be perceived as autonomous. In Poland, the project is housed in the American Studies Center, affiliated with University of Warsaw. Having a Country Director who speaks fluent Polish has also been advantageous.

Coordination with other Donors: To the extent possible, IRIS is coordinating its program with similar legal reform efforts underway in Poland. For example, EBRD has a substantial program in Poland to develop a collateral law using "model law" perspective. The World Bank is taking an active role in legal reforms, as well as are many U.S. and European law firms. The Foundation for the Development of Polish Agriculture (FDPA) is also working on development of Foundation Law.

Key Accomplishments of Program

Among its other achievements noted above, IRIS has recently published a Polish-language version of a guidebook on how to be a successful business person. IRIS is also in the process of translating Lynn Ross's book, "How to Write a Successful Business Plan" into Polish.

In one specific example of legal change in progress, IRIS research showed that the Polish Civil Code lacks an effective system for asset-based loan transactions, as in a collateral-based lending system. IRIS was able to assist in the legal reform process by working with the National Bank of Poland, the Ministry of Justice, the Commission for Reform of the Civil Code, the Ministry of Industry & Trade, and the Union of Polish Banks. IRIS's first six months were spent supporting reform of this law through regular meetings with these institutions and by involving local NGOs.

III. Future Needs and Directions

Based on experience in Poland, IRIS has noted several priority areas for promoting SME development in the future. In addition, several of these ideas could be successfully applied to other countries in Central and Eastern Europe:

Information Resource Centers: Entrepreneurs need access to information which could be met through provision of information resource centers. These centers could supply technical information needed to support market research and other information needed for running a successful enterprise. In addition, centers could be responsible for the collection and analysis of valuable information on the role and contribution of SMEs to the economy. This information could be used by government officials to support policy reforms favorable to SME development.

Replication to Other CEE Countries: IRIS is considering expanding its activates into three other countries in the region. Countries will be determined mainly based on their needs for collateral law reform.

Leveraging Assistance: In the future, U.S. advisors could be "twinned" with local consultants to maximize the potential for skills transfer and long-term sustainability of technical assistance.

180-0023 Activities Summary for MBA Enterprise Corps

The following is a summary of activities for the MBA Enterprise Corps in Central and Eastern Europe. The information was obtained through personal interviews with the headquarters and field staff, clients, and document reviews. Field research was conducted in their five countries of operation: the Czech Republic, Hungary, Poland, Slovakia, and most recently, Bulgaria. The discussion below is based on the best information available for each country. Section I describes the program, Section II details the lessons learned based on experience, and Section III discusses future directions and needs as determined by research interviews.

I. Program Overview

Description of Program[1]

Formed in 1990, the MBA Enterprise Corps is a consortium of 22 U.S. member business schools[2] which was formed to select volunteers to serve in CEE on a long-term basis after completing their MBA degree. The MBA Corps aims to encourage the development of free enterprise systems in CEE and the internationalization of U.S. businesses. It is managed by the Kenan Institute of Private Enterprise (Kenan-Flagler Business School, University of North Carolina) under the direction of a board comprised of representatives from each of the member schools.

Graduate MBA volunteers, called "Corps Members," provide technical assistance to private and privatizing firms which pay the Corps Members local salary and housing. Volunteers are active in the Czech Republic, Hungary, Poland, and Slovakia under 1800023 funding, and under a separate A.I.D. grant also provide assistance to the Bulgarian-American Enterprise Fund. The average assignment is for 15 months plus two months of training and orientation. Typically, assistance is provided in financial analysis, marketing, management, sales, economic issues, and trade. Each member school bears the cost of marketing, recruitment, and selection of its Corps applicants.

The goals of the MBA Enterprise Corps program are the following:

- To accelerate the development of private firms and restructuring of privatizing firms.
- To strengthen long-term business ties to the U.S. through technology transfer and increased access to U.S. markets.
- To increase understanding of international private enterprise among local and U.S. business leaders.

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[1] Source: "Review of Activities, 10/1/93 - 12/31/93.

[2] Five more schools have been invited to join in sending candidates for Corps 94: Georgetown, Purdue, Texas (Austin), USC, and Vanderbilt.

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Targeted Group and Criteria for Selection

Guidelines in targeting assistance are provided to the Corps Members and field staff from the MBA Corps headquarters office in Chapel Hill. Firms are selected for assistance based on these criteria: 1) private company; 2) should be majority local-owned; 3) firms should preferably be small in size with active management; 4) firm must have sufficient resources and willingness to support Corps Members.

In the selection process, firms complete application forms, then the Corps visits the site to assess potential for assistance. Criteria considered for selection also include the management style of firm directors, viability of strategic plans, existence of specific job descriptions for Corps Members, and ability of firms to support the volunteer. While the field offices actively seek potential client firms, local MBA Corps country directors do not select which host companies to assist. Final selection on clients is made in the U.S. home office.

In the Czech Republic, clients are generally larger-sized companies. This is partly a function of the high host-country cost requirements, and partly the bias of Country Director, who prefers the stability and support that large companies can provide for volunteers.

Geographically, the Corps is concentrating its assistance outside the capital cities. This is based on the recognized need to expand the activities offered to SMEs in the region. As of January 1994, the Corps was operating in 11 cities in Poland, including Gdansk, Poznan, Lodz, Krakow, and other areas where donor assistance is less available than in Warsaw. Half of the Corps Member volunteers were working outside of Prague in the Czech Republic; and in Slovakia, a third are outside of Bratislava.

Funding by Country

For fiscal years 1991 through 1993, the MBA Enterprise Corps receiving A.I.D. funding of $2,479,000 to operate CEE programs under the 1800023 portfolio. The chart below provides country-specific funding details of the program. The Corps' funding levels for Bulgaria have been excluded here, since the Bulgaria program is funded separately through the Bulgarian-American Enterprise Fund.

MBA ENTERPRISE CORPS - Central & Eastern Europe
Country-Specific Funding Levels - 1800023
FY 1991 - FY 1993
Source: SEED ACT Report, 1993

FY	CZE	HUN	POL	SLO	TOTAL
1991	$235,000	$127,000	$171,000	$101,000	$634,000
1992	$151,000	$215,000	$215,000	$64,000	$645,000
1993	$240,000	$150,000	$630,000	$180,000	$1,200,000
TOTAL	$626,000	$492,000	$1,016,000	$345,000	**$2,479,000**

Activities by Country

The following are highlights of specific MBA Enterprise Corps program activities in their different countries of operation. This information is not a comprehensive look at each country program, but is intended to provide key examples of different approaches and activities based on lessons learned in different countries.

Bulgaria: The Corps recently began providing volunteers to the Bulgarian-American Enterprise Fund. Two volunteers are currently active and another is expected soon. In an unusual arrangement for the Corps, there is no MBA Corps office in Bulgaria. Instead, the Director of the Enterprise Fund also serves as the Country Director. MBA Enterprise Corps activities in Bulgaria are not funded under the 1800023 portfolio, but through the Enterprise Funds.

Czech Republic: According to A.I.D.'s request, the Corps is phasing out in 1994 and is assigning volunteers only to the Czech-American Enterprise Fund. In Czech Republic, the MBA Enterprise Corps has been operating as a function of the Center for Democracy and Free Enterprise, a local, non-profit organization involved in various forms of assistance to democratic institutions and municipalities. Volunteers are assisting financial institutions such as the Opodne Bank, and large private firms or privatizing SOEs such as Skoda, Mora (a large appliance company), and a brewery in Plzen.

Hungary: Corps Members have been assigned to individual firms, providing assistance in financial and strategic planning, marketing, information systems, public relations, financial and business management. The MBA Corps has established an administrative liaison with the International Management Center (IMC) in Budapest. IMC currently serves as institutional "Country Manager" for the Corps in Hungary. In addition, there are two corps members in IMC's Small Business Consulting Unit who provide training in finance and marketing for various firms on a short-term consulting basis (1-2 weeks) at the equivalent of $14 hour. The Unit's goal is self-sustainability. Corps members have also been requested to work at the Hungarian-American Enterprise Fund as investment advisors, although the Country Director was not aware of any

actual placement to date.

Poland: Firms have been assisted in the following sub-sectors: 24% of firms assisted have been in manufacturing, 13% in the computer industry, and 9% in the consulting field. More host companies are being sought in outlying cities. The Corps is now operating in 11 cities throughout Poland.

Slovakia: Nearly half of the CDC recipients from 1992-1993 have received funding from the Slovak-American enterprise fund. Three of these companies were US joint ventures.[3] In April 1993, an independent MBA Enterprise Corps office was established in Bratislava after the break-up of the former Czechoslovakia. Before that, its activities had been coordinated with those of the IESC Office in Bratislava.

Outputs by Country

The following chart details the numbers of MBA Corps volunteers fielded throughout the CEE from 1991 to 1993, for a total of 184. This is based on an average assignment of 15 months.

MBA ENTERPRISE CORPS - Central & Eastern Europe
Number of Volunteers Fielded
FY 1991 - 1993
Source: MBA Enterprise Corps Report, July 11, 1994

FY	CZE	HUN	POL	SLO	TOTAL
1991	21	7	14	2	44
1992	20	17	22	8	67
1993	14	8	36	15	73
TOTAL	55	32	72	25	184

Impact Indicators

Several impact indicators are used to evaluate the MBA Corps programming. These include:

1) Measurable improvements in the host company.
2) Repeat requests from host companies for continued assistance by Corps members.
3) Number of new host companies applying for assistance.
4) Corps Member's completion of assignments.
5) Satisfaction of host companies (assessed through on-site visits and evaluations by Members of the Consortium Board.

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[3] Source: Interview with Country Director, Slovakia

Cost Measurements

The following two charts provide details on two different cost measurements of the MBA Enterprise Corps program in the CEE. The first chart provides information on the estimated total cost per volunteer, including the appropriate host company contribution. The second chart details the actual cost to A.I.D. of fielding an MBA volunteer per week, based on actual expenditures of A.I.D. funds.

MBA Enterprise Corps - Central & Eastern Europe
Estimated Total Cost per Volunteer
Source: Proposal for Multi-Year Funding of the MBA Enterprise Corps, 1/20/94

HOST COMPANY CONTRIBUTION	COST TO A.I.D.	TOTAL COST PER VOLUNTEER
$11,533	$26,667	$38,200

Regarding Host Company Contributions

The above host company contributions are figured on a 13-month basis. The Corps requires host companies to provide housing and stipend for volunteers. As the following information indicates, contribution amounts can be substantial for many host companies.

In the Czech Republic, the stipend is roughly 6000 Kr per month (roughly $210 after tax). This includes roughly 30% for taxes, plus utilities, phone, and health insurance. This local contribution is costly, and can usually be provided only by larger firms.

In Slovakia, the host country contribution for 1993 was $200 per month (net of tax) plus housing. In 1994, this increased to roughly $250 a month. In Bratislava, housing typically costs 10,000 - 12,000 SK per month (approx. $333 - $400[4]). Outside Bratislava, housing costs roughly 8,000 - 10,000 ($267 - $333)

In Hungary, host companies provide a stipend of 35,000 Forints a month net of taxes plus housing. This totals roughly 100,000 forints per month. Volunteer wages are calculated at $350/month (not including taxes, social security, or health insurance) and accommodations at $250/month. In Poland, volunteer wages are similarly calculated at $300/month .[5]

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[4] Exchange rate used: 30 SK per US dollar.

[5] Source: Proposal for Multi-Year Funding of the MBA Enterprise Corps -1/20/94.

Total Average Cost to A.I.D. per Volunteer per Week

The chart below details the total average cost to A.I.D. of fielding an MBA Corps volunteer which averages just above $237 per week. These figures are based on actual expenditures of A.I.D. funding to date and average assignment length of 15 months.

MBA ENTERPRISE CORPS
Summary Data for A.I.D. Grant Funds Disbursed and Volunteers Fielded
Source: MBA Enterprise Corps Report, July 1994
(based on average assignment of 15 months)

FY	FUNDS USED	TOTAL VOLS	VOLUNTEER WKS	
1991	$491,370	44	2,640	
1992	$769,588	67	4,020	
1993	To May 31,1994 $1,087,276	73	4,380	
	Total (estimate) $1,358,856			
TOTAL:	$2,619,814	184	11,040	
			TOTAL AVG COST TO A.I.D. PER WK PER VOLUNTEER	**$237.30**

Three MBA Corps volunteers working in Bulgaria have been excluded since they are not funded under the 1800023 portfolio but by the Bulgarian-American Enterprise Fund.

Other costs to the MBA Enterprise program are borne by matching and in-kind contributions by corporate sponsors, universities, and in-country client contributions of housing, salary, and other benefits. For example, each of the 22 member schools of the Corps spends approximately $5,000 per year in the marketing, recruitment, and selection of its MBA applicants.

II. Lessons Learned

Needs of Firms: The needs of enterprises are long-term in nature, so therefore long-term interventions are appropriate to meet these needs. Firms are now requesting more specific assistance in areas such as marketing and making contacts with local and international customers; financial and business management skills; searching for venture partners; and computer applications.

Target Areas outside the Capital Cities: Based on the recognized need to expand the resources offered to SMEs in the region, the Corps is concentrating its assistance outside the capital cities as mentioned above under "Targeting of Assistance."

Program Management/Administration

Managing Volunteers' Expectations: In order to better ensure satisfaction in their assignment, Corps is now better managing the expectations of volunteers. This is partly achieved by providing more detailed background information on assignments and by offering language training in-country to allow earlier cultural adjustment. Volunteers are also asked to commit to assignments with the understanding that their initial match might change based on the changing needs of firms. The Corps has also learned how to improve the process of matching volunteers and clients. This involves more thorough analysis of the proposed assignment and of the background of volunteers.

Cost Issues: In 1992, the Corps decided to end support for "significant others" in order to reduce costs. The Corps has also found that requiring cost-sharing by host enterprises gives them more of a vested interest in the program and in the assistance provided.

Acceptance of Volunteers: U.S. advisors appear to have more clout with government officials and clients than do local counterparts. This is partly due to the relevant skills the Corps Members provide, and partly due to a general perception by CEE nationals that resources which originate from abroad are inherently "better" than their own.

Country-Specific Lessons

Bulgaria: Unlike in other CEE countries, Corps Members are working for the manager of the Bulgarian-American Enterprise Fund who doubles as de facto MBA Corps Country Manager. Corps Members interviewed cited this dual role as potentially problematic: there was concern the Country Manager might not be able to remain as impartial in solving potential disputes that may arise as readily as an independent Country Manager. The potential for conflicts might jeopardize the volunteer's successful completion of the assignment. This situation needs to be closely monitored to determine how well this arrangement is working, and if it is a model which should be replicated in future programs elsewhere in the region.

Czech Republic: Based on a local roundtable discussion with A.I.D. grantees, most practitioners are concerned that it may be too soon for foreign assistance programs such as A.I.D. to be ending assistance to the Czech Republic. The country is eager to join the E.U., and in order to maintain

the favorable economic indicators necessary for E.U. membership, the government has not yet taken the last, possibly painful steps needed to complete the privatization process. While economic indicators look favorable now, practitioners are concerned they do not accurately reflect the true economic situation.

For example, large-scale privatization is still far from complete. In many small towns, one large company employs most of the adult population. Privatization will likely require liquidation or restructuring of these large firms. As a result, unemployment could rise greatly, and local governments will find it difficult to adjust. Local governments have little experience in tax revenue collection, or in other municipal-level functions such as public finance. For this reason, assistance providers cite the continued need for donor resources to enhance the economic development process.

Hungary: There is a need to focus attention to areas outside of Budapest. In addition, the financial contribution required by host country firms is prohibitive to most smaller-sized businesses. As a result, assistance is skewed towards larger firms. Ironically, as the Corps' activities move outside of Budapest, outlying firms tend to be smaller, with even fewer financial resources, and are unable to afford the cost of MBA Corps assistance. More assistance is still needed to improve the legal and regulatory environment for SMEs, and to continue training especially in finance, accounting, and marketing.

Poland: Assistance needs to be focussed outside of Warsaw to enhance the transition process. The Corps has found that having a Polish national in-country to help screen potential client companies is crucial to assuring quality matches.

Constraints to Achieving Goals and Objectives

Through the experience of the Corps staff and volunteers, key constraints to achieving program goals are summarized below.

Constraints faced by firms: Throughout the region, firms generally lack sound management ability; few firms have strategic plans or the tools to form them; access to capital is extremely limited or offered on prohibitive terms; firms lack paying customers; and foreign investors and customers lack interest in CEE products and services due to their inferiority. The Corps is trying to address these constraints through their firm-level interventions.

Constraints faced by Corps Members: These include language barriers, initial lack of trust by clients and government officials; difficulty of firms in implementing recommendations due to lack of capital or other constraints beyond their immediate control; assignments are often more complicated, time-consuming, and frustrating than originally anticipated. This is mainly due to factors outside the volunteers' control. To the extent possible, it is being addressed by more thorough preparation and screening by MBA Corps recruiters.

Programmatic Constraint: Currently, host companies must pay social security, health insurance, and other taxes on behalf of Corps members which can total up to 60% of salary. This is since volunteers are classified as employees in-country. These additional charges make the price of

receiving an MBA Corps volunteer prohibitively expensive to many enterprises. Often only the largest ones can afford the high cost of the volunteer. Yet, this prevents the smaller SME firms which are the key targets of the program from receiving the assistance they need.

To address this problem, the MBA Corps could consider re-classifying volunteers as consultants. This proposed change would help reduce the host company cost, but would also alter the nature of the MBA Corps program. In the future, the issue might be clarified or improved once bi-lateral agreements are finally reached between the U.S. and the CEE countries. In any case, an acceptable solution must be reached on this issue to ensure that SMEs targeted are receiving the assistance intended.

III. Future Needs and Directions

Based on the important lessons learned in the region, MBA Corps staff and volunteers have noted two priority areas for promoting SME development in the future:

Coordination with Other Programs: The MBA Corps has identified the need to continue coordinating with other A.I.D. grantees and other donor programs to leverage impact and improve results. For example, there is discussion of pairing MBA corps members with IESC volunteers for mutual benefit: short-term IESC volunteers can provide additional depth of experience, while the MBA volunteers can to supply follow-up on a long-term basis.

Pilot Program for Public Administration: An important idea for the future is a proposed pilot program to utilize recent graduates from Master's in Public Administration programs to assist with local public sector development in the CEE. The proposed program would work similarly to the MBA program, yet focussed on a different set of client recipients. For example, the MPA program could assist local municipalities in the Czech Republic and Hungary in the areas of municipal finance and to create councils for regional economic development. This is based on the concept that municipalities have similar needs as small businesses: needs for improved skills in management, financial control, organizational development, and strategic planning to enhance their future viability.

180-0023 Activities Summary for Peace Corps - Central and Eastern Europe

The following document is a summary of information on Peace Corps' Small Business Development activities in Central and Eastern Europe. The information was obtained through personal interviews with headquarters and field staff throughout the region, entrepreneurs, and government officials and others involved in the E.C.-Phare sponsored Enterprise Support Centers where Peace Corps volunteers are working. Information was also obtained through document reviews. The discussion below is based on the best information available for each country. Section I describes the program, Section II details the operating environment, and Section III documents future direction and needs as determined by research interviews.

I. Program Overview

Description of Program

In November 1990, the Peace Corps established a European Business Development Program for Central & Eastern Europe and the Baltic countries as an Interagency Agreement with A.I.D. The program aims to contribute to the development of free market economies by providing technical assistance, training, and business information through local public and private organizations. This is in addition to the Peace Corps' English language teaching programs.

Peace Corps' CEE Business program focuses on meeting three key constraints to SME sector growth: 1) lack of business management expertise and experience; 2) lack of privatization strategies and expertise at the local government level; and 3) lack of financial services for the private sector. To address these issues, Peace Corps' program aims to strengthen local government institutions and democratic practices, promote private sector businesses, and improve quality of life.

Throughout Central and Eastern Europe, the Peace Corps' Small Business Advisors are working to provide institutional and managerial support to the EC-Phare sponsored Enterprise Support Centers. Volunteers provide assistance in preparing business plans required for application of EC-Phare loans. Business advisory services are also provided to entrepreneurs starting or expanding businesses.

Targeted Group and Criteria for Selection

With some notable exceptions mentioned below, the Peace Corps Small Business program has not specifically targeted particular regional areas or sub-sectors for assistance. Generally, the program targets skilled individuals who otherwise lack experience in owning or managing a business.

Latvia: Unusual for Peace Corps programs in the region, volunteers are working exclusively in the agricultural sector. This is based on the specific request of the Latvian government, which has targeted rural development as a priority area in its transition process.

Poland: Peace Corps' Poland program has a municipal and public sector focus and volunteers are not generally assigned to private firms. Clients must be Polish, non-profit institutions working at the local level with active projects that can dedicate an individual as local counterpart for the volunteer. Due to a language barrier, volunteers often do not function optimally in the smallest towns. As a result, the Peace Corps places volunteers in larger towns with greater access to translation and other support services. Placement in a larger community also provides potential for impact on a greater number of entrepreneurs and counterparts. Originally, volunteers provided economic development advice to ministerial representatives at the municipal level. The Peace Corps believes it can have a greater impact by working outside the Ministries, and is now working with the newly formed Regional Development Agencies.

Funding Levels

Under the 1800023 portfolio, Peace Corps received an Inter-Agency agreement for FY 92 - FY 94, which totals $4,365,375. Peace Corps initially received $2,166,000 to finance Small Business Development activities planned in the CEE for FY 93 and FY 94. An additional $290,000 was allocated in FY 92 to cover implementation activities through December 1992. Poland and Bulgaria each received additional funding for their specific programs. Support was also provided for small projects to be undertaken in each country on a discretionary basis.

PEACE CORPS - Central & Eastern Europe
Small Business Program
1800023 Funding Levels
Source: SEED Act, 1993 and A.I.D./ RME

	FY 92	FY 93	FY 94	TOTAL
European Business Development Program (Regional)	$290,000	$2,166,000 (for FY93-94)	N/A	$2,456,000
Poland: FETC Inter-Agency Agreement (for FY92 - FY94)	$986,000	N/A	N/A	$986,000
Bulgaria: Support for Multi-Link Centers (for FY92 - FY94)	$172,000	N/A	N/A	$172,000
Small Project Assistance (Regional)	0	$341,375	$410,000	$751,375
TOTAL	$1,448,000	$2,507,375	$410,000	**$4,365,375**

Activities By Country

The following are highlights of specific Peace Corps program activities in different CEE countries of operation. This information is not a comprehensive look at each country program, but is intended to provide key examples of different approaches and activities based on lessons learned in different countries.

Many Peace Corps Small Business Advisors are providing assistance to the EC-Phare supported Enterprise Support Centers throughout the region. These centers assist local entrepreneurs in completing business plans as part of their application process for EC-sponsored loans. In addition, they provide technical, managerial, and organizational development assistance for the continued development of the Centers themselves. They also provide technical assistance to individual entrepreneurs on a consulting basis as needed and appropriate.

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Albania: Volunteers are working with the Enterprise Support Centers in six regions to provide management, organizational development, and business expertise in planning, accounting, marketing, and other needed skills. The team visited a Center in Korce, in Eastern Albania, which is working closely with the local mayor's office to encourage foreign investment, local privatization, and the adoption of local laws and policies favorable to private business.

Bulgaria: The Peace Corps initiated six Multi-Link Resource Centers (MLRCs) which are currently operating in six cities (Gabrovo, Pleven, Plovdiv, Smolyan, Stara Zagora, Varna) plus 11 smaller centers. These centers serve as local clearinghouses for information on English teaching, small business development, and environmental protection. In June 1992, Peace Corps fielded Bulgaria's first group of small business advisors. Currently, volunteers are working with banks and municipal governments, and are assisting the MLRCs. The team visited a Center in Plovdiv, where one volunteer has trained over 150 bankers in 60 different banks.

Czech Republic: Fourteen volunteers began in September 1993, working to provide training and technical assistance in organizational development and business management. Ten of these volunteers provide technical assistance to local government authorities and NGOs involved in environmental issues. In order to utilize an existing network, the other volunteers are working with the Regional Advisory Centers (RPICS and BICs) sponsored by EC-Phare. Volunteers provide assistance in organizational development to the centers as well as provide training to clients and local advisors.

Estonia: Nine small business volunteers began in FY93. Half are serving in county government offices, others in technical schools, and other organizations. One volunteer visited in Tartu has worked closely with a county government office to encourage private investment and local privatization. Partly based on the potential for success demonstrated by this volunteer, it is planned that the next round of volunteers in 1994 will all serve at the county government level.

Hungary: Ten Small Business Advisors began in September 1993. These volunteers are currently assisting the Hungarian Foundation for Enterprise Promotion, and Local Enterprise Agencies (LEAs) sponsored by the EC-Phare program. Eight volunteers are each working with local LEAs throughout Hungary. Assistance to LEAs includes enhancing the future institutional sustainability, building the client base of the LEAs, advising on services to offer, and marketing methods for attracting clients. In Budapest, one volunteer is working with the SUNY Business Center, and another is with the B'nai B'rith Foundation.

Poland: Poland is the Peace Corp's oldest and largest program in the CEE. The program has four main components detailed below.

- The Free-Enterprise Transition Consortium (FETC) of Krakow was created in 1993 under the Country Specific Interagency Agreement between Peace Corps and A.I.D. It's main goal is to support Poland's transition to a free market economy by linking local expertise with the technical assistance provided by Peace Corp's Business Advisors. The FETC aims to provide tailored training to Peace Corps counterpart organizations and to entrepreneur. In addition, it will formulate and distribute case studies, and maintain a Privatization Database.

- Municipal Advisors provide technical assistance and training at the municipal, county, and regional level on economic development, finance, small business assistance, regional promotion, and tourism.

- Business Training Advisors provide training and technical assistance on curriculum development, school management, and planning with general coordination from the Ministry of Education. Advisors are also active in development Business English curricula for Business Training Institutes.

- Privatization Advisors are assigned to Regional Development Agencies, Chambers of Commerce, or SOEs to provide technical assistance and training for regional economic development. Volunteers are helping to improve technical assistance, economic development liaison and training capabilities of counterpart institutions involved in privatization, business development and business training projects.

Romania: Since July 1993, small business development volunteers have been working with local NGOs to provide technical assistance and training.

Slovakia: Fifteen Small Business Advisors began September 1993: twelve are outside Bratislava, of which nine are working in the EC-Phare sponsored RPICS and BICs; one is in a Regional Development Agency; and two in other business entrepreneurship centers. The three volunteers in Bratislava are working in the Entrepreneurship Center and the EC-Phare sponsored Agency for Development of SMEs. The team visited two of these centers in Banska-Bystrica, in the central region of the country. One center was providing assistance in preparing business plans required for application of EC-Phare loans. The second center was successfully providing business advisory services to entrepreneurs starting or expanding businesses. These services, offered on a fee basis, include tax preparation, business registration, marketing, as well as other services tailored to individual firm needs.

Outputs By Country

The Peace Corps will have fielded 343 Small Business Advisors to ten countries in Central and Eastern Europe from FY 1992 projected through FY 1994, as indicated in the chart below:

PEACE CORPS - Central & Eastern Europe
Small Business Program
Average Number of Volunteers
FY 92 - Projected Through FY 94
Source: Peace Corps/ Office of Training & Program Support

FY	ALB	BUL	CZE	EST	HN	LAT	LIT	POL	RM	SLO	Tot
92	0	25	0	0	0	0	0	54	0	0	79
93	9	20	0	9	0	7	5	23	18	0	91
94	19	20	14	19	10	19	17	16	24	15	173
TOT	28	65	14	28	10	26	22	93	42	15	**343**

Cost Measurements

The charts below details the average cost to A.I.D. per week of fielding a Peace Corps volunteer, which is less than $49. The figures are based on actual expenditure of A.I.D. funds to date, and represent an average number of volunteers for each fiscal year. The average length of a volunteer's assignment is two years, or 104 weeks.

PEACE CORPS - Central & Eastern Europe
Summary Data for A.I.D. Grant Funds Disbursed and Volunteers Fielded
FY 1992 - FY 1994, as of July 1, 1994
Source: Peace Corps Report, July 1994

FY	EUR BUS DEVEL PROG	BULGARIA IAA	POLAND IAA	TOTAL VOLS	VOLUNTEER WEEKS
1992	$144,159	$102,986	$40,634	79	8,216
1993	$107,288	$68,694	$300,058	91	9,464
1994	$702,905	0	$273,900	173	17,992
TOTAL:	$954,352	171,680	614,592	343	35,672

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TOTAL EXPENDED	TOTAL VOLS	TOTAL VOLUNTEER WEEKS	TOTAL AVG COST TO A.I.D. PER WK PER VOLUNTEER
$1,740,624	343	35,672	**$48.80**

It is important to note that Peace Corp's Small Business Advisory Program receives from A.I.D. only a small portion of funding for its activities in the CEE region based on its Interagency Agreement. Thus, Peace Corps' cost to A.I.D. per volunteer-week of $49 is understandably much lower than other volunteer-based technical assistance programs which received higher funding levels from A.I.D.

II. Lessons Learned

Needs of Entrepreneurs: After several years of working with entrepreneurs in the region, Peace Corps has learned much about the needs of entrepreneurs. Many have technical ability in highly specified manufacturing skills, but have no management experience. In addition, many are supplementing their income by engaging in multiple, often unrelated, business ventures. Entrepreneurs throughout the region also lack marketing experience. The Peace Corps program is trying to address these needs throughout the region.

Support Capacity-Building: In the early transition stage, the Peace Corps found that firms needed basic business training. Now, as transition is underway, there is a need for training to provide more of a "democracy-building focus." This means providing training to enhance skills in decision-making, leadership, and other organizational tools. Peace Corps staff and volunteers commonly cited that capacity building is now more a key need than basic business training.

Regarding Volunteers: Peace Corps can attract highly skilled, experienced mid-career volunteers, which is unique to Eastern Europe. Many volunteers have family roots in the CEE, or are seeking future professional opportunities in the region. As a result, recruiters are fortunate to have a number of qualified professionals from which to choose as volunteers.

Historical Factors: Individual differences in history, entrepreneurial tradition, and historical business practices all factor into the new transition process. These important factors were unfamiliar to foreign assistance providers initially working in the region. However, they have contributed greatly to the impact of SME development in the various countries. They are an aspect of the potential success of enterprise development, and must be taken into account in future programming.

Country Specific Lessons

Czech Republic: Here, SME development has benefitted greatly by the fast pace of privatization, the great degree of political will to carry out needed reforms, and the early emphasis on restitution of private property to rightful owners.

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Estonia: Due to historical factors, women entrepreneurs in Estonia are often more successful than their male counterparts. Historically, Estonian men were forced to conform to rigid Soviet work structure and/or obligatory army service. As a result, women gained entrepreneurial skills needed to run their households in difficult times with limited consumer goods. Women are now applying these management and delegation skills to more innovative entrepreneurial endeavors outside the household.

Poland: Due to the language barrier, volunteers have not functioned optimally in the smallest towns. As a result, Peace Corps places volunteers in larger towns where they have greater access to translation and other support services. Placement in a larger community also provides potential for impact on a greater number of entrepreneurs and counterparts.

Constraints to Achieving Goals and Objectives

While many constraints to SME development in the region still exist, the following are key constraints as noted by Peace Corps staff and volunteers.

Constraints of Entrepreneurs: Lack of marketing and management experience and lack of access to affordable credit are generally cited as major constraints throughout the region.

Constraints of Volunteers: Since volunteers lack native language skills and clients lack English ability, communication can be difficult even through translators. As mentioned above, the Corps is addressing this constraint in Poland by fielding volunteers to larger towns with greater resources. Also, by grouping volunteers together in key towns or regions, they can benefit from mutual support.

Programmatic Constraints: In several countries, notably Bulgaria and Poland, Peace Corps has had difficulty finding local counterparts. Government sponsorship has often been inconsistent and unreliable. The Corps has been challenged to find host country organizations which can make a programmatic and financial commitment (often 50% of operating costs) to the program. It has also been difficult to plan program strategy amid political instability in countries such as Poland which have undergone several changes in government.

III. Future Needs and Directions

Based on the important lessons learned in the region, future priorities for promoting SME development as noted by Peace Corps staff and volunteers are summarized below. Country-specific recommendations for future programming are also mentioned where applicable.

Promote Junior Achievement Programs: Volunteers are promoting Junior Achievement in their communities, as noted in the Czech Republic and Bulgaria. This has been a useful educational tool to impart the workings of a free market economy. In the future, the Peace Corps' English trainers could impart the concepts of free market economics while teaching English to students.

Improve the Flow of Information: Peace Corps suggests establishing an annual conference on small business development. Workshops could be targeted to small and medium-sized businesses,

and to the manufacturing, and service sectors. Local entrepreneurs or counterpart organizations could be asked to prepare case studies to share key successes and lessons learned.

Enterprise Support Centers: There is a need to teach the Enterprise Support centers how to better assess client needs. For example, an entrepreneur's request for a loan might turn out to be better met through financial restructuring or streamlining of production methods. Local staff as well as volunteers need additional training to assess an entrepreneur's complete situation. This will prevent the Centers from "pushing credit" when it is not always in an entrepreneur's best interest.

180-0023 Activities Summary for PIET - (Partners for International Education & Training)

The following is a summary of activities for PIET in Central and Eastern Europe. The information was obtained through personal interviews with the headquarters and field staff, clients, and document reviews. Field research was conducted in their CEE countries of operation. The discussion below is based on the best information available for each country. Section I describes the program, Section II details the lessons learned based on experience, and Section III discusses future directions and needs as determined by research interviews.

I. Program Overview

Description of Program

Created in 1982, PIET is a joint venture of four U.S. PVOs: the Asia Foundation, the African-American Institute, World Learning, Inc., and AMIDEAST. The Entrepreneur International (EI) Program brings entrepreneurs from Central and Eastern Europe and the Baltics to the U.S. for 3-4 week of on the job training with U.S. businesses, attendance at conferences, and relevant site visits. Each program is individually tailored to the training needs of the participant.

PIET has established regional offices in Warsaw and Budapest, with field offices in their other five CEE countries of operation. The purpose of the program is to help entrepreneurs understand the American economic system and to develop personal and professional relationships with American business owners. The program aims to equip a broad base of leaders and professionals in the region with improved skills and practical knowledge to support democracy, free enterprise, and enhance quality of life.

There are two administrative components of the PIET program:

- Entrepreneurial Management and Executive Development Program (EMED): EMED is the administrative umbrella for the business exchange program between the U.S. and Hungary, Poland, Bulgaria, Slovakia, Romania, Latvia, and Lithuania. It's purpose is to enhance management skills and practices among business owners and senior managers of businesses in CEE. EMED has a country director in each of the seven CEE countries mentioned above.

- Partners in International Education and Training (PTPE): Under PTPE, PIET is able to operate its core activities, such as staffing of local offices and related administrative expenses.

Start Date and PACD

In September 1992, PIET signed an agreement with A.I.D. to implement the RITE Project (Removal of Impediments to Trade Expansion). This project developed in response to the President's "Trade Enhancement Initiative for Central & Eastern Europe" and aimed to help

SMEs in Poland, Hungary, Slovakia and Bulgaria enhance their export potential. RITE was extended through November 1993 along with PIET's core contract. RITE was the predecessor to the current EMED program.

The Entrepreneurs International Program in the CEE began in FY 1993 under Project 180-0047. PIET's current contract is funded for FY 1993 and 1994 under 180-0023, with an anticipated completion date of September 27, 1995. While country-specific programs initially started in 1993, due to several initial administrative delays, PIET did not became fully operational throughout the region until January 1994.

Targeted Group and Criteria for Selection

No particular sector or ethnic group is targeted, although PIET has a stated objective to seek women entrepreneurs. PIET staff work with local business associations, other A.I.D. programs, other donors and groups to recruit appropriate entrepreneurs for training. Prospective trainees are interviewed and selected on specific criteria, which include:

1) Proven experience as business owners or managers of small or medium-sized companies (or coop);
2) Excellent English ability; candidates must pass a written English test.
3) Actively seeking to expand or improve business operations.
4) Working in sectors that are considered priority by A.I.D. country strategy.

In some countries such as Romania, PIET is making an active effort to target firms outside capital cities. In addition, where possible, PIET prefers to work with entrepreneurs engaged in productive activities such as manufacturing, industrial services, agri-business, energy, environment, or other areas consistent with A.I.D. priorities.

In Latvia, the program is careful to ensure that entrepreneurs assisted are truly independent and are not controlled by outside interests, namely Russian "investors". In addition, the program looks for individuals with high potential impact in their communities and organizations.

Activities by Country/ Key Accomplishments

The following are highlights of specific PIET program activities in different CEE countries of operation. This information is not a comprehensive look at each country program, but is intended to provide key examples of different approaches and activities based on lessons learned in different countries.

Czech Republic: PIET does not offer the Entrepreneur International program in the Czech Republic. Yet, it offers local training to individuals on the basis of sector targets established by A.I.D. Prague. In addition, PIET has been asked by the Peace Corps to produce Czech-language business advisory pamphlets for free distribution to entrepreneurs through the regional ARPIC centers (EC-Phare supported) throughout the country. PIET will publish brochures on nine key business topics for free distribution in the Czech Republic and Slovakia. Roughly 5,000 copies will be published on the first printing.

Latvia: This program has been active in seeking a market niche for its training. PIET management has been working with the Association of Latvian Appraisers to train trainers and help develop appraisal laws, standards, and procedures. In addition, PIET actively publicizes the success of the training to set positive examples and enable trainees to leverage the benefit of their U.S. experience.

Outputs by Country

As the chart below indicates, from FY 1993 through mid-1994, PIET has trained 192 individuals from seven CEE countries.

PIET - Entrepreneur International Program
Total Number of Trainees Recruited - Per Country
FY 1993 - July 1994
(Source: PIET Report, July 12, 1994)

FY	BUL	HUN	LAT	LIT	POL	ROM	SLO	TOT
1993	10	11	0	0	29	0	9	59
1994 thru 7/1	24	27	19	13	42	30	37	**192**

PIET anticipates receiving approximately 33 more trainees by end of FY 1994, for a total of 225 trainees. To date, training have occurred mainly in the computer and tourism industries.

Cost Measurements

PIET estimates the total average cost per project participant is approximately between $10,000 - $11,000. While participant cost sharing was not required under RITE, program participants under EMED do share some program costs. EMED pays full costs of international travel, hotel during U.S. training, and U.S. per diem for all participants. U.S. companies are asked to donate their time and staff to meet with and train the entrepreneurs. Participants make some standard cost-sharing contribution which differs for each country.

Initially, trainees were asked to contribute roughly half of their international travel costs. Polish and Hungarian participants were initially able to do so, contributing the equivalent of U.S. $550 and U.S. $600 respectively. Due to currency exchange restrictions and lower per capita incomes, Slovaks and Bulgarians could only contribute US$220 and US$300 respectively towards per diem costs.[1]

In the Czech Republic, unlike other PIET programs in the region, trainees and/or their sponsoring organizations are required to pay their round-trip international airfare. In Romania, each

[1] Source: PIET/EI Final Report, December 30, 1993, p. 5.

participant must contribute the equivalent of $150 to participate in the program. In Slovakia, the amount of contribution is decided on case by case basis, unlike in Czech Republic where payment of international airfare is required.

II. Lessons Learned

Programming/ Management: PIET is organized with directors in each country as well as two regional directors. Several PIET field staff were concerned that this arrangement caused overlap and conflict between the different level managers. In addition, there were some concerns about lack of information flow and/or duplication of effort due to the administrative set-up of the program: the field program is administered under PTPE, it is managed out of Washington through the EI Program, and financed under World Learning. These issues could be helped by a better method of feedback from the field to the home office concerning administration, budgeting, and ideas for program focus.

PIET has also learned how to improve marketing efforts to solicit increased program participation by U.S. businesses. To this end, PIET has now set up volunteer committees in various U.S. regions which look for and solicit training opportunities. In addition, field staff are learning to better manage the expectations of participants to ensure better matching of needs and resources.

Training Focus: Some PIET staff believe that the program needs to focus more on the public sector at the municipal level. Rural communities are being overlooked in many countries, as entrepreneurs tend to be more active in the larger cities. Some staff also felt that key industrial sectors should be identified to target training.

Constraints to Achieving Goals and Objectives

Constraints to Recruiting: Based on experience to date, PIET/EMED has noted less response or interest in training in several CEE countries than anticipated. This is due to a number of reasons. Currently, there are other training being offered in CEE countries, so there is more competition among assistance providers. The program has also found it difficult to find appropriate entrepreneurs who speak English, and who are able to leave their businesses for the 3-4 weeks required for U.S. training. The fee requirement is also sometimes prohibitive for entrepreneurs. In some countries, such as Slovakia, political uncertainty also makes entrepreneurs hesitate to leave their businesses for any duration. For these reasons, in-country training programs look more attractive to entrepreneurs.

While some of these constraints are inherent to U.S.-based training programs, others can be relieved through several suggestions mentioned by PIET staff. These are discussed in the following section, "Future Needs and Directions."

Conflicting Interests: PIET has encountered conflicts between participant interests and the intentions of the training program. Participants are often looking for capital or venture partners, yet the program offers industry-specific training and offers no promise of foreign investment. As mentioned above, field staff have learned to better manage client expectations to ensure greater satisfaction from the training.

Programmatic Constraints: Administrative delays have caused some programmatic constraints in the program. Since the previous RITE program was only one year long, the last quarter was devoted to project "wind down"; unfortunately the first quarter of RITE's antecedent, EMED, was devoted to "start up." These delays have caused less than optimal use of resources, and may result in recruitment of fewer trainees than anticipated. In the future this could be avoided through longer funding cycles.

III. Future Needs and Directions

Based on the important lessons learned in the region to date, PIET has noted the following priorities for future programs.

Training of Trainers: Resources need to be focussed on training of local trainers to leverage the impact of assistance. Other trainees will also benefit from receiving technical training in their local language.

Encourage Follow-Up Activities: For broader impact, training could be linked to follow-up activities in-country, such as application of U.S. methods learned to local production methods. Entrepreneurs need to be able to incorporate new skills to their local context, and need practical follow-up to ensure their implementation.

One idea to leverage training resources is to require trainees to participate in local activities in-country to demonstrate their new skills upon their return. This could include training others in the new skills or production methods obtained, or demonstrating changes made as a result of the training. Participants could be featured at seminars, roundtable discussions, or trade fairs to share their knowledge and become role models for other entrepreneurs. These ideas are currently being implemented by PIET's program in Latvia with favorable results.

Promote Services: Technical assistance and training programs need to better promote their services. There is a lack of information to participants and among service providers on available assistance resources. This could be addressed through a local resource which would function as an information clearinghouse.

Develop Delegation Skills: In order for entrepreneurs to be able to devote time to training, they must be able to delegate responsibility to others in their absence. A middle management structure is needed for an entrepreneur to have the independence to attend training. It is also important because lack of management delegation is a key reason why growing firms often fail -- firms typically face their most difficult challenge at the point in their development where delegation becomes necessary. For these reasons, future training should help entrepreneurs understand the importance of delegation for long-term growth, and help to develop the needed skills.

180-0023 Activities Summary for World Council of Credit Unions (Woccu) - Poland

The following is a summary of WOCCU's activities in Poland. The information was obtained through personal interviews with the headquarters and field staff, clients, and document reviews. Section I describes the program, Section II details the lessons learned based on experience, and Section III discusses future directions and needs as determined by research interviews.

I. Program Overview

Description of Program

Based in Madison, Wisconsin, WOCCU is an umbrella organization comprised of community credit unions from around the globe. It has been active in Poland since 1992 to establish a credit union movement. Poland already had a system of mobilized savings through the mandatory contributions of employee unions. WOCCU is currently active only in Poland in the CEE region.

Funding

Under the 1800023 portfolio, WOCCU received grant funding of $2,100,000 for activities in FY 1992 and 1993, as indicated below:

WOCCU - Poland
1800023 Funding Levels - 1800023
FY 1992 - 1993
Source: SEED Act Report, 1993

FY	AMOUNT
1992	$700,000
1993	$1,400,000
TOTAL:	$2,100,000

Activities

WOCCU's Poland program can be divided into the following four general groups of activities

- Credit Union Growth and Development: WOCCU has been actively involved in the development of a specific Credit Union Act to be adopted by the Polish Parliament. Passage of this Act is the fundamental legal basis for true credit unions to be able to function as they do traditionally elsewhere around the world. The act will authorize key credit union activities which cannot be undertaken under current law, such as the

organization of community credit unions.

- Foundation/Association Self Sufficiency: The Foundation for Polish Credit Unions (FPCU) was formed as a non-profit charitable and educational foundation to support development of the credit union system in Poland. To this end, the FPCU carries out promotion, training, legal, and legislative functions to support this development. WOCCU has also been active in establishing a National Association of Cooperative Savings and Credit Unions (NACSCU) to represent the national interest of Polish credit unions.

- Credit Union Safety and Soundness: FPCU is active in setting up a Stabilization Fund as an external service to credit unions. The purpose is to create depositor confidence in credit unions by protecting member's savings. It is not government deposit protection insurance, but is created by collective credit union deposits placed in pool of funds administered by elected credit union representatives. This resource pool enables the Fund to provide its services to credit unions in financial distress.

- Education, Information, and Training: In September 1993, a Credit Union School was established in Gdynia which offers a two-year, licensed, credit union course. In addition, courses are offered in three levels of credit union training, as well as specialized courses. WOCCU provides seminars to inform communities about credit unions, their services, and necessary steps in their formation.

Outputs

As of April 1994, WOCCU had established 119 registered credit unions in Poland, of which 67 or 56% were fully operating. This represents a total of over 44,000 primary members. Other project outputs are noted in the chart below.

WOCCU - Poland
Project Outputs
FY 1993 - April 1994
Source: Project Goals Comparison Report, Third Quarter 1994
(based on conversion ratio 21,900 zl = $1 USD)

FY	NO. OF REGISTERED CUs	NO. OF PRIMARY MEMBERS	TOTAL CU SAVINGS	TRAINED LEADERSHIP (estimate)
1993	51	17,461	$3,616,000	1,188
1994	68	26,645	$8,700,000	3,000
TOTAL:	119	44,106	$12,316,000	4,188

II. Lessons Learned

Need for Long-Term Focus: Given Polish legal constraints, changes of government, and other macro-economic structural constraints, the development of a credit union movement in Poland will take much longer than originally expected. WOCCU believes it was unrealistic to expect to set up 430 credit unions in 4 years, as in their original scope of work for Poland.

Credit Unions as Non-Bank Alternatives: Despite constraints to credit union operation in Poland (detailed below), credit unions can provide an important non-bank alternative to meet financial needs not being met by the commercial banking system. Credit unions generally offer several advantages over other financial institutions. These include their ability to be tailored to a local community; can lend at fair market rates; and can offer a broad range of services targeted to specific needs.

Constraints to Achieving Goals and Objectives

Aside from the macro-economic constraints inherent to Poland, the key constraint to the successful development of credit unions is caused by limitation of Polish law. Based on imperfection of the law, credit unions in Poland cannot function normally. Firstly, credit unions are limited to serving well-defined employee groups. As such, they are prohibited from providing services to their local communities. This is in contrast to traditional credit unions which are usually founded on a community basis.

Secondly, the credit unions are further hindered from offering full services even to their strictly-defined constituencies. This means that even as credit unions begin to be able to mobilize savings, they are greatly restricted from lending activities. WOCCU would like to see a Credit Union Act which would allow broad-based services and allow credit unions to function as financial institutions. WOCCU is actively working to address these constraints through their program.

Key Accomplishments of Program[1]

As of April 1994,

- 67 credit unions are now operating each of which employ a staff of 15-20 on average.
- WOCCU has provided over 3,000 trainings in credit union formation, operation, and management to credit union leadership.
- Polish credit unions provide services to over 77,000 estimated beneficiaries.

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[1] Source: Project Goals Comparison, Report by WOCCU, April 1994.

Impacts and How Measured

WOCCU uses the following key criteria to measure actual results against goals. Some results of these results are mentioned above under "Key Accomplishments of Program."

- Number of registered and operating credit unions.
- Number of primary credit union members.
- Estimated number of beneficiaries.
- Total credit union savings.
- Average deposit size.
- Total credit union loans, capital, and assets.
- Estimated number of trained leadership and interns.
- Total stabilization reserves.
- Total lending.
- Amount of Polish contributions.

III. Future Needs and Directions

Based on the important lessons learned in Poland, WOCCU has noted several priority areas for future programming. A.I.D. needs to adopt a longer timeframe for assessing the success of the credit union movement in Poland. Due to constraints in the Polish legal system and other obstacles, the development of credit unions will take much longer than originally expected.

As mentioned above, credit unions can play an important role in meeting financial needs in the future. Since the commercial banking system is unable to meet the financial needs of firms, credit unions should continue to be encouraged in Poland, and could also be promoted in other CEE countries as viable, non-bank alternatives for financial services.

Attachment B:

Contacts Made

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Attachment C:

Documents Reviewed and Other Reference Materials

Country/Category	Author/ Institution	Title	Sub-Title	Where Published	Date
Albania	American ORT Federation	Year End Report	Small Business Management Program	Tirana	Dec-93
Albania	The Eastern Regional Business Agency, Korça	Business Prospects in the Eastern Region of Albania			Jun-94
Albania		CDC - Assistance to Albania	Activities of U.S. Nonprofit Organizations		
Albania		Rural Development Project	Initial Executive Project Summary		Jan-94
Baltic		Terms of Reference	Technical Assistance for SMEs in the Baltic Countries		
Baltic	The World Bank	Estonia	The Transition to a Market Economy	Washington, D.C.	Mar-93
Baltic	The World Bank	Latvia	The Transition to a Market Economy	Washington, D.C.	Mar-93
Baltic	The World Bank	Lithuania	The Transition to a Market Economy	Washington, D.C.	Mar-93
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Bulgaria		Opportunity International	Summary of Accomplishments	Oak Brook, IL	
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CDC	Citizens Democracy Corps	A Proposal for Continued Funding for Central and Eastern Europe			Feb-94
CDC	Derek Bok, President Emeritus, Harvard University	Universities in Hungary	A Review of the Hungarian Parliament's Proposal to Reform Hungary's Higher Education System		
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CDC	Gordon S. Riess	Weekly Report No. 1		Czech Republic	Apr-94
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CDC		Citizens Democracy Corps - Assistance to Estonia	Activities of U.S. Nonprofit Organizations		
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CEE/SME	Business Monitor International Ltd.	Eastern Europe Monitor	Executive Brief - Vol.1 No.3		May-94
CEE/SME	Business Monitor International Ltd.	Eastern Europe Monitor	Executive brief - Vol. 1 No. 2		Apr-94
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CEE/SME	Checchi and Company Consulting, Inc.	Final Report - A Program Evaluation of A.I.D.'s Investments in Voluntary Assistance to Private Enterprise Development in Central and Eastern Europe	IQC No. AEP-0085-I-00-3003-00 - Delivery Order No. 2	Washington, D.C.	Oct-93
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CEE/SME	Veronica R. Clifford	Working Papers	Implementing Privatization Policy in Developing Countries: A Selected Literature Review	Washington, D.C.	Aug-93
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CEE/SME		Centre for Co-Operation with Economies in Transition	Programme of Work *** 1994	Paris	
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CEE/SME		DRAFT - Capital Development Initiative	Close Out Report		Feb-94
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CIPE	Maciej H. Grabowski, Przemyslaw Kulawczuk	The Gdansk Institute for Market Economics	Small and Medium-Size Enterprises in Poland Analysis and Policy Recommendations	Gdansk	Jun-05
CIPE	Public Policy Institute Foundation	Papers and Proceedings 1993	Private Sector Development and Local Government in Hungary	Budapest, Hungary	September 10-11, 1993
CIPE		CIPE Newsletter	The Economic Policy of the Hungarian Democratic Forum	Budapest, Hungary	Jun-05
CIPE		Concept Paper	Baltic States, Bulgaria, Hungary, Slovakia Project Agency for International Development, Regional Mission for Europe, Office of Economic Restructuring, AID Project No. 0023		
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Czech Republic	American Embassy Prague	United States Seed Act Assistance Strategy for The Czech Republic	1993-1995		Jul-93
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Czech Republic	Dennis A. Rondinelli	International Private Enterprise Development Research Center	Private Enterprise Development and The Transition to a Market Economy in Czechoslovakia		Jun-05
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Czech Republic	EUROPMI	Entrepreneurs Association of the Czech Republic			
Czech Republic	Gordon S. Riess	Weekly Report No.'s 1 & 2		Praha	April 4, 11, 1994
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Czech Republic		American Czech & Slovak Enterprise Fund	1993 Annual Report - Third Annual Report For the Year October 1, 1992 to September 30, 1993		
Czech Republic		Center for Democracy and Free Enterprise &	Anglo-American Business Institute, Inc.	Prague, Czech Republic	
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Estonia	American Embassy Tallinn	United States SEED Act	Assistance Strategy for Estonia	Tallinn	1993-1995
Estonia	EVEA	Evea Estonian Small Business Association	Estonia: Entrepreneurial Environment and Entrepreneurs major problems		Jun-05
Estonia	Statistical Office of Estonia	EESTI Statistika	Estonian Statistics 1994 - Monthly No. 4 (28)	Tallinn	Jun-05
Estonia		Development Assistance Strategy Memorandum Update	Draft	Oar Estonia	Apr-94
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Hungary		Crossed Paths: Straightening the Road to Private Sector Growth	The Legal & Regulatory Reform in Hungary Project		Spring 1994
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Hungary		Hungarian Foundation for Enterprise Promotion	Monthly Update		Feb-94
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IESC	Charles Sweet, David Holt, Andrea Love, Paul Prentice, David Harbin; Checchi and Company Consulting	A Study of the International Executive Service Corps	Appendix B.	Washington, DC	Oct-93
IESC	International Executive Service Corps	Business Development and Support Program for Central and Eastern Europe			Mar-94
IESC	Thomas S. Carroll	Multiple Business Services	Increasing Competitiveness & Achieving Growth	Stamford, CT	
IESC		Country Specific Action Plan	Draft - March 21, 1994	Hungary	
IESC		IESC Bratislava Activity Report			Apr-94
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IESC		Small and Medium Private Enterprises in Bulgaria	IESC Assistance to SME in Bulgaria		
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IFC		3P/PBAS - Polish Business Advisory Service	Report on Operations for the 18 Months		Dec-92
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Latvia		Latvia: What American Companies Should Know			
Lithuania		SEED Country Assistance Strategy Update	Issues Due ENI/ECA Desk Jennifer Karp (202) 736-4077		Jun-94
Macedonia	UNDP	Consultative Group Meeting for the Former Yugoslav Republic of Macedonia	Technical Co-operation Needs and Priorities of The Former Yugoslav Republic of Macedonia	Paris, New York	Jun-94
MBA	David Gergen	"It's much more important for young Americans coming out of business school to spend a year or two on the shop floors of Warsaw than to spend a year on the trading floors of Wall Street."			November, 1989
MBA	Dennis A. Rondinelli	International Private Enterprise Development Research Center	Case Study, Privatization and Economic Reform in Central Europe: Experience of the Early Transition Period	Chapel, N.C.	Nov-92
MBA	Lynne Gerber	Trip Report	Trip to Czech Republic, Hungary, Bulgaria, Slovakia, and Poland		March 16 - April 8, 1993
MBA	MBA Enterprise Corps	Letter Series			Fall 1993
MBA	MBA Enterprise Corps	Proposal to The Agency for International Development For Multi-Year Funding of the MBA Enterprise Corps, Inc.	for Programs Beginning in 1994, 1995, 1996		Jan-94
MBA	MBA Enterprise Corps	Review of Activities of the MBA Enterprise Corps	October 1, 1993 - December 31, 1993, prepared for Funding Organizations	Chapel Hill, N.C.	Jan-94

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MBA	The Kenan Institute of Private Enterprise	Second Quarterly Report on The MBA Enterprise Corps	Review of Activities December 1, 1991 - March 31, 1992, Prepared for USAID	Chapel Hill, N.C.	Apr-92
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Peace Corps	M. Mari Novak	Small Business Development	Project Plan		Feb-93
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Peace Corps		Overview - Hungary	Hungary's Peace Corps Program by Sector	Hungary	
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PIET		Site Visit Report	Evaluation Survey	Romania	
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Poland	Bruce Heatly, Cynthia Lynn Chrzan-Lanigan	Study of The Financial Sector and SME Development in Poland	Volume One: Main Report		Feb-94
Poland		Comprehensive State Policy for The Development and Support of Small and Medium Enterprises	Draft for Discussion		
Poland		Development Alternatives, Inc.	GEMINI/Poland Small Business Project Extension Proposal		
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Poland	C. Jean Weidemann and Carol Finnegan	Small Enterprise Development in Poland	Does Gender Matter		May 26th, 1994
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Poland	Martin H. Billings	Outline of an Agricultural and Rural Development or Poland	A strategy intended to support the implementation of the Support for Eastern European Democracy, program, 1994-2000	Warsaw	Mar-94
Poland	The Scientex Corporation	Polish Small Business Advisory Centers: A Successful Model			Jan-94
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Poland		Polish-American Enterprise Fund	An answer to small and medium size business' financial needs		
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Poland		Study of the Financial Sector and SME Development in Poland	Volume One: Main Report		
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Poland		Testimony before the House Subcommittee on Foreign Agriculture and Hunger			Mar-94
Region-Wide	OECD/OCDE	Overview of Humanitarian and Technical Assistance to the Newly Independent States of the Former Soviet Union		Paris	Jul-93
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Region-Wide	Stuart Thompson	Assessment of EC PHARE Support to SME Development			Jul-93
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Romania	American Embassy Bucharest	United States Seed ACT	Assistance Strategy for Romania - 1993 - 1995	Romania	Jul-93
Romania	ASEBUSS	EMBA 1993-1995		Bucuresti, Romania	
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Romania	RDA	Press Release			Sep-93

Country/Category	Author/ Institution	Title	Sub-Title	Where Published	Date
Romania	RDA	The Actual Development Stage of the National Private SME Sector and the General Priorities in the Field	Proposed by the Romanian Development Agency for the Period 1994-1996	Bucharest	Jan-94
Romania	Romanian Development Agency	Law Digest for Foreign Investors		Bucharest	Sep-93
Romania	Romanian Development Agency	The Actual Development Stage of the National Private SME Sector and the General Priorities in the Field	Proposed by the Romanian Development Agency for the Period 1994-1996	Bucharest	Jan-94
Romania		EMBA - Academy of Economic Studies	Program Brochure 1994 - 1996	Bucharest, Romania	
Romania		Foundation Crimm	Small Business is our Business		Apr-94
Romania		Romania Encyclopedic Survey		Bucharest	
Romania		Romanian Investment	Review - Vol. 3, No. 2 - March April 1994	Bucharest, Romania	
Romania		The Chamber of Commerce and Industry of Romania - The National Trade Register Office	Monthly Statistic Synthesis, No. 29		December 1990 - April 1994
Romania		The Chamber of Commerce and Industry of Romania - The National Trade Register Office	Report of Activity, November 15, 1990 - December 31, 1992	Bucharest	Mar-93
Slovakia	American Embassy Bratislava	United States SEED Act	Assistance Strategy for Slovakia 1993-1995		Jun-93
Slovakia	Bank Austria AG	The Slovak Republic	Country Report May 1993		May-93
Slovakia	Development Alternatives, Inc.	Slovakia Small Business Assessment			Feb-94
Slovakia	Eastern Europe Business Information Center	Slovak Republic	National Agency for Development of Small and Medium Enterprises	Washington, DC	Feb-94
Slovakia	George J. Yost, III	1994 International Tax Summaries	A Guide for Planning and Decisions		Jun-05
Slovakia	Okresny úrad	How to Successfully Realize The Economic Revival in the Zvolen Region	District office Zvolen, Township Zvolen		Nov-92
Slovakia	Tony Barclay, Bruce Heatly	Slovakia Small Business Assessment	GEMINI Technical Report No. 74	Bethesda, MD	Mar-94
Slovakia		A Sustainable Microenterprise Credit Institution	Opportunity International May 1994		May-94
Slovakia		I.E.S.C. Bratislava Activity Report		as to April 20, 1994	
Slovakia		Introduce to institutions and inhabitants of the region the project of	Scientific Technological and Innovation Center Banská Bystrica (STIC-BB)	Banská Bystrica	Nov-93
Slovakia		National Agency for Development of Small and Medium Enterprises	Your Business is our Business		
Slovakia		The Founding Deed of	The Foundation for Regional Development of the Slovak Republic		

Country/Category	*Author/ Institution*	*Title*	*Sub-Title*	*Where Published*	*Date*
WOCCU	Foundation for Polish Credit Unions/World Council of Credit Unions	Building the Polish Credit Union System	Work Plan - October 1993 - September 1994		Nov-93
WOCCU		Work Plan October 1993 - September 1994	Building The Polish Credit Union System		Nov-93

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Attachment D:

Scope of Work

STATEMENT OF WORK
DEVELOPMENT OF A STRATEGY FOR SMALL BUSINESS DEVELOPMENT

BACKGROUND

In January, 1991 the 180-0023 project was authorized as part of the Regional Mission for Eastern Europe's Office of Economic Restructuring portfolio. Since that date the project has been extended to September 30, 1996.

The overall purpose of the project was to assist in the development of the technical, management, and economic skills necessary to restructure Central and East European economies and assist in the development of competitive markets and businesses. This purpose has been further refined to accelerate the growth of private enterprises in CEE countries by providing direct technical expertise to individual firms and improving the regulatory environment in which these firms operate. Special emphasis was placed on small and medium size enterprises as target firms and on private voluntary organizations which can provide a cost effective delivery mechanism for technical expertise.

The project is predicated on the assumption that direct assistance to private enterprises and improvement of their operating environment are critical counterparts of the major privatization program in CEE countries.

Project No. 180-0023 includes a range of activities being implemented through grants, cooperative agreements, and buy-ins to centrally funded projects. They include a Cooperative Agreement (C.A.) with the International Executive Service Corps (IESC); Grants with The Center for International Private Enterprise (CIPE), the World Council of Credit Unions (WOCCU) and the MBA Enterprise Corps; an Inter-Agency Agreement (IAA) with the Peace Corps; a Grant (Letter) with the International Finance Corporation (IFC) for the Polish Business Advisory Service; and buy-ins to the centrally funded GEMINI and IRIS projects. The purposes of these various agreements are summarized below.

IESC: To furnish management and technical expertise to businesses in countries in Central and Eastern Europe and the Baltics, to contribute to private sector development in those countries.

CIPE: To provide technical assistance to enterprises via two separate but related project activities. In the Baltics, CIPE is developing a network of business entrepreneur associations and public institutes to encourage business formation and growth as well as to improve the enabling environment for private business. In Hungary, CIPE is working with business and public policy

organizations to change the laws and regulations affecting private business, particularly small business formation and growth. CIPE has also recently submitted a proposal for additional funding to USAID, and has received tentative approval, for expansion of its activities throughout the region.
WOCCU: To train in Poland national leaders, managers, staff and members of savings and credit unions (SCUs) with the necessary technical and motivational skills to effectively manage and build a self-sustaining network of SCUs and secondary service organizations such as national associations, a central credit union, financial stabilization programs and cooperative insurance providers.

MBA Enterprise Corps: To use graduate MBA's from 20 member schools to provide management assistance to private and privatizing companies in Central Europe.

Peace Corps: To contribute to the development of free market economies by providing technical assistance, training, and business information to local public and private organizations which support small business development.

IFC/Polish Business Advisory Service: To provide assistance in the growth of the private sector in Poland by establishing a financial and technical advisory service for small and medium-size businesses.

GEMINI and IRIS: To assist the Government of Poland and local business organizations to create an environment supportive of small business by setting up procedures to identify and remove obstacles to business development.

Essentially, current 180-0023 activities fit into the following framework:

1. Direct technical support at the firm level (IESC, MBA Enterprise Corps, IFC, and Peace Corps, for example);

2. Support for institutional development and capacity building among local organizations such as business associations, chambers of commerce, or credit unions (CIPE and WOCCU, for example); and

3. Work at the macro economic policy level to ensure that policies and regulations are in place that support rather than hinder the development of small and medium businesses (IRIS, GEMINI, and WOCCU, for example).

The intent of such an approach is to allow information about specific enterprise needs to inform the objectives and goals of private sector associations and institutions. These strengthened

organizations can then more effectively inform policy makers of their macro economic policy and regulatory needs, which if implemented create an environment which enables the healthy development of small and medium businesses.

To date, 180-0023 activities have received relatively good marks in those countries where grantees have been active. Its programs have been viewed as appropriate for the transition period during which strategies and priorities have been unclear. However, as 180-0023 activities expand to many countries in the region, a more cohesive implementation strategy is required if maximum impact is to be achieved.

It is now timely to review the lessons learned in the CEE by the above-mentioned organizations implementing 180-0023 activities as well as other non-USG funded organizations. Accomplishments will be reviewed against the initially proposed efforts in small business development. Possible new directions for a second phase of activity utilizing a more cohesive and synergistic strategy of small business assistance will also be identified.

TITLE

Project: Technical Assistance to Enterprises
Number: 180-0023

OBJECTIVE

The overall purpose of this scope of work is develop a strategy to provide guidance for the future direction of the 180-0023 project and for a new, small business development project following completion of the 180-0023 project. The strategy is also intended to provide guidelines to field offices to assist them in the development of their own country-specific small business development strategies. Specific objectives are to:

1. examine the contributions to small business development of the various sub-agreements implemented to date under the 180-0023 project, as well as other USAID and non-USAID funded small business development programs; and survey mission and host country perceived future small business development needs;

2. recommend programmatic strategies for overcoming possible constraints to small business development by identifying key areas of intervention where the greatest complementarity and potential for synergy exist, including descriptions of assistance which USAID could consider; and

3. recommend a specific small business development strategy which would include an overall goal and specific objectives, benchmarks, indicators, measures of impact, and measures of cost-effectiveness.

STATEMENT OF WORK

As stated above, the strategy development will focus on three broad sets of issues:

I. The Impact of 180-0023 Contributions to Small Business Development and Perceived Future Needs

The team will first assess the impact of all on-going 180-0023 activities. In addition to review of project files in USAID/Washington, five trips to the field are anticipated (Trip 1 - Talinn, Riga and Vilnius; Trip 2 - Warsaw, Brussels, and Paris; Trip 3 - Bucharest and Sofia; Trip 4 - Prague and Bratislava; and Trip 5 - Tirana and Budapest)

The team will: (a) examine the contributions to small business development of the various agreements implemented to date under the 180-0023 project; (b) identify and examine other USAID and non-USAID funded small business development programs and report on their perceived impact; and (c) conduct interviews with the appropriate people to determine future needs as perceived by the mission and host country.

A. 180-0023 Contributions to Small Business Development

- What have been the major accomplishments of specific 180-0023 activities to date? How is the impact measured? What factors and constraints, if any, may have hindered grantees from producing results?

- Have 180-0023 activities resulted in policy reforms, legislative changes or otherwise contributed to positive changes in small business development?

- What specific constraints, such as the policy and regulatory environment, access to financial services, institutional capacity, or access to adequate management training, have most affected small business development?

- What factors have contributed to the success of small business development?

- In what sectors/sub-sectors have 180-0023 programs been most active?

- Have 180-0023 activities had an impact in helping to

understand problems associated with small business development in countries where 180-0023 activities have been implemented? How has this impact been measured?

- Have the programs been aimed at benefiting individual enterprises or groups/associations? Who, specifically, (male/female, ethnic group) has participated? Have there been constraints to participation associated with gender or ethnic group?

- To what extent have 180-0023 programs had an impact on employment and income generation?

- Have the programs been aimed at supporting firms already in existence or have they encouraged the formation of new firms?

- Are interventions at the firm level cost effective relative to costs associated with interventions at the institutional or policy level?

- How cost effective is utilization of volunteer organizations such as IESC, the Peace Corps and the MBA Enterprise Corps relative to other technical assistance mechanisms?

- Has the administrative and institutional capacity of the organizations used to implement 180-0023 activities had an effect on implementation and impact?

- What impact has the USAID/RME management structure for this program had on the development and implementation of 180-0023 programs?

- What impact has the USAID/RME field office organizational structure had on the development, implementation, and impact of 180-0023 activities?

- What recommendations could be made to mitigate any negative effects of the USAID/RME organization structure and enhance its positive effects on small business development in CEE countries?

B. <u>Other USAID and non-USAID Funded Small Business Development Programs</u>

- What other small business development programs are being undertaken by USAID (both worldwide and in the Region), and other donors and NGOs (in the Region)? What has been their impact? Whom have been the targeted beneficiaries. What has worked? What have been the constraints?

- What lessons have been learned from existing small business development strategies including financing of small businesses, technical assistance and business support services, working through intermediary institutions, enhancing the policy environment, and technology transfer?

- What are other USAID project, donor and NGO priorities in small business development in the Region? Are they taking into account socio-economic and gender issues as barriers to participation?

- What is the estimated amount of funding being allocated to this sector by other donors and NGOs? What is the estimated percentage of funds being allocated, relative to other programs?

C. Mission and Host Country Perceived Future Needs

- Are the programs presently being carried out under 180-0023 of continuing relevance to current concerns of USAID and other donors?

- For each country, is there an existing small business development strategy? Has the strategy adequately addressed the cross-cutting issues of equity and democratic participation?

- What are the felt needs of Missions, NGOs and Host Countries with regard to improving small business development? What are the emerging priorities?

- How does small business development relate to the overall USAID Rep., NGO, and host country development priorities?

II. Small Business Development Strategy

The team will also recommend a specific small business development strategy emphasizing: (a) overall goal and specific objectives, (b) benchmarks, (c) performance indicators, (d) measures of impact, and (e) measures of cost-effectiveness.

A. Goal and Specific Objectives

- What should be the overall goal of an USAID/EUR small business development strategy?

- What should be the specific objectives of an USAID/EUR small business development strategy?

- In what way do these objectives complement one another

and support overall Mission objectives and strategies, as well as host country priorities in the Region?

- How can gender and other social identity issues best be integrated into such a strategy? What needs to be done to assure that women as well as men of all ethnic and religious and other social identities are fully integrated into project activities?

- What are the categories of project activities that will help to achieve this goal?

B. Benchmarks

- What specific benchmarks will serve as the best indicators that programs are being implemented effectively and reaching targeted male and female beneficiaries, as well as other social categories?

C. Performance Indicators

- What specific indicators of program success can be identified?

- Are these consistent with those developed under USAID's PRISM system?

D. Impact

- How can programmatic effects be assessed and measured?

E. Measures of Cost-Effectiveness

- How can cost-effectiveness of small business programs best be assessed?

- What methodology can be best used to inform USAID decisions about the best use of project funds?

- In what way can project costs, results and benefits be compared in small business development programs?

III. Recommendations for Future Areas of Assistance

The team will next make specific recommendations for overcoming possible constraints to small business development by: (a) identifying key areas of assistance where the greatest complementarity and potential for synergy exists; (b) recommend beneficiaries, e.g. women, to be targeted; (c) changes in area of 180-0023 focus; and (d) implications for project management and staffing.

A. Key Areas of Assistance

- In light of RME/ER and field office priorities, where does the greatest potential for complementarity and synergy exist in EUR/RME's small business development portfolio?

- What specific programs, including on-going 180-0023 activities, should be included in a small business development program? Is executive and management development, including training a possible priority?

- How can policy constraints, access to financial services, access to other small business support services, and technical assistance needs, best be addressed?

B. Targeted Beneficiaries

- In light of RME/ER and field office priorities, what size and type of enterprise should be targeted for inclusion in small business development project activities?

- How can/should assistance be targeted to ensure that gender, ethnicity, religious and social identities are not barriers to participation?

C. Changes in 180-0023 Focus

- What are the basic directions and priorities EUR/RME should pursue in the area of small business development?

D. Implications for Project Management and Staffing

- In light of any modifications in 180-0023 implementation, what are the implications for project management and oversight in USAID/W and in the field?

IV. Staffing

This statement of work will require a team consisting of five individuals. Position descriptions of the team members are provided below.

Small Business Development Specialist (A): This individual will serve as the Chief of Party (COP) and will be responsible for the successful completion of all tasks specified under the Scope of Work. The Small Business Development Specialist will manage work performed by the other team members, and will coordinate closely

with USAID on a day-to-day basis to ensure proper implementation of the tasks to be carried out under this work order.

Small Business Development Specialist (B): This individual will work under the supervision of the Chief of Party (COP) and will assist the COP in organizing interviews, data collection in the field including round table discussions and one on one interviews. In addition, this individual will assist in analyzing survey results and facilitating strategic planning discussions.

Project Analyst: This individual, working under the supervision of the Small Business Development Specialist, will review documents prepared to date on 180-0023 activities, and prepare a summary of those activities, and their reported impacts and contributions to small business development in Eastern Europe. The Project Analyst will collect and review information as well on other donor programs in Eastern Europe. This individual will also participate in field trips and interviews with contractor/grantee staff to collect additional information relevant to the team's findings and conclusions. Finally, the Project Analyst will assist the Small Business Development Specialist in preparing all reports and presentations required under the work order.

Senior Business Development Advisor: This individual will serve as a senior technical advisor to the team and USAID in addressing strategic issues about future program directions. The Senior Business Development Advisor will have input at critical points during the implementation of this work order. For example, s/he will participate in briefings on the status of current USAID efforts under 180-0023 once the team members have completed a review of literature on these activities. The Senior Business Development Advisor will also participate in two field trips where s/he will meet with contractor/grantee staff, USAID and other donor representatives, and local counterpart organizations to discuss current issues and probable future directions. Finally, s/he will review the work completed by the team and participate in debriefings with USAID on the conclusions and recommendations.

Senior Program Specialist: The role of this individual will be to ensure that the work is conducted in a fashion that will lead to the making of strategic program decisions for the Eastern Europe portfolio. The Senior Program Specialist will facilitate a Team Planning Meeting involving the contractor team and USAID staff at the start up of the project. The Senior Program Specialist will also facilitate a meeting in which the team will present its review of 180-0023 activities to USAID prior to beginning the field visits. Finally, this individual will be responsible for facilitating a strategic planning session involving representatives from USAID and the team once field work

has been completed and the team has finished a draft report of its findings, conclusions, and recommendations. At regular points during the implementation of this exercise, the Senior Program Specialist will be briefed by the Small Business Development Specialist about the team's progress. This individual will also participate in one of the field trips. The individual assigned to this position will also be a senior staff member of the contractor organization and will serve as the Principle-in-Charge of this work order on the Company's behalf.

The output of this effort will be a Small Business Development Strategy. In addition to guiding overall EUR/RME and field office small business development activities, the strategy will guide on-going 180-0023 and future project implementation. The strategy shall include descriptions of potential areas of assistance and activities which USAID could consider supporting, and target countries and beneficiaries, taking into account gender issues.

REPORTS

The contractor will prepare a final report, incorporating the findings and conclusions drawn from document review, interviews, all field trips, meetings with USAID and other organizations. The final report shall include recommendations for areas of assistance, descriptions of interventionsoptions which USAID could consider, and target countries and beneficiaries and shall contain strategic options for small business development. The report shall include a matrix that indicates which activities, by country, and over time, should be supported by USAID, assuming overall funding levels for CEE remain the same for the next three years. The report shall be submitted in draft to USAID for comment, three and one half months after commencing the work. The final report, incorporating USAID comments, shall be submitted to USAID not later four months after work commences. Five copies of the report shall be provided to USAID.

RELATIONSHIPS AND RESPONSIBILITIES

The EUR/RME/ER 180-0023 project manager will provide oversight for this activity, with the support and involvement of the EUR/RME/ER/TI Division Chief. Other EUR staff will contribute to the strategy development as well, including a project development officer, a monitoring and evaluation specialist, and an economist. In addition, the USAID Women In Development (WID) office will serve as a resource for technical advice as needed. A committee with designated members from relevant offices will also be convened to provide advice, review reports, and attend briefings throughout this effort. The committee will be chaired by the EUR/RME/ER/TI Division Chief.

The contractor will be responsible for making its own travel arrangements to countries in Central and Eastern Europe, and for lodging at these sites. The contractor will be responsible for providing its own word processing and copying facilities.

USAID's 180-0023 project manager, will make all pertinent documents available, will arrange meetings, and reserve meeting rooms.

PERFORMANCE PERIOD

Implementation of this statement of work will be carried out over a four-month period, with submission of a final product submitted at the end of the four-month period of the delivery order.