

The Role of the Government in Supporting SME Development in Croatia

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The role of the Government in the transition process is a much-debated issue. The more this process advances and the more problems appear, the clearer it becomes how unfounded were the expectations that the influence of the Government would weaken with the collapse of communism.

The transition process required the selection of new models for individual segments of transition, and the establishment of new institutions. Thus, for example, models had to be designed for privatization, for the consolidation of banks, for macroeconomic stabilization. Institutions charged with these tasks had to be built from scratch, such as privatization funds, bank reconstruction agencies, and other parastatal institutions. And, in order to obtain the loans needed for the work of these institutions or for the implementation of the models for different segments of the transition process, it was again the Government which had to negotiate with international financial institutions. At the same time, the Government was expected to begin withdrawing from the market, to stop interfering in economic processes, to provide for an allocation of resources that was market-based rather than arbitrary. The new Government administrators, and even the leaders of some countries, found themselves in a highly contradictory position: they had to intervene, but subtly so, at the same time preparing the ground for a reduction of Government intervention.

The problem created by this situation is very delicate and quite different from the problem of the role of the Government in capitalism, that is, Keynesian Government capitalism. There, the Government interfered in order to set up a welfare Government, and, in a situation of affluence, of sufficient material and financial resources, it carried out a small amount of social redistribution, which caused little headache to anybody, as there was more than enough for all social strata. Under such conditions, few people felt that Government intervention aimed at rectifying some market inequities in favour of a more equitable distribution of resources represented a great burden.

In the situation brought about by transition, Government administrators find themselves in the position of having to act under the conditions of relative poverty, being subjected to critical scrutiny by the public, and having to create a practically new system. This requires of them a high degree of expertise, good political sense and great moral integrity. They wield great power and may easily be tempted to perpetuate their interventionist role and assume control of developments over a prolonged time span, instead of reducing their influence already in the first stage of transition.

One of the examples of such a delicate and subtle role of the Government is its attitude to the development of small and medium-sized enterprises (SME). It is in the nature of things that SME's develop on the basis

The article focuses on the specific role of Government in the transition process with special emphasis on the policy towards the small and medium-sized enterprises (SME), as well as regional development in Croatia. Authors point out to the specifics of transitional countries, noting that the role of the Government in such circumstances should be more supportive regarding stimulation of the SME development by way of supporting the development of the economic support infrastructure. Further, the reasons for a more active role of the Government regarding SME development policy are discussed and specific policy recommendations are offered.

Key words: Small and Medium-sized Enterprises, Regional Development

of an authentic business interest and it may seem that, as such, they are self-sufficient. Where such interest exists and there are favourable business opportunities, the entrepreneur will find the motif and the way to develop such an enterprise. One might be tempted to conclude that an entrepreneur of this kind has no need for the involvement of the Government.

However, it has been found in the West European countries, particularly where the so-called European model of development prevails (in contradistinction to the Anglo-Saxon model prevalent in the United Governments and Great Britain), that there are distinct advantages to a well-thought out policy of regional development, in which an important role is played by SME's. This presupposes their industrial and informational networking and the evolution of new forms of organization of production based on very dynamic links between SME's as well as between SME's and large firms.

On the basis of such experiences, the role of the Government in supporting the development of SME's in countries in transition, including Croatia, should be reconsidered and should certainly find its place within the broader policy of regional development.

The Government can work out the general elements of a regional development model, to include the necessary legislative instruments and elements of tax, financial and technological policies supportive of the development of SME's. Within this model, the Government should develop the supporting infrastructure to meet the SME's needs. This would include local developmental agencies, technological agencies, technological parks, incubators, business information centres, training centres and programmes, etc.

The Government, especially in countries in transition, can thus support SME's while confining its role to that of a global co-ordination of supporting policies. This is particularly important for Croatia, where large parts of the country were devastated during the war and can only be economically revived with considerable help from the Government. It is natural that the development of such regions will require, at least initially, top-down solutions in the form of co-ordination, financial support and building of the economic support infrastructure.

In this process, obviously, the Government dictates the rules of the game, which might prompt it, theoretically, to continue to cling to its powers even beyond the point at which it should leave further development to market agents. But it should be remembered that while Government assistance is necessary and beneficial up to a certain point, it becomes counterproductive beyond this point. It is the experience throughout the world that the classical instruments of "centralized" regional policies - such as the

centrally directed reduction of regional disparities - produce very unsatisfactory results. This has gradually become apparent also on the supranational level within the European Union. That is why the skill and expertise of the Government administration consists in recognizing the borderline between the "top-down" and the "bottom-up" approach and the point beyond which the "top-down" approach becomes counterproductive and should be replaced by the "bottom-up" approach.

The role of the government in promoting regional and SME development

The past few decades have shown that the earlier role of the government in stimulating regional development, and thus also the development of dynamic systems of production with a well-developed entrepreneurial environment and innovative SME's, has been an utter failure. The reasons for this failure are to be sought in the very nature of the strict hierarchical control and centralized management, which has blocked the implementation of effective regional policies, including the policy of promoting the development of SME's.

The inability of the central government to promote local development, economic restructuring and entrepreneurial vitality and innovativeness at lower levels has been felt all the more acutely as demands for greater competitiveness have become louder.

Present-day competition in the private sector requires ever shorter terms of delivery, just-in-time co-ordination of different manufacturing units, and modern logistical systems capable of cutting production cycles from several months to several weeks or days, in order to meet the requirements of different markets (Cappellin 1994). This necessitates a much more dynamic and flexible organization of the entire system of production, including not only the institutional and regulatory but also economic support for small and medium-sized enterprises by the Government and its various bodies and institutions.

Numerous polemics concerning the role of the government in regional and SME development start from two opposed extreme views. One view advocates the neoliberal approach in the laissez-faire tradition, claiming that the market will, in the best possible way, guide the scarce resources towards their most efficient use; the other, structuralist view, holds that the market operates with many imperfections, which need to be corrected, and the market itself requires guidance in the form of additional Government intervention. Structuralism favours resolute Government intervention, planning, and reallocation of resources to selected branches of the economy.

The failure of the latter approach since the late seventies has again paved the way for neo-classical,

i.e., neoliberal, tendencies, according to which Government intervention in the pursuit of growth and efficiency is unnecessary. It was precisely the realization of the Government's ineffectiveness in matters of regional development that led to the alternative, "bottom-up" approach, which stresses the importance of SME's.

The need to reduce the amount of supervision, co-ordination and control from the top, from "outside", has led, over the past fifteen years, to a veritable boom in local developmental initiatives in many regions. Such initiatives have been triggered, *inter alia*, by the growing awareness on the part of local administrative and other bodies and individuals, groups, and chambers of commerce, of their potential role and contribution in the design and implementation of local policies (Roberts, Collis, Noon 1990).

This awareness is most strongly present in the new professional group of so-called "local development practitioners" (Jensen 1991), that is, individuals who have appeared on the local and regional level with the idea to promote regional economic growth and development. It is important that such local agents should perceive their own local community in a broader environment and that they should possess a clear vision of its future. A high degree of local interaction and cooperation among the local "agents" (primarily private and public enterprises, research and other institutions) and all the subjects involved in the process of local development helps to secure the implementation of the necessary measures and the realization of such a vision.

Garofoli (1992) stresses the potential role of "social entrepreneurs", who may serve as "pivots" of the local economy within the co-ordinated strategy implemented by private agents, public and collective bodies and institutions. Such a co-ordinating role is necessary in places where there are many small enterprises, which possess short-term flexibility, but are unable to recognize long-range scenarios, work out proper strategies of transformation, and introduce the necessary changes in the spatial division of labour.

With their involvement and action, such subjects/agents not only contribute to greater employment and improved living conditions but also strengthen the local negotiating position vis-a-vis outside enterprises, the central government and international organizations. This contradicts the established classical doctrine of economic development, which relies predominantly on central macropolicy instruments and pays no attention to spatial, social and structural conditions in which an individual entrepreneur runs his business (Star 1992). The advantage of local or regional actions and developmental initiatives in the process of restructuring consists precisely in the fact that they can identify, mobilize and combine differ-

ent potential local resources much better than the central policy can do this.

While in earlier times local developmental processes evolved spontaneously, using the already mentioned initiatives/instruments, we can now create and implement policies to promote such processes. Such policies seek to provide a favourable environment for SME development, for the productive use of local potentialities, for the solution of specific problems of the local economy, and, finally, for the overcoming of all obstacles (Vazquez-Barquero 1990). In this way, local communities can profit from the links established between the local economy and government policy.

This shift of attention towards the local has led to new paradigms of local initiatives and an orientation to a productive interaction of the local, regional and national levels which is gradually replacing the earlier markedly interventionist approaches.

Relying on local developmental initiatives and local agents, that is, bottom-up policy measures, makes it possible to avoid the interventionist excesses by the government and all the attendant negative repercussions that can come from too much government interference in stimulating the development of SME's.

The question of the role of the Government is being increasingly linked with the "principle of subsidiarity", according to which nothing should be done on higher levels that can be effectively done on lower institutional levels.

Lower levels are closest to the problems for which solutions are sought and are therefore best equipped to deal with such problems. The principle of subsidiarity should be applied not only in the relations between regional and central Government administrations, but also between different public and private organizations active in a given region (Grote 1993).

Reasons for a more "hands-on" approach in promoting SME development in Croatia

A consideration of the measures needed to promote the SME sector in Croatia logically leads to the following question: Should the Government play a more important role in the development of the SME sector? This is the question faced by all governments as they try to design policy measures that will result in a more favourable entrepreneurial environment for the development of such enterprises. The dilemma is the following: if such an enterprise can be profitable for a private investor, there is no need for special Government support; if it is not profitable, the Government should not get involved in establishing and/or supporting loss-making enterprises. However, though this argument appears quite logical, it ignores at least three possible reasons of failure of small en-

terprises. These reasons may discourage potential investors in countries in transition, especially Croatia.

The first possible reason of failure of SME's may be financing, since banks and other financial institutions are reluctant to approve loans under acceptable terms to small enterprises.

The second reason could be inadequate access to business information, consultancy, management advice, etc., all of which are either too expensive for small enterprises or simply not available to them.

The third possible reason are bureaucratic barriers and the absence of an ethical and functional business environment. Hence the strongly felt need for an active (even interventionist) provision of business services directly to small enterprises.¹

It is particularly important for Croatia to develop SME's actively because they can —

- contribute to the design and implementation of a concept of self-sustainable development suitable to Croatia's needs;
- accelerate and ease the process of transition to the market economy by fostering entrepreneurial culture;
- speed up Croatia's development relying on the comparative advantages of its economy as a spring-board for integration into the highly complex process of globalization;
- stimulate the development of the export-oriented economy;
- stimulate foreign investments in Croatia;
- stop technological backwardness and encourage the growth of an innovative, knowledge-based and technology-driven economy;
- accelerate the restructuring of industry, especially large and complex enterprises;
- speed up the reconstruction of the war-devastated counties and the development of underdeveloped counties;
- promote Croatia's regional development by providing support for dynamic local production systems;
- increase employment, especially of young educated people, stop the brain drain and loss of the best human resources, and attract top foreign professionals to work in Croatia;
- contribute to a faster improvement of the quality of life in Croatia;
- bring about changes in the traditional decision-making structures for the creation and implementation of policy measures for development and encourage the introduction of new, innovative forms of management at all levels in the country.

In addition to all these reasons, Croatia has an added reason to secure government support for SME development: this country-specific reason is a combination of factors such as its size, degree of integration in the international system, position on the world market, consequences of the patriotic defence war,

complex problems of transition, problems of restructuring of the economy, developmental potential, etc.

For all these reasons, SME's in Croatia evidently need Government support at all levels - central, regional and local, and especially at the regional level. That is why an exclusively liberalistic approach, which is often advocated in certain quarters in Croatia without valid arguments, would be out of place here. In all OECD countries, namely, as well as in the countries of Southeast Asia and Central and Eastern Europe, the Government is actively involved in supporting the growth and development of the SME sector - within the framework of their industrial, regional, technological and other policies.

Such support should be based on the view that the government ought not to interfere directly in the operation of the market mechanism, acting instead by means of horizontal policy measures. The substance of this policy is that Government support is not directed at specific branches or enterprises but aims to create a favourable environment, supporting infrastructure and key production inputs (human capital, research and development, etc.); such a policy is beneficial to all, affects all branches, and does not vitiate an efficient allocation of resources.

The policy of support to SME should be decentralised and based on "bottom-up development", so as to make full use of the advantages and specific features of individual Croatian regions. The Government has a particularly crucial role to play in promoting the development of SMEs in underdeveloped areas, which requires a combined "bottom-up" and "top-down" approach to development.

Judging by the experiences of western market-oriented economies, the formulation as well as the implementation of SME policies in Croatia should be characterised by an extremely active role of sub-national levels of government, reflecting the important place which SMEs do, or could, occupy in regional economic development. The challenge which central government bodies will have to meet is to ensure vertical co-ordination and consistent policy implementation, to avoid duplication of work and contradictory measures, and not to lose sight of the fact that a large portion of measures aimed at the SME sector should be locally defined and, especially, implemented.

In spite of all controversies, it appears that the Croatian government and its institutions can do a great deal to promote the emergence of new and the expansion of existing small and medium enterprises. This is the only way to develop, within a relatively acceptable time-span, a propulsive sector of industrial and innovative SMEs, capable of launching the processes of reconstruction, economic restructuring and further development of the Croatian counties.

Policy recommendations for promoting SME development

In view of this, and in support of SMEs, Croatian government institutions on the central level should make a greater effort to:

- observe the principle of subsidiarity,
- refrain from intervention regarding tasks which the market performs better than Government bodies (concentrating, instead, on measures to rectify market failures),
- encourage partnership, cooperation and non-hierarchical communication between all major factors of economic development (cohesive and linking role),
- support all sectors by non-selective horizontal industrial policy measures (by stimulating the growth of the relevant economic, scientific and technological-innovative support infrastructure, by investing in human resources, etc.),
- assume the neutral status of supervision, regulation and guidance, rather than the role of active control and centralised management.

There is urgent need to provide the requisite economic support infrastructure for SME's. It is a fact that in Croatia at the moment neither the local nor the regional support infrastructure has been developed for SME's, to animate industrial restructuring and the development of the technological-innovative environment. Intermediary institutions (supporting "bridges") are also missing, establishments which are set up for the purpose of building links between industry and science, industry and the service sector, and between the private and the public sectors. They facilitate the flow of information and offer consulting, promotional and intermediary services between private and public bodies, so as to stimulate the growth of all those factors which play a role in modernisation and innovation processes. Services, namely, particularly the more sophisticated, complex and innovative ones, are increasingly regarded as key elements in creating an environment that will attract new activities to a given region (Soy, 1994).

The existence of a compact and diversified framework, regional or local, of enterprises from the service sector and of advisory institutions/centres for developmental and technological matters ought to be an important component of regional, technological and industrial policies in Croatia.

Irrespective of the parts of Croatia where entrepreneurial development is meant to be specially stimulated, horizontal industrial policy measures should be provided to small and medium enterprises to support them at least in the costliest and riskiest "start-up" stage. Only after some basic support is provided to newly established enterprises on the level of central, county and local administrative and developmental bodies and institutions will it be possible to speak

about leaving these enterprises to the action of the market laws and market competition in the true sense of the word. Support will also be required during the subsequent stages of their development - by creating conditions for the growth of competitive and innovative enterprises using up-to-date technology and capable of standing on their own in foreign markets.

In the next short-term period, however, a non-preferential policy will have to be applied with somewhat greater flexibility in areas devastated by war. It will be necessary, to this end, to continue for a certain period with the existing instruments and incentives, and even to devise new ones, in order to encourage the establishment of new enterprises and the growth of existing ones.

In these areas, maximum encouragement should be given in the initial period to the development of the category of farmers-entrepreneurs and small businessmen (family businesses). Such a strategy, based on the so-called "mass-entry policy", would result in an expansion of SME's and higher employment, in addition to some related benefits. It would also expand the basis for the establishment of partnerships among smaller enterprises and between SME's and the existing larger enterprises. Without such a large initial pool of SMEs, the main factors favouring the establishment of links between enterprises: a large number of potential partners, provisional and experimental contracts, fast sectorial innovation, widespread information exchange, etc., would be missing. Once a satisfactory number of SME's has been achieved, the emphasis in policy measures can be shifted to the quality of the existing enterprises and to support for new production and development-oriented entrepreneurship projects². Such a flexible approach to the development of an environment favouring entrepreneurship would presumably result in a faster rate of reconstruction and of economic development of those areas.

To attain such economic growth, local and county administrations should evolve new forms of assistance to the entrepreneurial sector. They should also recognize the primacy of the need to support three key aspects of the development of enterprises - sectors, linkage and support institutions, instead of supporting individual "problematic" enterprises, large or small.

Another incentive to the growth of the SME sector would be the creation of a support network comprising all public and private bodies and institutions relevant to SME development. The final aim of this network would be to accelerate the emergence of new SME's, to aid the emergence of certain structural characteristics of this sector and to foster their growth potential.

Since the main purpose of this co-ordinating network would be to facilitate good horizontal and ver-

tical communication, it would have to be based on a decentralised and comprehensive concept. By unifying and actively involving all Government and private subjects relevant to the SME sector, it would be possible to avoid the danger of a hierarchic, rigid and bureaucratic approach in promoting the development of this sector, which is vital for Croatia.

The priority tasks of this network would be to:

1. foster the development of the economic support infrastructure
2. offer financial assistance to entrepreneurs
3. support technological development of SMEs
4. provide education and training facilities.

The first step to be taken in Croatia in this respect is to encourage in all counties the establishment of agencies and similar institutions to provide information, consulting and related services to entrepreneurs. Possibilities should be explored, already in this initial stage, for offering the largest possible range of such services in a single place. This would help to save time, to prevent duplication and overlapping of competence, and to avoid the subsequent costs of having to regroup such related institutions and bring them under the same roof. This is not to say, of course, that all of SME eggs should be kept in one basket. SME's, namely, need some highly specialised professional services, and it would be unrealistic to expect that all of them could be provided from one place.

Reasons in favour of developing such institutions/instruments can also be found in the fact that such mechanisms are very common not only in all developed Western economies, but lately also in all countries of Central and East Europe. The schema on the following page shows this clearly.

Centres of this kind should be developed at the lowest levels, to take advantage of the accumulated "local know-how". No less important is the possibility to activate local resources in dealing with the specific problems of future or present entrepreneurs. The awareness, namely, of the need to encourage the development of this sector and of all activities that can accelerate its growth and make it more efficient must originate at the grass roots level, stemming from the entrepreneurs themselves and from other local agents or factors, whose initiative and familiarity with local conditions and problems and whose influence make them extremely valuable in helping to bring about a new business climate and environment, and thereby also the creation of dynamic local productive systems.

Concluding remarks

Modelled on the experiences of the developed countries, policies and measures to stimulate the growth of the SME sector in Croatia should be pri-

marily aimed at the regional and local levels, which, although unable to exercise control directly, can nevertheless encourage and co-ordinate the integration of various public and private initiatives and agents from different fields. The idea is to concentrate local elements and to lend them a regional dimension, in order to encourage the emergence of new small businesses and to assist the existing ones in overcoming the difficulties they encounter in their operation.

This approach to the development of SMEs in Croatia, if endorsed, would imply a changed role of the government, involving:

- * institutional support to technological and industrial development by encouraging entrepreneurship and innovation;
- * establishment of intermediary institutions between industry and science, between industry and the service sector, and between the private and the public sectors;
- * instituting changes in the organisation of government administration (including the co-ordination function of Government bodies and institutions) and in the education and training of civil servants;
- * acquisition and broad dissemination of information at horizontal and vertical levels.

Finally, it seems evident that a balance should be struck between the forces acting "from below" and those affecting development "from the top" - including market processes and the role, although changed, of the government. A "bottom-up" approach, namely, makes for guidance, for proposals, incentives, training, informing, linkage, complementation and adjustments, all of which act in favour of regional, industrial and technological development and growth of entrepreneurship. It is also to be expected that the current debates and political pressures will produce planning processes that will be not only more flexible but also operate in both directions, "from below" and "from the top down", including closer cooperation and compromise between local, county and central levels of government. It would appear that it is not only regional industrial and technological policies, but also economic policy in general, which require a simultaneous, co-ordinated combination of market and Government influences - and hence also the need a new role of the government.

According to this new role, the government does not directly interfere in the operation of market mechanisms but imposes non-selective horizontal industrial policy measures⁵. Such measures support the development of all branches and economic subjects, even though in recent years assisting the development of human resources, infrastructure and technological growth, together with SME development, is regarded as a major strategic priority. As these are at the same

Mostly implemented SME support instruments

	Regional agency	Local agency	Guarantee funds	Micro loans	Incubators	Innovation centres	Tax relief	Less administration	Education & training	Information centres	National strategy	Support form industry	R & D support	Chambers	Associations	Marketing	Export support
Austria	x		x		x		x			x			x	x			x
Belgium	x			x	x	x	x	x		x		x			x	x	x
Canada	x	x	x	x	x	x	x		x			x	x				x
Czech Republic	x		x	x	x	x	x		x				x		x		
France	x	x	x			x	x	x		x	x						x
Germany	x	x	x	x		x		x	x	x			x	x		x	x
Greece	x	x	x	x				x	x	x	x	x	x		x	x	x
Hungary	x	x	x	x	x	x			x	x	x			x	x		
Italy	x	x	x	x	x	x	x		x	x	x		x		x	x	x
Netherland		x				x	x	x				x	x	x	x	x	
Norway	x	x	x	x	x		x	x	x	x	x	x	x		x	x	x
Poland	x	x	x	x	x	x	x		x	x	x	x		x		x	x
Portugal		x	x	x	x	x	x	x	x		x	x	x		x	x	x
Slovakia	x		x	x	x	x			x	x	x		x	x	x		x
Spain	x	x	x			x	x		x	x					x	x	x
Sweden	x	x	x		x		x		x	x	x	x			x	x	x
GB	x	x	x		x	x	x	x	x	x		x	x		x	x	x
USA	x	x	x	x	x	x	x	x	x	x	x	x	x	x		x	x

time key factors of regional and local development, Croatia, together with an increasing number of other countries, should implement these measures at lower levels, where they were found to yield faster, cheaper and more effective results. ■

Notes:

1 For more information on this topic, cf. Will Bartlett, "SME Development Policy in Great Britain", as a contribution to the project "The Programme of Economic Development of the Brodsko-Posavska County until the Year 2005".

2 It must be borne in mind that the "mass-entry" stage of SME development often entails a large number of failed enterprises. Although such failures greatly affect the owners, they also play a positive economic role, because this facilitates a fast and continuous circulation of resources, capital, technologies and ideas (Bateman, 1997).

3 For more detail, see: Kesner-Škreb, (1996) "Teorijski okvir državne intervencije", *Financijska praksa* 19(5), p. 413, Zagreb.

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