

# What works, and why, in business services provision for SMEs : insights from evolutionary theory

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**What Works, and Why, in Business Services Provision for SMEs:**

**Insights from evolutionary theory**

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# What Works, and Why, in Business Services Provision for SMEs: Insights from evolutionary theory

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## Abstract

Programmes providing services for small and medium enterprises are important in developed and developing countries alike. Yet, the quality and impact of many of these programmes continues to be relatively disappointing. In this paper we analyse the performance and functioning of the Small Business Service in the UK, and the Business Development Services support model that has been commonly adopted in less developed countries. Modern theories of innovation and services marketing management serve as our analytical lens. Important weaknesses in programme structure and implementation practices emerge, which mainly revolve around user-producer interaction, organisational issues, and the lack of a broad systems perspective.

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## 1. Introduction

Small and medium enterprises (SME) play a major role in countries at all levels of economic development. They generate much employment, and are widely considered to be vital for competitiveness and economic growth. In OECD countries SME constitute 95 per cent of firms and 60 to 70 per cent of employment, and create large numbers of new jobs (OECD, 2000, p.1). In developing countries, too, very substantial numbers of poor working people rely for their livelihood on employment in SME. For instance, in twelve leading Latin American countries employment in enterprises with fewer than six employees comprised as much as 42 per cent of total urban employment.<sup>1</sup>

As globalisation is proceeding world wide, many new business opportunities are opening for small and medium businesses, but competitive pressures are increasing at the same time. Only a small segment of the SME sector is capable of making full use of new business openings and coping effectively with threats without assistance. It is widely agreed among policy makers that smallness confers some inherent competitive disadvantages, and that some sort of external support is warranted in order for these enterprises to reach their full potential (OECD, 2004). Services to promote and enhance SME competitive performance accordingly constitute important policy instruments in many countries. This is as much the case in the economically advanced countries of Western Europe, the USA and Japan, transition countries in former Eastern Europe and the CIS, as in developing countries in the South.<sup>2</sup>

However, in spite of the considerable experience acquired with design and delivery of SME support services, one is still hard pressed to find good reviews that have tried to distil common success and failure factors across programmes and countries. Piecemeal evidence suggests that the impact of the programmes has been uneven, and disappointing in many cases (for example, Hjalmarsson and Johansson, 2003; Storey, 2000; Inter-American Development Bank, 2003; de Ruijter de Wildt, 2003, Manu, 2002). Moreover, it has not been unambiguously established which factors are responsible for this state of affairs. There is thus a clear need to examine current practices more systematically in order to increase effectiveness and impact.

The aim of this paper is to contribute towards a better understanding of what works, what doesn't, and why, in the field of support services for SME. We do this by examining the validity of current SME support models in the light of two bodies of economic literature, namely innovation theory and services marketing theory. We propose that these theories generate suitable guideposts for analysing current practices, by furnishing a conceptual lens through which the support practices can be viewed. On the basis of this exercise we can derive lessons about reasons for (lack of) effectiveness and draw up guidelines for policy.

The choice of the two specific bodies of theory has a clear rationale. The relevance of innovation theories derives from the fact that a new business service constitutes an innovation in the local setting within which it is being introduced. The services marketing literature offers the additional insight that business services are innovations with specific attributes that differentiate them from product innovations. As a consequence their successful implementation needs to be treated differently in some respects from the commercialisation of new product innovations.

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<sup>1</sup> Unweighted average, calculated from individual country data. Source: ILO Regional Database for Latin America and the Caribbean (<http://www.ILO.org/public/english/bureau/stat/>).

<sup>2</sup> For details of SME services programmes in individual OECD countries, see [http://www.oecd.org/countrylist/0,2578,en\\_2649\\_34197\\_1783457\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/countrylist/0,2578,en_2649_34197_1783457_1_1_1_1,00.html) accessed on 5 November 2004. Comprehensive information about business services programmes in developing countries can be found on [http://www.bdsknowledge.org/dyn/bds/bdssearch.home?p\\_lang=en](http://www.bdsknowledge.org/dyn/bds/bdssearch.home?p_lang=en) and <http://www.seepnetwork.org/bdsguide.html> both accessed on 5 November 2004.

We begin by outlining key insights from the two theories in section 2. We then analyse the essential features of two different models of service provision. We have chosen to focus on the UK model (section 3) and the current practices shared by many less developed countries (LDCs) (section 4). Both these models are well established and there is abundant literature about them. We tease out the strengths and weaknesses of the current approaches adopted in these respective models in the light of the insights provided by the theories. In section 5 we formulate overall conclusions.

## **2. Insights from modern theories of innovation and services marketing**

### *Evolutionary innovation models*

Innovation models before the 1980s adopted a linear perspective on the innovation process. In a stylised view of these early models, innovation begins with research, followed by development, which in turn leads to production and finally marketing. There are no feedback loops in the system. There is also a clear division of labour between the different stages in this sequence of activities, particularly between those involved in ‘knowledge seeking’ and those pursuing activities geared towards ‘knowledge use’ (Clark, 1995, p. 250).

However, the hierarchical ‘pipeline’ notion has proven wrong, most of the time. In a world characterised by imperfect information, innovation is inevitably an iterative process full of trial and error and incremental adaptation at every stage. In particular, a central claim of later innovation theories, widely corroborated by practice, is that making users an active partner in innovation leads to higher uptake of new products and services because continuous feedback leads to innovations that better fulfil user needs. Supplier-dominated markets promote unsatisfactory innovations (e.g., Lundvall, 1988, p. 356 and p. 365; Gardiner and Rothwell, 1985; Rothwell and Gardiner, 1989).

This evolutionary view of innovation has gained widespread acceptance, variously denoted as the coupling model of innovation (Rothwell and Zegveld, 1985), the chain-linked model of innovation (Kline and Rosenberg, 1986), or the learning selection approach to innovation (Douthwaite, 2002; Douthwaite *et al.*, 2002). “... Knowledge is not best conceived of as ‘stuff’ flowing down a pipe, but rather as a more ‘entropic’ substance whose value has the ‘non-linear’ property in that it depends ultimately on the interplay between the supplier and the recipient [of the innovation]” (Clark, 1995, p. 253). Von Hippel’s famous study about innovation in the scientific instruments industry offers a good illustration. Here, users typically perceived the requirement for an advance in instrumentation, invented the instrument, built a prototype, proved the prototype’s value by applying it, and diffused detailed information on the usefulness of his invention and how it could be reproduced. Only after all these stages had been passed did an instrument manufacturer enter the process to conduct engineering for improved design, and carry out production and marketing. This pattern deviated starkly from the ‘pipeline’ model, in which the manufacturer is supposed to start with an idea, which he develops into a workable new product that he will then bring to market. Clearly, then, in some industries users assume the leading role in the development of innovations, while the suppliers who are ultimately responsible for producing the innovations play only a subsidiary and facilitating role (Von Hippel, 1976, pp. 220-1).

The importance of active user involvement applies to high-tech innovations in economically advanced countries as much as to simple adaptive innovations in developing countries. The similarity in innovation patterns is shown in Douthwaite (2002) and Douthwaite *et al.* (2002) with examples of Danish windmills, Philippine farm equipment, Linux open source software, and Local Exchange Trading Systems. All these innovations were allowed to evolve over a period of time, giving them a chance to be perfected. More often than not, this incremental adjustment process took several years. There are manifold

other cases of close user-producer interactions contributing to innovation success in developing countries that exhibit the same pattern (for example, Biggs, 1989; Gamser, 1988; Bruton, 1985).

The above authors have emphasised the importance of active and ongoing user involvement for the development of suitable new artefacts that will meet customers' needs. But there is an even more profound reason why user participation is so vital in the innovation process. The process of interactive search and improvement itself also yields the enhancement of "...the ability of the informal systems to do research, and of informal systems to request information and services from formal ones" (Biggs, 1989, p. 8). Lundvall (1988) likewise points to the importance of adequate (re)search capabilities of users for a well-functioning national innovation system as a whole. In his words "...lack of competence of users and the tendency of producers to dominate the process of innovation might be as serious a problem as lack of competence on the producer side" (p. 358). Clark likewise points out that building the capacity for assimilating, processing and using relevant information which is crucial for economic competitiveness and sustainable growth, cannot depend on hierarchical organised systems. It needs to rely on local actors as they alone have the expert knowledge of their local context that is the key to successful innovation (Clark, 1995, pp. 255-6). Bruton even goes so far as to identify the acquisition of such widespread innovation search capability by all major stakeholders, including end-users, as the essence of the development process in an economy (Bruton, 1985).

The emphasis on capability building by different interacting stakeholders draws attention to the fact that user-producer interactive processes in evolutionary innovation models are viewed from a broader perspective than in linear innovation models. Several evolutionary theorists (e.g., Edquist, 1997; Freeman, 1987; Lundvall, 1992) have adopted the concept of the 'innovation system', which expresses the notion that innovations develop in a "... network of institutions in the private and public sectors whose interactions initiate, import, modify, and diffuse new technologies" (Freeman, 1987, p.1). A key notion in the development of systems over time is that path dependency may occur (Arthur, 1989). Past actions can influence the feasibility of future innovations, favouring those that build on earlier work in the same line. This can lead to lock-in, when potential superior alternatives fail to become viable due to the market dominance of existing inferior innovations. Examples are the QWERTY keyboard and the VHS video system. In a broader interpretation, path dependency also embraces stickiness of structures, functionings, and organisational routines as a result of prior mental conditioning.

### *Innovation in services*

While intensive user involvement in innovation is important in general, the actual extent of user participation and initiative does tend to vary across sectors. Von Hippel's instruments industry is an example of a user-dominated sector. The services sector, which has special relevance for this paper, has also been widely noted for its high user-involvement. Unlike physical products, services cannot be stored. They constitute processes that have to be produced and consumed simultaneously, requiring the physical presence of the consumer during their production (Grönroos, 2000, p. 6-7; Zeithaml and Bitner, 2003; Sundbo and Gallouj, 1998, p. 5; Heuvel, 1999, p. 20). The link between service production and its consumption is so close that the togetherness and interaction of service producers and their consumers has been labelled as 'prosumership' (de Vries *et al.*, 2001, p. 30). Customers have a dual role. They are the users of a service, and at the same time they participate in the service production process. In that sense they are co-producers (Sundbo and Gallouj, 1998, p. 5; Heuvel, 1999, p. 20). Since each customer to some extent has unique individual characteristics and perceptions, he or she will also have an idiosyncratic and heterogeneous

demand for services. This means that each act of service provision has to be in a sense tailor made (Zeithaml and Bitner, 2003, p. 21).

Prosumership is becoming increasingly vital for successful innovation and economic growth, because effective mastery of new physical products increasingly requires complementary services to be offered alongside them. Modern machines and equipment are often complex to operate, so that customers require training in order to use them properly. Such 'embedded services' have become major competitive tools for manufacturers. For instance, customers may stick to a particular manufacturer when they receive good assistance to tune a new product to their specific business requirements, or when they are provided with effective repair and maintenance when needed (Kuusisto and Meyer, 2003, p. 24).

While prosumership is necessary even for delivering well-established services (for example annual training courses, consulting or advertising services), it is all the more vital for the design and development of new services. "Beyond just providing input on their own needs, customers can help design the service concept and the delivery process" (Zeithaml and Bitner, 2003, p. 222). Customer requirements are often so idiosyncratic that the actual development of service innovations frequently is located within the customer firm itself. Both parties learn from the interaction. The customer firm gets its problem solved, while the service supplier can generalise the solution and sell it -- in adapted form -- to other customers (Sundbo and Gallouj, 1998, p. 6). Knowledgeable and demanding customers are a valuable asset to the service-producing firm. They support the development of new ideas, solutions, and technologies by sharing their requirements, strategic insights, information and knowledge (Grönroos, 2000, p. 9). In a French survey among 279 service providers, 76 per cent perceived users as an important source of knowledge and competencies for innovation. Only 5 per cent considered users to be unimportant. Their own sales force and client contact personnel came next, with 67 per cent. Remarkably, other sources of innovation which assume more significance in manufacturing firms, especially universities and other educational institutes, were rated much less important among the service firms. Only 9 per cent listed them as important, and 71 per cent as unimportant (Kuusisto and Meyer, 2003, pp. 26-27).

The recent emergence of knowledge-intensive business services (KIBS), also called strategic business services, underscores the importance of prosumership. KIBS include such things as computer software and information processing services, R&D and technical services, marketing services, business organisation and human resource development services. These kinds of services are considered to an engine of sustainable growth and a key element of the knowledge-driven economy (Kuusisto and Meyer, 2003, p. 9). The interaction needed to produce and deliver KIBS has been typified as "an essentially bilateral learning process; a co-production of capabilities. ... It can even be concluded that KIBS play a key role in transforming firms into learning organisations" (Hauknes, 1999, pp. viii-ix). Thus, the production of knowledge-intensive services not only constitutes innovation, but at the same time contributes to the acquisition of technological and organisational capability of different stakeholders, in the same way as production of new physical products has been known to do.

The notion of a broader innovation system which influences market dynamics at the micro-level is thus again evident here. In fact, this concept has particular significance in the case of business services, because a buoyant demand for new business services is likely to develop only when there is sufficient demand for the products made by the potential users of these services. In other words, business services comprise a derived demand, which is organically linked to the demand situation further downstream in the value chain. Awareness of this interdependency is crucial for understanding the scope for initiating and developing new business services.

The benefits of sharing in service provision discussed earlier will not occur spontaneously. A vital requirement is the establishment of durable relations with customers. Provider and buyer have to earn each other's trust and loyalty, and they have to become used to each other's way of thinking and acting. A shared understanding of problems and opportunities is needed. This common way of thinking and doing does not develop overnight and needs to be cultivated. The two parties need to learn to view each other as partners. "The marketer must not view the customer as an outsider who should be persuaded to choose the seller's solution whatever it takes" (*Ibid.*, p. 34). The relationship needs to be nurtured on a continuous basis. In this relational perspective, a customer should be treated as a customer at all times, also when no services are actually purchased (*Ibid.*, p. 34).

This being said, companies cannot realistically expect to create ongoing partnership relations with their whole customer-base. Some customers – perhaps even the majority – may not be interested in, or capable of, establishing and entertaining close contact with their service suppliers on an ongoing basis (*Ibid.*, p. 34). Lack of purchasing power and conservatism (in the case of KIBS) can also be barriers to extensive user involvement (Sundbo and Gallouj, 1998, pp. 17-18). Only a minority of customers tend to be truly articulate, motivated and financially capable enough to maintain close linkages with service providers.

Fortunately, active partnering with a small group of active and enterprising customers is generally sufficient for a service provider to build a successful customer-driven service strategy. Innovation diffusion models have widely noted that the initial uptake of new products and services tends to be driven by a few highly motivated pioneer adopters. These people can handle risk and have an inherent interest in co-experimentation and contributing to incremental improvement of early prototype designs, without caring much about short-term financial gain. The key to successful market development for a supplier lies in identifying these key lead users, who will be prepared to act as its early development partners. More risk-averse users will be enticed to adopt the innovation once it has evolved into a more or less robust design, when they are able to observe its practical usefulness through demonstration by the early adopters (Rogers, 1995).

Possible barriers to effective user-producer interaction also exist on the supply side of the market. Services are intangible -- they constitute performances rather than physical products. Objective performance standards are hard to set and verify. Also, since a service has to be produced on the spot at the time when the customer consumes them ('inseparability'), uniformly high motivation and quality of service delivery by sales staff is essential. Heterogeneity in the service delivery can be a problem as well. Aside from idiosyncratic user requirements on the demand side, it is difficult on the part of the supplier to assure uniform service quality, because of varying performance of service personnel (Parasuraman *et al.*, 1985).

Lack of possibilities for suppliers to protect service innovations from competitors can be an additional stumbling block. Patenting and trade marking are often irrelevant due to the incremental nature of the innovations. Other policies that have been conventionally used to promote product innovation are also unlikely to work well. Tax incentives for R&D cannot work when the expenses involved in producing new services predominantly consist of informal development costs and salary costs of sales staff. Due to their incremental and invisible nature, venture capital for service innovation is also hard to come by. Finally, suppliers may lack the flexible, team-based, open and informal setting required to develop ideas for service innovations (Sundbo and Gallouj, 1998, pp. 17-18).



### *Conclusions and implications for the case studies*

The process-based philosophy that inspires both evolutionary innovation theory and recent service marketing theories, clearly contrasts with the short-termist and narrow view characteristic of the older transactional approaches to innovation and marketing. In these older approaches, the main task confronting business is to push scientific ideas down a pipeline from concept to market. In this setting, marketing consists of selling pre-defined goods and services to a somewhat anonymous and isolated 'market' by 'throwing them over the wall', so to speak. In that approach, the main effort is geared to achieving short-term sales and profit. Making customers buy is what counts. In contrast, in the theories reviewed above, the strategic orientation of the firm is service-oriented. It is integrally geared towards customer relationship management and networking as the foundation for long-term competitiveness in a systemic context.

There will often be a trade-off between a focus on short-term value-creating activities and the investment in long-term sustainable customer partnerships that the relational view of customer marketing management implies. The latter strategy cannot work if the firm's shareholders change their portfolio at the first sign of disappointing quarterly results. For relational innovation and marketing to work, a company's financiers need to be patient, and they need to be committed to the long-term development of the firm (Grönroos, 2000, p. 10).

### **3. The UK model of SME support**

First we introduce the basic facts about the SME support practices in the UK. After this we will apply insights from the theoretical review in Section 2 to the case. It will be shown that the successes and failures encountered in practice can be readily explained when they are viewed from a theoretical perspective. In Section 4 we will use the same format to analyse the SME support model in less developed countries.

#### *Basic features of service delivery*

Small business support in the UK is rooted in the belief that information failures affect small business more than larger ones, thereby impeding growth and innovation in the economy. Market failures which particularly affect SMEs include underestimation by entrepreneurs of the benefits of starting or growing a business; lesser awareness on the part of small entrepreneurs of benefits from obtaining external expert advice; and inaccurate risk assessments by financial institutions leading to under-funding of new small ventures (Curran and Storey, 2002). The significance of these problems derives from the sheer size of the small business sector. Small firms in the UK employ 12 million people, and constitute 50 per cent of private sector economic activity (SBS, 2002).

The first policy assistance initiatives for SME date back to the publication of the Bolton report in 1971, the first serious study about the small enterprise sector and its position in the economy. A profusion of initiatives were launched thereafter. The first major scheme was the Small Firms Counselling Service established in 1979, which primarily provided information, counselling and consulting services, education and training and financial resources. Delivery was primarily generalist and supply-driven, and aimed at start-ups. The support also lacked transparency due to the large number of overlapping schemes in existence. In 1990s, the organisation of the support was overhauled with the establishment of Training and Enterprise Councils (TECs) in England and Wales, and similar Local Enterprise Companies (LECs) in Scotland. However, this did little to reduce the complexity of the support structure with a profusion of agencies (Priest, 1999).

In 1992 a comprehensive policy review was undertaken by the responsible government agency, the Department of Trade and Industry (DTI), with the purpose of rationalising the

institutional organisation of the support, raising awareness of the availability of assistance on the part of potential clients, and becoming more customer focused. Following this review, a large number of Business Link (BL) centres were created in England in 1992/3, aimed at establishing a nation-wide network of local support outlets. These would co-ordinate assistance offerings by different agencies at the local level by functioning as 'one-stop shops'. Thereby the BLs would boost professionalism and efficiency and ensure increased customer focus (*Ibid.*; Bennett and Robson, 1999).<sup>3</sup> By 1999, a total of 89 BLs were in existence (Bennett and Robson, 2000).

BLs were designed to co-ordinate a multitude of support schemes. About 200 schemes were estimated to exist in the country in the mid 1990s (Curran and Storey, 2002). The co-ordination function also aimed to bring about inter-institutional collaborations, including organisations such as Chambers of Commerce, Regional Enterprise Agencies, TECs, and private consultants. The BLs could also offer a core of assistance services of its own, mainly through experienced and knowledgeable Personal Business Advisors (PBAs). PBAs were meant to develop contacts and nurture long-term relationships with a set of client companies, and to facilitate access to support services (Lean *et al.*, 1999; Mole, 2002). There was a shift in the target clientele, following the insight that considerable more employment was being created through business expansion than creation of new companies. Thus, PBAs were charged with assisting ongoing companies showing growth potential, rather than start-ups and survival-type entities (Lean *et al.*, 1999). Although core funding from government sources in recognition of permanent market failures remained, some pressure has been exerted on the PBAs to become partially self-financing since SME support is very costly. The government spends £ 2.5 billion per year on SME service provision (SBS, 2002). Additional reasons for eliciting client contributions have been given as well, especially that the willingness to pay a fee for a PBA's services could be taken as an expression of satisfaction on the part of clients. In addition, a client would attach more value to the service by paying something for it (Lean *et al.*, 1999).

However, even the decentralised BL-led system continued to suffer from the old problems. Customers complained regularly about inconsistent quality, lack of customer focus, too many schemes and organisations, lack of continuity of support initiatives, inaccessibility for ethnic minorities and remotely located firms, and lack of partnering with the private sector (SBS, 2000). A further reorganisation was therefore carried out in 2000. In this latest makeover, a central co-ordinating agency was established within DTI. This Small Business Service (SBS) was charged with enforcing common good quality standards, ensuring coherence, and encouraging cross-BL dissemination of good practice (Curran and Storey, 2002). The SBS was also established to address lack of customer focus by operating as a two-way information and communication "SBS Gateway" between small business and central government (Robson and Bennett, 1999). Under the SBS, the BL structure remained in place, but the number of centres was reduced to 45. Each of these centres was subjected to competitive bidding in order to receive a local franchise from SBS to deliver support in their area (Mole, 2002). The latest organisational change thus constituted to some extent a re-centralisation of the support system, with a recognisable national brand and logo, but it has maintained a localised presence, with services being delivered through a brokerage model involving BLs with key partners (Robson and Bennett, 1999; Smallbone *et al.*, 2003).

There is no doubt that the UK support system is comprehensive. In 2003, BL helped over 430,000 businesses, plus 170,000 people thinking of starting a business.<sup>4</sup> According to the latest available information, however, the benefits from the introduction of the SBS are not

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<sup>3</sup> Similar models were established in Wales under the name of Business Connect, and in Scotland under the name of Business Shops. See, e.g., Bristow and Munday, 1997.

<sup>4</sup> See: <http://www.sbs.gov.uk>, accessed in December 2004.

yet clearly visible. In a cross cutting review of governmental small business services undertaken in 2002, it was pointed out that business support services usurp GBP 1.8 billion per year, while reaching only 10 per cent of SMEs. National services show customer penetration levels of between 8 and 15 per cent (*Ibid.*, p. 52). In comparison, universal services which are available to the whole population of SME without any restrictions on size, aims, sector, ambitions, and location, take up a mere GBP 740 million while reaching almost all SME in the country (SBS, 2002, p. 38). What is more, when measured in terms of statistics for customer services and quality, the performance of SME support has actually deteriorated since the introduction of the SBS. Small businesses continue to complain of disjointed and incoherent service delivery and fragmentation (*Ibid.*, p. 65). It thus appears that the UK model suffers from rather intractable problems, for which the consecutive re-shuffles of the institutional set-up have not been able to provide adequate solutions. Possibly this has to do with a lack of understanding of the underlying forces and factors that impede the effective functioning of the system. An evaluation of its operation from a theoretical perspective is one way of enhancing our insight into these issues.

#### *Introduction to the performance analysis*

Much of the discussion in Section 2 revolved around the importance of being customer-focused as the key to successful service delivery. Therefore we take this as the starting point for our analysis, by asking to what extent current practices in the UK are informed by an awareness of this aspect, and whether this awareness manifests itself in the actual service delivery practices as well.

#### *Customer focus*

The SBS cross cutting review, which represents the state of the art of thinking and practice, clearly suggests that awareness is there, at least at the central government level: "...One theme emerges clearly: The importance of customer focus, of small firms acting like customers, and government treating them as customers" (SBS, 2002, p. 2). "An important first step is to develop an in-depth understanding of customer needs and expectations. Every aspect of the organisation should then be adjusted so that it is aligned to customer values" (*Ibid.*, p. 67). Yet, in practice "... very few departments and agencies have placed SMEs at the heart of the policy development and delivery process. On the whole, departments and agencies are undertaking fragmented policy initiatives, which concentrate on the policy design and performance evaluation stages. Far less emphasis is placed on customer-focus at the development and implementation stages." (*Ibid.*, p. 69). Furthermore, "...many departments and agencies have not recognised that customer focused delivery is a means to an end (i.e., meeting organisational objectives), rather than an end in itself. Some organisations made specific reference to customer focus as a marginal activity which lies beyond their core functions" (*Ibid.*, p. 95). A good illustration of this state of affairs is given in a recent study among BLs of the effectiveness of SME policy support in rural areas in the UK: "...although distinctive characteristics and needs of rural enterprises are recognised by staff in the majority of [29 interviewed] BLs with rural areas within their catchment, there is little evidence of a systematic policy approach to addressing these in many agencies. Moreover, a majority of those responsible for delivering support to rural businesses considered existing approaches to be inadequate" (Smallbone *et al.*, 2003, p. 833). This example reflects the wider observation in the cross-cutting review that few departments and agencies treat small firms as entities with distinct needs, and also fail to identify distinct segments within the SME target population itself.

In sum, it appears that awareness of the importance of putting customers first is present in at least part of the support system, but this is not reflected in actual practices on the ground, except for a few initiatives (see, for example, Smallbone *et al.*, 2002).

The reasons for the gap between awareness and practice does not appear to have been clearly pinpointed by policy makers. Although the SBS does emphasise the nurturing of long-term ongoing relationships with clients, which is a good sign, there is still no mention of the need for actual user *participation* in the cross cutting review. According to the theories discussed in Section 2, ongoing user-producer interaction is merely part of a process in which users actually participate in the service design and delivery itself (i.e., prosumership). In sum, the notion of 'customer focus' and in SBS is clearly not in accordance with what is being advocated in the theories.

Moreover, the acknowledgement of relationship building is not encouraged in policy practice. The incentive structure facing BLs and PBAs still reflects the old notion that "more is best". They are being assessed according to short-term quantitative targets, especially the number of clients visited and the fees collected from such visits (Lean *et al.*, 1999; Priest, 1999; Mole, 2002). The quality of the contacts developed and long-term relationships built do not feature in the measurement of their activities, let alone initiatives to elicit active user involvement in the service design and delivery.

Since the financing of the local centres by SBS is partly tied to their performance on these quantitative criteria, the incentives have a powerful effect on the way in which the system functions, giving rise to subversive strategic behaviour on the part of the PBAs. Although the government is (understandably) emphasising the need to bet on potential 'winners' (i.e., firms with clear growth potential), the PBAs are induced to serve all needy customers in order to maximise the number of contacts, and try to extend the definition of 'growth-oriented firms' (*Ibid.*). For the same reason, they concentrate on providing generic, sector-neutral business advice because this is quick and easy to administer and replicate (Curran, 2000, p. 44; Mole, 2002, p. 189). In a recent survey just before the latest reorganisation, which covered 51 BLs (out of a total of 79), a large majority did not view the development of services adapted to the local setting as a priority activity (Priest, 1999, p. 188). Reminiscent of old top-down approaches, providers still consider their standard offerings to be the know how for business success, (Curran, 2000, p. 44).

Yet, when asked about their own opinions, PBAs do place importance on product flexibility and customisation. Only a few would wish to offer standardised products (Lean *et al.*, 1999, p.614). They overwhelmingly see their job as requiring face to face contact, informal, using experience, and acknowledge that every sector, locality and individual customer is different (Mole, 2002, p. 187). Their practical experiences clearly concur with the theoretical insights that emerged in Section 2 concerning prosumership and customer heterogeneity. At the same they are in stark contrast with the priorities set in their daily work practice which are dictated by adverse incentives emanating from higher organisational levels. Not surprisingly, the old problem of low take-up of services still persists in the UK.

In sum, the recent addition of a mere additional layer in the support hierarchy (the SBS) has not yet done enough to address the problems with the functioning of local BLs on the ground. The concept of 'customer focus' has remained a rather empty slogan since it is not yet backed up with a review of performance targets for those who have actually are charged with execution of the service development and delivery to the clients. What is lacking is a simultaneous reorientation of operational objectives and the way of thinking in the organisation as a whole. This problem can be readily explained by the notion of path dependency in evolutionary theory. Achieving outreach in terms of simple numbers of businesses covered has a decades-long history in SME support in the UK, and is difficult to change quickly because it is embedded in organisational routines and culture. This explains

that, although many researchers have already pinpointed and discussed the incentive problems, and many people in the organisation are keenly aware of the need for change, it is still very difficult to enact in practice.

### *Organisational features*

Another major factor impeding effectiveness in SME support in the UK has been the lack of certain vital organisational features, namely organisational flexibility and creative adaptation to changing requirements. Owing to a long history of reorganisations in the support structure, the support network has become ever more complex and fragmented over time (see, for example, SBS, 2000; 2002; Curran and Storey, 2002; Priest, 1999), so there is an urgent need to promote inter-agency streamlining and improve the co-ordination of the support. There is a plethora of agencies with partly overlapping mandates and functions, which makes it difficult for SME to know where to go for what. Organisations established in an earlier phase (such as TECs and LECs) continued to function alongside more recent ones (BLs) that have been established to carry out similar or overlapping tasks. Due to the institutional complexity, it is highly time-consuming for SME to find out how the support network functions and what is on offer by whom. Many SME can ill afford to invest in a protracted search process of this sort. Thus they frequently lack information about the whole gamut of available services, and miss out on potentially beneficial assistance.

Inadequate organisational flexibility and creative adaptation also gives rise to "... a lack of formal processes for inter-agency sharing of good practice", identified in the cross cutting review (SBS, 2002, p. 72). Although good practices can indeed be found at all levels in the support organisation, mechanisms for their wider dissemination are underdeveloped. The infrastructure has not been designed to be a 'learning network' (SBS, 2000, p. 16).

The establishment of the SBS was partly motivated by the desire to improve matters on both these fronts. It was expressly designed to improve inter-agency co-ordination and streamlining, and to facilitate the much-needed inter-agency dissemination of good practices that did not occur under the decentralised BL structure that existed until 2000.

When we view these problems (as well as the envisaged solution) from a evolutionary theoretical perspective, this state of affairs signals inadequate institution building. No adequate routines appear to exist for what we have called cumulative knowledge building or 'capability acquisition'. They signal 'path dependency' and 'lock in'. More importantly, the theory also leads us to understand that the failure of institutions to engage in cumulative learning is linked to the fact that they are still too much top-down ('pipeline') in their approach. The establishment of a central co-ordination body (SBS) will undoubtedly help to some extent to rationalise the system, as well as to promote inter-agency information diffusion. However, organisations can only learn truly effectively when they are open to continuous inputs from the local actors on the ground. Only the client SME themselves, in interaction with the PBAs, can generate the expert knowledge of their local context and idiosyncratic needs that are the key to successful service provision.

### *Systems perspective*

An additional insight from evolutionary innovation related to inter-agency co-ordination failure and lack of institutional learning is that taking a broad innovation systems approach can be effective in overcoming these problems. Smallbone *et al.* (2003) have documented highly successful examples, in which integrated local action akin to an innovation systems approach have sought to incorporate SME support into a wider development framework. In these programmes, which aimed at rural regeneration, local communities were closely involved in holistic 'village appraisals', in which the main inter-related constraints on local development were identified. These were dealt with by means of a range of co-ordinated

programmes covering issues such as inward investment, housing, transport and social issues. Different agencies were involved, leading to greater inter-institutional co-ordination and collaboration (*Ibid.*, 2003, p. 834).

#### *Service quality*

As a final problem in the UK support system, we should discuss the high variability of service quality in the BLs as signalled by Robson and Bennett (1999). Differences in client satisfaction about PBAs arise from variations in the quality of the advisers delivering the service (*ibid.*, p. 786). Based on a large-scale survey undertaken by the ESRC Centre of Business Research among 2,474 respondents in 1997, Robson and Bennett conclude that any systematic variability in customer satisfaction levels is chiefly the result of differences in the manner of delivery, rather than use, of the schemes. This points to differences between schemes and their suppliers (*Ibid.*, 782). The occurrence of this problem is explained readily with the help of our theoretical discussion about service marketing in Section 2. Quality control in service delivery is inherently difficult due to the specific characteristics of services as opposed to physical products, notably the inevitability of re-producing the service each time it is delivered. Not only the performance of the supplier is likely to vary over time, but his/her interaction with different clients also ensures a unique outcome. It must be noted that the government has already acknowledged the problem of inconsistent quality, and has taken action in this respect. After the establishment of the SBS, measures have been taken to professionalise the PBA support. PBAs are now rigorously vetted and their performance is being regularly monitored.

#### **4. Business Development Services for SME in developing countries<sup>5</sup>**

SMEs in poor countries provide employment to very large numbers of people, but incomes tend to be at subsistence level. Support to these enterprises dates back to the early 1970s, when it was widely justified in terms of its alleged poverty-reducing effects. In recent years, there has been a growing recognition that SME can also help boost countries' overall competitiveness and innovation performance, and that they should be assisted to help realise this potential. However, despite manifold promotion programmes, the great majority of small-scale enterprises in developing countries still remain undynamic activities, struggling for survival. The overall success record of SME support in the developing world continues to be patchy.

#### *Basic features of service delivery*

SME assistance programmes across a wide range of developing countries in Asia, Latin America and Africa share a number of key features. This makes it possible to discuss these programmes as one coherent model. Until the early 1990s, that model was heavily supply driven: SME support was predominantly centrally organised and administered by governments, and heavily financed by foreign donors. Projects for new start-ups were conceived by bureaucrats in their offices, who would then search out a person whom they considered worthy of turning the factory key, taking charge of operations, and transforming him(her)self into an entrepreneur.

These top-down programmes suffered from widespread corruption and inefficiency, and lack outreach, impact, and relevance. The organisational set-up necessitated in-depth knowledge of a wide range of industries and service-functions on the part of the service-providing agencies. Not surprisingly, these generalist organisations frequently degenerated

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<sup>5</sup> The analysis of this case draws on Caniëls and Romijn (forthcoming).

into huge ineffective bureaucracies, supplying services of limited use. It also induced severe market distortions, since many programmes could rely on continuing donor funds that were passed on to clients in the form of highly subsidised services. This led to highly wasteful programmes.<sup>6</sup>

A lot has changed since then. A new approach evolved in the course of the 1990s, called Business Development Services (BDS). This approach, which will be the subject of discussion in this paper, is widely believed to hold more potential than the earlier programmes. BDS are aimed at start-ups as well as improvement of ongoing businesses. Services include assistance with market access; input supply; technology and product development; training and technical assistance; infrastructure; policy/advocacy; and alternative financing mechanisms. In stark contrast to earlier schemes, a key feature of BDS is that service delivery is organised along commercial lines, with an indirect facilitative role for donors, NGOs and other developmental agencies (see Figure 1). These so called ‘BDS facilitators’ target private-sector service suppliers (called ‘BDS providers’) with technical assistance and incentives, to encourage them to initiate and launch new services and enter new markets (Miehlbradt and McVay, 2003; Committee of Donor Agencies for Small Enterprise Development, 2001).

**Figure 1: Facilitating BDS market development** (Based on: Miehlbradt and McVay, 2003, p.20; Hileman and Tanburn, 2000, p. 11)

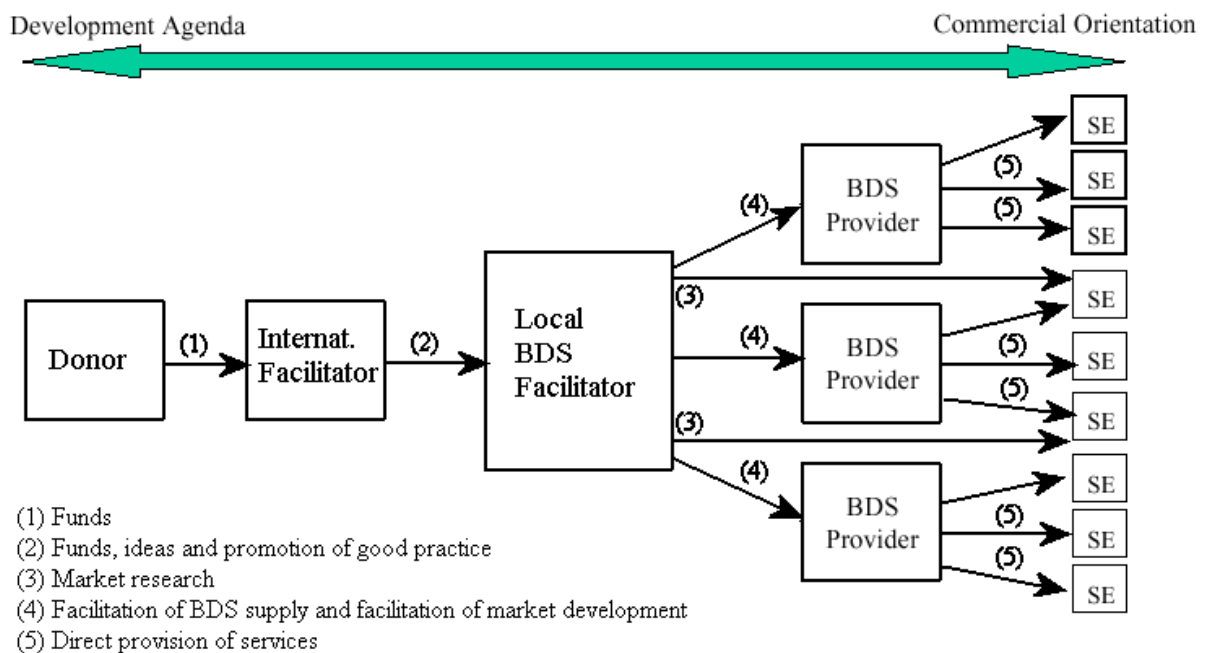


Figure 1 illustrates that the BDS facilitators frequently comprise a whole chain of actors. Several steps removed from the ultimate SE clients are ‘international donors’ who contribute public development funds. Donor funds are used by ‘international facilitators’, whose role is to develop new ideas, promote good practice and initiate innovation. These organisations in turn finance programmes and projects in developing countries in partnership with ‘local BDS facilitators’, local organisations that promote the actual suppliers (providers) of BDS services by developing new service products, exploring new markets, setting standards, or influencing government policy. The role of the local BDS providers lies in the actual service delivery

<sup>6</sup> See UNDP *et al.*, 1988, for a good review of these problems.

itself. BDS providers are the supply-side actors that are in direct contact with small enterprise clients (Hileman and Tanburn, 2000, pp. 11-12).

Some successes have been achieved by applying these organisational principles.<sup>7</sup> Yet, even now, many small enterprise programmes based on the new philosophy continue to struggle for impact. For example, in a recent evaluation of over 100 BDS projects of the Inter-American Development Bank (2003), few quantifiable impact results on the intended users of the new services were reported, and the financial sustainability of the projects was problematic.

The commercial approach has proved to be especially inapt in reaching the poorest segments of the small enterprise spectrum. Often heard complaints include weak markets for many services (particularly in rural areas), mismatch between BDS supply and demand, and discrepancies between needs for new services and willingness to pay (de Ruijter de Wildt, 2003). These signals suggest that it is fruitful to subject the BDS support model to critical review, and to continue to explore new avenues to improve BDS effectiveness and impact.

Three issues that featured prominently the UK case, namely customer focus, organisation, and the systems of innovation perspective, are also closely bound up with the performance of BDS programmes. The discussion below is therefore organised accordingly.

### *Customer focus*

We have seen that BDS programmes aim to ensure effective service provision by being market- and demand-driven. But what does this mean in practice? Unlike earlier programmes, stringent commercial criteria are imposed. New services should quickly prove their worth in the market, by means of a demonstrated willingness to pay on the part of small enterprise clients. Services that fail to pass this test within a short time span (typically a few months) after their launch will automatically disappear, as BDS facilitators withdraw their support to BDS providers. Commercial marketing survey techniques that are commonly used in the private sector have been adopted to ensure that new services meet SME needs (Miehlbradt and McVay, 2003).

On the face of it, this commercial approach should be a major step forward compared to the old-style programmes, because it avoids all the pitfalls that these programmes were so prone to. The service development and delivery functions are performed by different actors (the local facilitator and the local provider, respectively), which enables one and the same facilitator to serve a wide range of local providers. The new set up also avoids direct market-distorting interventions by development agencies. These agencies now indirectly stimulate market development activities that are undertaken by parties in the private sector.

Yet, several features of the BDS model militate against ongoing user-producer interaction, and thereby impede good performance. One of these is the stringent donor requirement of rapid commercial sustainability, which reminds us of company shareholders with short-term performance horizons (see Section 2). This is caused by the dismal financial sustainability record of earlier SME support programmes, and a political climate that favours rigorous commercial operation of aid organisations. Yet, there is now a clear risk that potentially valuable ideas for new BDS services are not given sufficient opportunity to undergo the needed incremental improvements that will arise only from a prolonged period of active user-producer interactions. The theories reviewed in Section 2 tell us that new market development can rarely be the result of a quick try-out of a new service that is conceived as a final ‘off-the-shelf’ design, meant to maximise the number of short-term commercial transactions. Rather, it requires an iterative learning process, in which relationships are gradually formed and institutionalised. The question “How can *practitioners* select high-

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<sup>7</sup> For examples of success stories, see [www.seepnetwork.org/bdsguide.html](http://www.seepnetwork.org/bdsguide.html)



impact services?” posed in a well-known BDS Reader (Miehlbradt and McVay, 2003, p. 27), is really an inappropriate way of posing the issue from an evolutionary innovation perspective. Locally appropriate services are not amenable to ‘selection’ by external agencies. These agencies could only make initial suggestions in collaboration with the other concerned local parties, which could then form a *starting point* for further exploration and development in an evolving process of prosumership. Quotes such as the above signal a lack of awareness of how new service markets actually develop, and the key role played by users in that process.

Some donor organisations are beginning to recognise this, and returning to a more genuine developmental outlook. In the earlier-mentioned Inter-American Development Bank evaluation, it is admitted that the complexities involved in market development have been underestimated in project design, and that objectives have been too ambitious in relation to the limited time and budget allocations. A more gradual approach is advocated for second-generation projects.

Things are also changing at the level of project execution on the ground. For example, in the Farm Implements and Tools (FIT) programme executed in Kenya and Ghana by the ILO, “... the specific outlines of a particular service, and how it can best be delivered, are open-ended – improvement and adaptation to a particular market are dynamic and continuous processes” while “...the ideas must be tested, developed and/or adapted in partnership with providers and their MSE clients”. Focus group discussions involving clients are used regularly. Moreover, “seeking opportunities to expand or develop the area where the ethic of profit can intersect with a development agenda means placing a premium on innovation ... building on what is already functioning in the marketplace” (Hileman and Tanburn, 2000, p. 23). In other projects, too, where demand and supply cannot be mobilised quickly, the emphasis is more on education and capability-building activities, which take longer to translate into commercially sustainable results.

A second factor impeding active user-producer interaction in the BDS model lies in its approach to needs identification. BDS concentrates on getting basic information about demand, supply and their mutual interactions through conducting market surveys or rapid appraisals, usually by BDS facilitators. These techniques capture the desire by small entrepreneurs for certain new services, the features and benefits that a new service should have in their perception, and their willingness and ability to pay (Miehlbradt and McVay, 2003). These tools are useful, but if they are the only market information-gathering instrument used, the potential clients’ role will be essentially limited to providing initial information to BDS facilitators and suppliers. The possibility that potential users could also act as active co-developers of new services along with the parties on the supply side, will then go unrecognised. Indeed, this appears to be happening in many BDS programmes. The services marketing literature suggests a rather more inclusive marketing strategy, in which users are viewed as mature and equal partners of suppliers. In that model, market research is not limited to a one-shot activity that is separated from the actual service delivery. It must be an ongoing interactive process, which is part and parcel of the actual service provision itself.

A third factor that militates against active user-involvement in BDS programmes is a tendency towards a one-size-fits-all approach, as in the UK model. While it is true that BDS programmes have tried to incorporate heterogeneous demand by introducing some flexibility in service delivery (for example in the form of distributing user vouchers that can be used by clients to choose from among a range of training services), creating individual choice in service *use* is only one aspect of successful targeting. There must also be a recognition that some users are capable of playing a key role in the *new service development* process. The theories on service innovation clearly suggest that it would be beneficial to identify and engage a few venturesome SME clients who could help BDS suppliers to actually co-design a

new service already at the early stages of project design and planning. However, there is little sign of that being practised in BDS projects.

### *Organisational features*

Another problematic issue that warrants discussion in the light of the theories discussed in this paper is the manner in which the various actors in the BDS model are organised and linked. Although the BDS model is in many ways different from the purely supply-driven programmes of the past, it still exhibits certain organisational features that remind us of the traditional linear model of innovation. Indeed, one gets the impression from the key BDS publications that the best way to develop new BDS markets is still to push services down a pipeline, which runs in top-down fashion from donors through facilitators and providers to end-users. There is also a clear-cut division of labour between the parties in the pipeline: the facilitators are seen as the prime sources of new ideas and initiatives, with the providers essentially seen as the implementers of these ideas. The main role of the users is to accept (or reject) what is being offered to them.

The conception of the user as more or less passive receptor is illustrated well in Hileman and Tanburn's elaboration of the BDS model, where end-users are visualised as "The entrepreneurs who run small enterprises [who] invest their time and money in business development services which they hope will increase incomes or secure survival" (2000, p. 12). The importance of small enterprises is seen in terms of non-innovation related characteristics, such as a large workforce and a major consumer group (*Ibid.*, p. 9). Viewed from the perspective of the innovation theories, what is missing here is the acknowledgement that small enterprises are also *innovative producers* in their own right, who undoubtedly are capable of forming their own ideas about their business requirements, and who could also play a crucial role in the actual *design* and *development* of new BDS solutions.

In one respect, the recent BDS organisational model actually may have introduced a new problem compared to old-style support practices. This stems from the idea that local BDS facilitators should no longer be involved in direct service delivery. This obstructs direct interaction between the chief generators of ideas for new services and the potential users of these services. The communication now runs through the intermediary of the BDS providers, who are essentially supposed to implement the new ideas furnished by the facilitators but who are not the chief idea initiators. This prescribed institutional separation between BDS facilitator and provider has sometimes been experienced as problematic by practitioners (Manu, 2002). Such discomfort is entirely logical from the perspective from the innovation theories, which predict that direct ongoing interaction between generators and users of innovations is in fact *the* key to the evolution of new services that will truly meet market needs.

However, another organisational feature of the BDS model warrants a positive comment. In contrast with the UK model, where there is no well-functioning mechanism for the diffusion of good practices among different regions and agencies, BDS practitioners in different agencies (NGOs in developed and developing countries; governmental agencies, multilateral development institutions, and so on) have built a good structure for inter-agency communication and exchange. There are a few key websites where one can find documents with clear explanations of the key features of the BDS model, state of the art case studies, and recent discussion papers about what works and what doesn't work (see, e.g., footnotes 2 and 6). Annual BDS conferences and regular training courses bring together practitioners from around the world.

### *Systems perspective*

The systems of innovation view in evolutionary thinking makes us aware of yet another problem with the BDS approach. Importantly, this view draws attention to the fact that the typical SME customer of BDS services is actually not at the end of the value chain. Beyond the SMEs, there are the final users of the products and services produced by the SMEs. In the current BDS model and practice, this final market for products made by the users of business services remains hidden. Yet, the characteristics of the final market are crucial to the success of new business services for SMEs. Lack of demand for small enterprise products is an often-experienced problem in less developed economies because consumers tend to suffer from low purchasing power. This factor could thus be a serious limitation on successful BDS development in many cases.

The system of innovation approach draws attention to the need to address this problem up front, through broader-focused interventions. It suggests the need for a more integrated approach, which would ensure that stimulation of markets for business services takes place in a context where viable end-markets for the products of client enterprises already exist, or where the stimulation of end-markets is itself an essential part of the support intervention.

## **5. Conclusions**

The two case studies of SME business support services were analysed in this paper by means of confronting their basic features with key ideas from evolutionary innovation theory and services marketing theory. This exercise yielded a number of new insights.

First, it is overwhelmingly clear that the successful design and delivery of business services hinges on an iterative process of user-producer interaction (prosumership). In this respect, both support models have limitations. In the case of the UK programme, these lie chiefly in the domain of performance incentives which distort the behaviour of practitioners in the field. These incentives do not yet adequately reflect the general awareness of the issue that is already present among PBAs, policy makers and researchers. In the LDC support model, lack of awareness itself is still the biggest obstruction to improved practice. The dominant approach advocated in BDS development still revolves around the traditional transactional style of marketing.

Second, the theories draw attention to the fact that this problem is exacerbated by certain organisational features that hamper user-producer interaction in projects on the ground. In both models, there is still a hangover from the old top-down structures, and institutions exhibit lack of adaptation and capability building.

Third, there is a general lack of awareness of the fact that new services evolve in a wider setting: a system that consists of various interacting stakeholders. Performance has been good in the few cases where a wider perspective was adopted by means of an integrated area development programme (in the UK).

Finally, the theories have pointed towards the problem of variability in service quality, which has clearly been an unresolved issue in the UK case.

In sum, the theories provided a coherent framework for conducting a systematic performance analysis of the practical cases. The application of this framework yielded a number of flaws and weaknesses in the design and implementation in these programmes. These insights present themselves almost spontaneously when we view the cases through a theoretical lens. The framework thus seems to be a valuable complement to more practical and empirical performance analyses of business service programmes. In the case of the UK model, many problems identified in our paper had already been noted by academics conducting practical policy assessment studies, but who did not ground their results in

theoretical terms. In this case, our results confirm the shortcomings noted by these studies, and provide a theoretical underpinning of their work.

In the case of the LDC model, such empirical evaluations as have been conducted in the UK have not yet been done. In this case, therefore, our findings serves as a direction for future empirical research, in the form of hypotheses generation and testing.

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