

SMALL AND MEDIUM-SIZED ENTERPRISES IN TURKEY

ISSUES AND POLICIES



ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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Table of Contents

List of Acronyms	5
Foreword.....	7
Assessment and Main Recommendations	9
<i>Chapter 1. Main Features of the Small and Medium-sized Enterprise Sector in Turkey</i>	27
Size and structure of the sector	27
Fundamental weaknesses of the sector	29
The policy context surrounding the SME sector	31
<i>Chapter 2. Strengthening the Business Environment in which SMEs Operate</i>	35
The financial system	35
Public sector reform	41
Creating a climate more conducive to investment	42
Labour market	44
Education policies	46
Innovation policies	48
Competition policy	49
<i>Chapter 3. SME-specific Policies</i>	51
Government financial support for SMEs	54
Business start-up processes	56
Training and certification issues	60
Development of SME support services and technology and innovation capacity	63
Standardising and accrediting business service organisations	67
Internationalisation and export promotion	67
Expanding local and regional clusters.....	69
Facilitating communication between small enterprises and other institutions	69
Increasing the flow of non-financial services	70
<i>Chapter 4. Policy Evaluation</i>	71
<i>Annex. The Expansion of the Small and Medium Industry Development Organisation’s Responsibilities</i>	75
Notes.....	77
References	83

List of Acronyms

BEST:	Business Environment Simplification Taskforce
BTYK:	Supreme Council for Science and Technology
DIE:	State Institute of Statistics
CSGB	Ministry of Labour and Social Security
DPT:	Undersecretariat of State Planning Organisation
DTM:	Undersecretary of Foreign Trade
EU:	European Union
EUROSTAT:	European Statistics Office
FDI:	Foreign Direct Investment
ICT:	Information and communications technology
IGEM:	Enterprise Development Centre of KOSGEB
ILO:	International Labour Organisation
IRC:	Innovation Relay Centres
ISKUR:	Turkish Employment Organisation
KGF:	Credit Guarantee Fund Inc.
KIT:	Public Economic Enterprise
KOBINET:	Small and Medium Enterprises Network
KOSGEB:	Small and Medium Industry Development Organisation
KSS:	Small Scale Industrial Estate
KÜSGET:	Small Industry Development Organisation
MEB:	Ministry of National Education
MEGAP:	Strengthening the Vocational Training and Education System in Turkey
MEKSA:	Foundation for the Promotion of Vocational Training and Small Industries
OSB:	Organised Industrial Zone
SEGEM:	Industrial Training and Development Centre
SME:	Small and Medium Sized Enterprise
SPK:	Capital Markets Board
TEKMER:	Technology Development Centre of KOSGEB
TESK:	Confederation of Turkish Tradesmen and Craftsmen

TESKOMB:	Union of Credit and Guarantee Cooperatives for Tradesmen and Craftsmen of Turkey
TIDEB:	Technology Monitoring and Evaluation Board
TISK:	Confederation of Employer Associations of Turkey
TMSF:	Saving Deposit Insurance Fund
TOBB:	Union of Chambers of Commerce, Industry, Maritime Trade and Commodity Exchanges of Turkey
TPE:	Turkish Patent Institute
TSE:	Turkish Standards Institute
TTGV:	Technology Development Foundation of Turkey
TÜBİTAK:	The Scientific and Technical Research Council of Turkey
TÜRKAK:	Turkish Accreditation Agency
TURK-IS:	Confederation of Trade Unions of Turkey
VCIT:	Venture Capital Investment Trusts

Foreword

SMEs play a particularly important role in the Turkish economy, because of their number and because of the large share of the workforce involved. The government authorities have for many years carried out a variety of programmes to support these enterprises. The design and implementation of such programmes have received increasing attention since Turkey joined the Customs Union with the European Union on 1 January 1996, and the authorities are developing them in a framework of international co-operation. Turkey's participation in the first OECD Conference on SMEs at Ministerial level, held in Bologna in June 2000, and the adoption of the *Bologna Charter on SME Policies* are evidence of its interest in the work of the OECD. Also, as a candidate for membership of the European Union, Turkey ratified the European Charter for Small Enterprises in April 2002 and participates in the Multi-annual Programme for Enterprise and Entrepreneurship (MAP) 2001-05.

During the preparation for the second OECD Conference of Ministers Responsible for Small and Medium-sized Enterprises, hosted jointly by the Turkish Ministry of Industry and Trade and the OECD on 3-5 June, 2004, in Istanbul, the OECD Working Party on SMEs and Entrepreneurship agreed to carry out a peer review of Turkish policies toward SMEs in the context of its core activity of evaluation of SME policies and programmes. The assessment required for this review is a challenge in view of difficulties that are inherent in such an exercise. International comparisons are always limited by national particularities and the differences in countries' framework conditions. However these problems may have been greater in Turkey than they are in other OECD countries in view of very unstable general economic conditions in the past, which have strongly distorted government policies and programmes in this area and have made it difficult to achieve the desired results. Among the reasons for some of these difficulties have been:

- Turkish firms have for many years had to operate in a particularly unstable and unfavourable macroeconomic environment characterised by high inflation and a succession of deep recessions and sharp upturns – resulting, all told, in only modest growth – as well as by considerable exchange rate instability.
- The government's macroeconomic adjustment policies and structural reform programmes have, in the short term, accentuated the climate of instability in which SMEs operate.
- While the purpose of these policies is to give Turkey a period of balanced and sustainable growth conducive to the development and strengthening of SMEs, which will themselves help to drive that growth, Turkey's monetary and fiscal adjustment policies have weighed not only on SMEs' own resources, but also on those set aside for the support programmes in their favour.
- Not a great deal is known about the cost of the support programmes for SMEs. It is true that the figures for direct budgetary expenditure are known, but the amount of indirect assistance in the form of tax allowances is more difficult to calculate.

- Even more than their cost, it is the effectiveness of the measures that is hard to assess. The main reason is the lack of statistical information about the sector. Turkey does not currently carry out an exhaustive statistical census of SMEs on the basis of homogeneous definitions and criteria. What is more, large sectors of the economy, such as tourism and services, lie outside the scope of specific support policies.
- Lastly, because of the particularly large number of undeclared activities and jobs in this sector, a very large share escapes investigation.

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Assessment and Main Recommendations

SMEs' are a major part of the Turkish economy

Small and medium-sized enterprises (SMEs) play a very important role in the Turkish economy owing to their large share in the total number of enterprises and in total employment. Their average profile is different from that of SMEs in the European Union or in most other OECD countries in that their average workforce and turnover are much smaller. They also lag well behind in terms of know-how, skill levels, capital investment to support their activities, and access and ability to take advantage of modern technologies, especially in the information and communications fields. As in most other countries, they find it difficult to obtain financing.

The business environment in which SMEs operate has been difficult for many years.

The economic context in Turkey has made the situation particularly difficult for SMEs in recent decades. An inflationary economic climate and increasing public sector debt have led to a lack of confidence, a series of financial crises, a sharp rise in real interest rates and marked depreciation of the Turkish lira. GDP has fluctuated strongly, punctuated by recessions, and average growth has been modest given the Turkish economy's growth potential and its needs. In addition to these general economic difficulties, SMEs have had to face the initial shock of the opening of the economy and competition following the Customs Union with the European Union in 1996.

Stabilisation and structural reform are prerequisites for the healthy development of SMEs.

The Turkish government has been committed for several years now to stabilisation and structural reform programmes, notably in the framework of agreements with the International Monetary Fund, which have been stepped up since 1999-2000. In the future, Turkey will have to pursue a sweeping structural reform policy to deliver the high and stable growth that can narrow its per capita wealth gap with the highly developed countries, and with Europe in particular, insofar as Turkey's per capita GDP, in terms of purchasing power parity, is only about 30% that of the euro area. The entry of large numbers of young people into the labour market, a huge shift of jobs from the farm sector to industry and services, and the swelling ranks of women in the labour market (women accounted for only 27% of the formal labour force in 2000) will require substantial new job creation in industry and services over the years ahead. Judging from the experience of a great many countries, the bulk of this

Policies toward SMEs take account of international approaches, are co-ordinated with those of the European Union, and ...

job creation will be in SMEs. Continuation of an economic policy that can sustain strong growth in a climate of stability is thus an essential prerequisite for the development of SMEs, which in many cases are not as well equipped as larger firms to protect themselves from internal and external shocks. But it is also the development of SMEs that will spawn conditions more conducive to the job creation that Turkey needs for stability and growth in per capita income.

Through the choices Turkey has made in recent years to begin a process of international integration geared towards Europe, it has embarked upon a variety of economic policies and medium- and long-term economic strategies that affect SMEs either directly or indirectly because of their prominent position in the economy. This process began in the 1960s and was reinforced by the general opening of the Turkish economy in the 1980s. At the same time the Turkish government developed a specific SME policy and created SEGEM (Industrial Training and Development Centre) and KÜSGET (Small Industry Development Organisation), which, later on, were united under the umbrella of KOSGEB (Small and Medium Industry Development Organisation) in 1990, as a major instrument for the execution of these policies.

A very important step was the creation of the Customs Union with the European Union in 1996 which strongly intensified the influence of international competition on Turkish industry, especially SMEs. The first SME Action Plan was introduced at that time, but it was not implemented owing to lack of funding. Following the acceptance of Turkey's application for membership in the European Union, the policy of support for SMEs was co-ordinated with that of the EU in order to enable Turkish SMEs, *inter alia*, to sustain competition with their counterparts in the EU and in other applicant countries. Creating a business environment conducive to entrepreneurship and the development of innovative SMEs has been high on the European Union policy agenda, and stressed in the Lisbon European summit in 2000 as part of a broader strategy for economic growth. The Turkish government signed the European Charter for Small Enterprises in 2002 and agreed to take concrete steps to develop policies and programmes for SMEs. Turkey participates in the Multi-annual Programme for Enterprise and Entrepreneurship, in addition to the BEST (Business Environment Simplification Taskforce) Programme. Along these lines, the Turkish government also adopted the *Bologna Charter* in 2000, together with other OECD countries and non-OECD economies, to promote bilateral

... are integrated in the 8th Five-year Development Plan.

and multilateral initiatives to foster global SME partnerships.

A range of policy initiatives in the 8th Five-year Development Plan (2001-05) aims to improve the productivity of Turkish SMEs and enhance their international competitiveness. Based on international best practices, the plan calls for raising product quality and enhancing the innovation and technology capacity of small business through collaboration with universities, introduction of new financing instruments, such as risk capital, and modern management techniques. Partnerships with foreign companies will also be encouraged in order to develop SMEs' export capabilities. A new approach to improve and expand service delivery to SMEs will be to create joint centres at local level, "synergy focal points", between KOSGEB and the Union of Chambers of Commerce, Industry, Maritime Trade and Commodity Exchanges of Turkey (TOBB).

Consolidation of a favourable business environment

Strengthening the overall business environment must have the highest priority.

Achieving these objectives requires, first and foremost, the institution and consolidation of an economic climate, and of a framework, conducive to the long-term development of the business sector, which is dominated by SMEs. The instability of the macroeconomic environment has long constituted an obstacle to the complete success of these policies, which, apart from their overall influence on the economy, have a direct impact on the creation, survival, productivity and competitiveness of SMEs. The success of these policies is thus essential to SMEs' long-term development strategy. The government and the Turkish authorities have been striving for several years to implement policies that could effectively optimise markets by correcting their dysfunctions and enhancing efficiency. They have had considerable success but more intense analyses of market failures and their causes are needed. This analysis should include a review of how existing laws and regulations produce differential effects on businesses of different sizes. In particular, more needs to be done in the following policy areas:

- Consolidation of public finance, and more particularly of the central government budget, as well as sound management of public debt in order to ease the pressure on capital markets and reduce private-sector eviction. This ought to make it possible to effect an easing of long-term real interest rates to levels consistent with the long-term

returns on SME investment.

- Further reduction and stabilisation of inflation at a low level approaching European Union objectives, in order to eliminate the inflation premium on interest rates and allow for stable real exchange rates at levels compatible with satisfactory international competitiveness.
- Reinforcement of the financial and banking sectors to enable better collection of savings and steer them towards the private sector and investment to foster development of loans to the economy, and to SMEs in particular. *Inter alia*, this entails developing a banking “culture” geared more towards SMEs, especially at the local level.
- Improving SMEs’ terms of access to financial markets, fostering the availability of venture capital and access to securities markets.
- While significant progress has been made, for example, the reduction of the business registration process from 19 steps to three, administrative and regulatory reform and rationalisation of the role of government to scale back its direct interventions in the economy must continue. Further easing of bureaucratic constraints will support new business creation and help to attract foreign direct investment.
- Strengthening of competition policy, so as to avoid monopolies and encourage new players to enter markets.
- Development of a tax system that does not discourage free enterprise and that promotes private domestic saving, attracts foreign investment, enables businesses to boost their cash flow and, more especially for SMEs, does not impose excessive burdens in the event of divestment or inheritance.
- Creation of modern infrastructure networks, especially in the realms of transport, telecommunications and energy.
- Continuation of a regional policy to reduce geographical disparities in terms of lines of business and income that could help to limit

internal migration to the largest cities.

- Increased human and material investment throughout the education system – primary, secondary, university and vocational – to meet the challenges of the swelling ranks of younger students and the increased needs in the area of research and development (R&D).
- Ensure that the labour market works efficiently in order to maintain a balance between the imperatives of social protection and employment flexibility for businesses.

SME policy makers must act as spokesmen for the necessary reforms in internal policy debates.

Most of the reforms listed above are not the direct responsibility of SME policy makers, including the Ministry of Industry and Trade and KOSGEB. These policy makers nevertheless have an important contribution to make by participating in internal policy debates, providing intellectual support and acting as spokesmen for the necessary policy measures and legislation.

The experience of many OECD member countries in the area of structural reform shows that even in an environment less unfavourable than the one Turkey has known until recently, such framework policies are difficult to implement because of political, sociological and bureaucratic rigidities. Helping to mobilise the necessary political support for such reforms, especially within the public sector, is one of the most important strategic roles that SME policy makers have to play.

Implementation of SME-specific policies

Many policies and programmes exist to strengthen SMEs.

The government formed in the wake of the 2002 elections has committed itself to a significant array of programmes, tax policies and funding schemes aimed at making industrial SMEs more competitive, more capable of applying modern technology to improve production processes, and more effective exporters. The government recognises that a stronger SME sector is critical to achieving several other important goals. In the future, SMEs are expected to produce large numbers of far better-paying jobs and to create much more value added than do current jobs in the sector. SMEs are also expected to be significant contributors to government policy and programme efforts to foster development in Turkey's least developed regions. The government also hopes that SMEs will be able to give a significant boost to Turkish exports. In many programmes, the degree of

Most of these are well-designed by international standards.

But some strategic reorientation should be considered over the longer term.

A broader mandate for KOSGEB could facilitate this.

support is in fact linked to general economic development goals, with higher relative support earmarked for the less developed regions. The Turkish government is attempting to apply European standards to these SME support programmes so that they programmes benefit SMEs and regions alike.

The staff of KOSGEB and the Ministry of Industry and Trade are very aware of SME support programmes in Europe, North America and Asia. The major programmes operated by KOSGEB and its Enterprise Development Centres (IGEM) and Technology Development Centres (TEKMER) are structured much like successful programmes in a number of OECD countries. The laboratories operated by KOSGEB are similar to centres operated by Japanese prefectural governments and provide SMEs with access to state-of-the-art testing and analysis equipment and methodologies that would otherwise not be available to most small firms. All of these programmes appear to be well designed and effectively managed according to international standards. The technological and managerial assistance provided to the limited numbers of SMEs enrolled in the programmes appears to have helped these firms to cope successfully with their business problems.

Nevertheless, the set of SMEs policies and programmes is less effective than it might be. Generally, ways should be sought to allow greater numbers and broader classes of SMEs to take advantage of the services and assistance that SME policies and programmes can provide. Given budgetary stringency, this may require shifting resources from existing uses. In some areas, progress with structural reform should make SME support policies and programmes less necessary, and, in some others, cost-effective reallocations should be sought.

One way to facilitate this would be to broaden KOSGEB's mandate to make it the support agency for SMEs in all sectors of the economy, with the exception of agriculture. This would require a change in KOSGEB's authorising legislation. Although its present focus is on industrial SMEs, many of the programmes co-ordinated by KOSGEB, particularly those co-sponsored by professional associations, chambers of commerce and industry, universities, etc., already potentially include non-industrial businesses. The present focus on technology improvement should be retained, but it can be easily expanded to apply to service and distribution businesses as well as production businesses.¹ KOSGEB can also adjust its programming approach to facilitate outreach and counselling for all

SMEs financing problems are mainly due to a poor business environment,...

SMEs needing help with technology, information and training. This work can be done through an expanded presence and co-operative efforts with professional associations and chambers of commerce and industry.

One of the major priority areas for SME policies has been access to financing. The main problem is the poor business environment. Chronic budget deficits have triggered excessive growth in the money supply, saddling the economy with chronic and unpredictable high inflation and high real interest rates while absorbing much of private saving, leaving the banking system with very limited funds for making loans. Under the circumstances, banks have protected themselves, first by purchasing government bonds and then by making loans to large businesses, and only occasionally to smaller industrial enterprises. Many, if not most, of the banks in Turkey do not make loans to small firms, which are estimated to obtain a very small proportion of aggregate loans to businesses. Small businesses are therefore forced to seek funds elsewhere in the economy, and it is doubtful whether they often find enough to meet the demands of new and growing enterprises. No information is available on the use of personal assets or loans from families and friends or about recourse to such potential funding sources as the mortgaging of assets. The development of non-traditional financial instruments, such as venture capital and business angels, is also lagging notably behind.

... but programmes have been created to address them.

To overcome the banking system's apparent inability to provide funds to support SME investment and related infrastructure investments, the government of Turkey has created a number of targeted investment credit programmes in support of SMEs. KOSGEB, in particular, is continuing to examine new approaches to improve the flow of finance to SMEs. The government has made credit available to state-owned banks (which are however moving towards privatisation); and, to support the development of small-scale industrial estates (SSIE), it has set up industrial areas with access to quality industrial space with the necessary utilities and central services. The government also subsidises SMEs' purchases of capital equipment through a series of tax incentives and offsets. The administrative arrangements for this tax relief have recently been simplified to remove an explicit requirement for government approval. The credits now flow as a part of the tax system with many fewer paperwork requirements. Similar tax credits are used in many countries but are usually intended to augment private saving and investment rather than to replace private saving.

These should be reviewed and evaluated before expanding them.

Before considering expansion of financial support programmes, however, an evaluation of the existing loan schemes should be undertaken.² This should be done as a comprehensive review, examining the rationale for the programme and the extent and causes of the market failures that prevent banks from making loans to SMEs.³ The evaluation process should also look at the costs and benefits of loans made by banks supplied with government credit. Current practice is to describe the number and size of loans made, but not to examine default rates, employment changes related to loans made, growth rates of firms receiving loans, growth rates of employment or the output of similar firms not receiving loans. Bank managers may have an idea of the differences in the structure of loans supported by government credit or guaranteed through a state guarantee programme, but no published documents provide this information to interested parties outside the banks. The banks that lend to industrial SMEs appear to have a set of rational criteria for determining which firms receive loans, but no information is available to assess their relevance. Any evaluation of the financial support programme of the Halk Bank and the Industrial Development Bank (and any new banks that join the programme) should consider the needs of both policy makers and programme managers.

A particular issue on which a formal evaluation of lending to industrial SMEs might shed valuable light is the question of why most banks do not lend to SMEs and would choose not to do so even if loan funds were available. Part of the rationale may be that the government has been active in this market for some time and banks see no reason to become involved in the government programme or to compete with government-backed credit. Another possible explanation is that banks are not used to making loans to small businesses and do not have the skills to underwrite such loans effectively. Bankers may prefer to disregard all small enterprises rather than make the effort to evaluate loan requests on their merits. They may also be convinced that the transaction costs would more than wipe out any profit they might make by lending such small amounts. Turkish evaluators should try to ascertain why SMEs do not have access to credit before recommending changes or improvements to loan programmes.

The Turkish government might also consider expanding its training of bank loan officers and SME owners/managers to help improve the loan market for small enterprises. Several good training models are available

from OECD member governments. Bankers have to know how to evaluate loan requests on the basis of less information than they normally have for loans to large businesses. SME owners have to be taught how to prepare better loan requests in order to provide the information needed by a diligent loan officer. Even with better information from SMEs, however, bankers may still be reluctant to lend to SMEs, since they cannot reasonably hope to recoup their losses by seizing SME assets pledged as collateral when there is a default on a loan. A review of the legislation on creditors' rights should aim at achieving a more productive balance between the protection afforded debtors and lenders in order to encourage the expansion of bank loans to SMEs.

Policies to strengthen SMEs' capacity to use information and communications technology ...

A second major priority area for SME policies has been to strengthen SMEs' technological capacity, particularly in the area of information and communications technologies (ICT). Wide use of microcomputers could enhance dissemination of the information published by the government to promote exports. Increased Internet use could help industrial SMEs to procure raw materials and capital goods more efficiently, thus trimming their costs and boosting their productivity. These positive effects have been clearly demonstrated in the North American and European markets. The Internet can also help SMEs to advertise their products and simplify purchasing decisions for businesses and consumers alike. Computers can also help SMEs control production processes and manage inventory.

... should engage industry associations to assist with training and enhancing skills, ...

While the government is working to improve the infrastructure on which e-business depends, especially by supporting development of the Internet in Turkey, it does not appear to have formulated any overall programme for training industrial SMEs in the necessary skills. Providing support for the introduction of the necessary equipment and teaching SMEs to use it successfully would require considerable manpower and a sizeable budget. In many countries the learning process is driven by industry associations, which are well placed to identify the best technologies and practices, provide training and disseminate the findings of their market research to identify both internal and external markets. Innovations, whether product, process, or management, spread quickly thanks to these industrial associations. Consideration should be given to encouraging the Confederation of Turkish Tradesmen and Craftsmen (TESK) and TOBB to lead the technology improvement drive, with co-ordination and support provided by KOSGEB.

...while gathering better information on which to base policies.

Evaluators should look closely at why computer use by industrial SMEs is so infrequent. Given the usage levels in most OECD countries, it should be relatively easy to ascertain why firms use microcomputers in those countries and what benefits they derive from it. Most of the answers to these questions can be found in the marketplace or in research supported by computer producers and IT service providers. The government should also evaluate the use being made of its KOBINET, an online network for communicating with SMEs, to determine what types of information are most useful and what changes should be made to the content uploaded to the Internet.⁴

Support should be made available to larger numbers of industrial SMEs, and ...

It may be difficult to increase technology use significantly since KOSGEB and related programmes, both public and private, only reach a relatively small number of industrial enterprises. Given current programme levels, relatively few SMEs receive major support at IGEM or TEKMER centres. In view of the budget funds available and the level of support to a few select businesses, it is difficult to see how these programmes could be significantly extended without some changes in their structure. Some alternative programme delivery structures that might be explored are described in Chapter 3. A shift in programme approach may be necessary to stimulate change in all sectors with significant SME populations. Turkey has chosen to develop an SME support structure with relatively high levels of support for relatively small numbers of SMEs. This may produce positive outcomes for some SMEs, but is unlikely to do much to stimulate change throughout the economy. An alternative model, which would award smaller subsidies to many SMEs, could provide greater returns to the government and the economy.

... to SMEs in important parts of the services sector.

While the government actively seeks to support industrial SMEs in many areas, some of the support schemes have shortcomings, especially from a long-term standpoint. For instance, the government has focused on increasing productivity and competitiveness in the SME industrial sector but has placed far less emphasis on improving competitiveness in other sectors, such as wholesaling and retailing, whose activities are tied closely to those of industry. Moreover, if the industrial sector currently accounts for an especially large share of GDP and employment, the services sector can be expected to expand rapidly in the years ahead if the prospects for rapid growth are confirmed. From a long-term standpoint, it can be expected that SMEs in service

industries, such as trade and tourism, will be associated more closely with government policies to support business.

Indeed, many structural changes will take place as industrial SMEs become more adept at applying modern technology to their production processes. Some firms will indeed use technological processes more effectively, and they will be able to optimise production and cut costs more quickly, expanding their market shares both in Turkey and abroad. Conversely, SMEs that lag behind in applying new technology will find themselves relatively less competitive, jeopardising their development if not their survival. The issue of the long-term consequences of potential structural change may not be sufficiently factored into policy formulation, even though the number of SMEs is considerably greater in the non-industrial than in the industrial sector.⁵ This may stem from the fact that the government perceives no major weaknesses or problems in non-industrial sectors, or that problems in these areas can be dealt with by TESK or TOBB, which represent most of these businesses.

Many types of support for SMEs need greater development.

Apart from the lack of funding, Turkish SMEs appear to suffer from a lack of industrial space, a lack of information and efficient production technology, scant use of management and control systems, inability to access consulting services, lack of computer knowledge and related deficiencies. Most countries experience these shortcomings to varying extents, but they seem especially significant in Turkey. The authorities note that many of the markets needed to support industrial SMEs have not developed, thus failing to supply many of the services that could help to improve technology use and general productivity. The failure of these markets to develop may be due in part to a lack of demand on the part of SMEs and not just to a lack of supply in the market. The government approach to improving supply in some markets, such as support services for SMEs, is to encourage provision of expanded services, while in other markets, such as technological support, the government appears to have decided to provide many of the necessary services itself.

Many of these well-designed government programmes have been tailored to the Turkish business environment, but government provision of market services is often expensive and most government programmes only reach a limited number of businesses. In most OECD countries, SMEs seem to be more capable of competing with larger businesses, and markets appear to be more

efficient in providing the goods and services needed to support them. It is important to try to ascertain why small businesses appear less competitive in Turkey than in other OECD or other developing countries. The small average size of Turkish SMEs, and in particular the large proportion of micro-firms, may explain in part these failings of the markets for support services. It is also important to examine the potential negative effect of government production of services that compete with private production of similar technical and managerial support services. It is difficult for private consultants to sell to SMEs if the government provides similar services at less than market prices.

More counselling could play a role.

IGEM centres could increase their outreach and counselling to many firms on many issues, placing greater emphasis on services delivery and on management issues, such as business planning, marketing, financing and production technology.⁶ Outreach would focus in particular on coordinating counselling with training activities sponsored by chambers of commerce and industry or by local professional organisations. Counsellors could point out that a change in culture among Turkish SMEs is unavoidable and emphasise the need for more openness when dealing with banks or other financial intermediaries. Skill training could be developed and delivered at convenient times and places to encourage business owners to participate. This outreach model could be added to the existing IGEM model relatively easily. The emphasis would be on teaching businesses to act for themselves rather than on doing something for them. Counselling or training activities could help to increase the demand for specialised consulting or management services.⁷

SMEs' links with large firms should be encouraged, ...

Policies and strategies for SMEs, such as those set forth in the "SME Strategy and Action Plan", seek essentially to correct the fundamental weaknesses of Turkey's industrial SMEs but could place greater emphasis on their existing and potential strengths. One way to do this is to develop their links with larger firms. Because of their size, larger businesses can achieve economies of scale that lower the cost of production for a given good or service. These businesses generally produce standardised goods and operate best in a stable macroeconomic environment. They prefer demand to remain steady so that production levels can sustain full use of their plant, equipment and labour. Larger businesses find it difficult to adjust to rapid changes in demand.⁸ Smaller businesses, on the other hand, are

more adept at reacting to changes in demand triggered by changes in tastes or preferences or by changes in overall supply and demand conditions. Smaller businesses often operate in niche markets, which are usually too small to warrant coverage by larger firms, and produce non-standard goods. They meet fluctuations in the economy by adjusting production levels. If upward fluctuations, which may result from changes in demand, appear to lead to a permanent change, larger businesses will build plants, lower prices and take sales from the smaller businesses that increased their output to meet the increase in demand.⁹ In those industrial sectors where demand appears to fluctuate rapidly, small businesses may dominate the industry.¹⁰

In most economies and in most industries, both large firms and SMEs can survive. The number of small, medium or large enterprises should be determined by market competition. The growing specialisation of modern industries often leads to a more diversified production process, with many semi-finished goods assembled to produce the final product. This gives SMEs a good chance to grow by producing highly specialised and technologically advanced parts. For example, in the modern automobile industry, only 20% to 30% of the final value added is produced by the big automobile enterprises. Furthermore, if SMEs survive in an industry in which large firms are the clear low-cost producers, then they must be providing something of value not provided by the larger firms.¹¹

... especially to enhance SMEs' access to export markets.

A major goal of the Turkish government is to increase the international competitiveness of industrial SMEs in order to make them more outward-oriented and increase their level of exports. In most countries, there are SMEs whose activities are essentially export-oriented and achieve remarkable results, but on the whole SMEs do not contribute much to exports. Many governments have concluded that this is an area in which much progress can be made. Despite their efforts, however, there is little evidence that industrial SMEs are increasing their share of exports in most countries. This is partly a function of size. Many small industrial firms already find it very difficult to establish themselves on the domestic market. This is certainly true of Turkey, which is a relatively large country in terms of both population and geography and where the average size of SMEs is quite small. Turkish plans call for an extensive review of export support programmes in other countries in order to determine under what circumstances programme approaches are likely to be effective. There is a possibility that there

is no approach that will work well.¹²

The Turkish government approach involves providing marketing information about demand in foreign countries and a possible government role as a facilitator to help with strategic alliances or partnerships. This may yield results, but the amount of resources used to support these activities needs to be evaluated carefully to determine if such activities are sufficiently productive. One potential way to increase exports is to encourage more joint ventures between Turkish industrial SMEs and larger businesses, especially foreign-owned, internationally oriented firms. As the Turkish economy becomes more competitive, the government should see a decrease in the vertical integration of large companies. Rather than perform the full range of business activities in-house, larger businesses will outsource or contract out functions that are not directly related to their primary manufacturing expertise. Many large firms in Europe and North America now contract out services such as data processing, payroll, employee benefits, computer maintenance, information system design, Internet servicing, advertising, training, legal support, inventory measurement and control, and product servicing. The larger firms have found that they can contract out such services and obtain both lower prices and better quality. These developments have been facilitated by the presence of smaller enterprises that draw on modern technology and their experience to develop new services. There appear to be many opportunities for this type of service business in the Turkish market. A shift of or an increase in government export support for large firms may increase exports more effectively than a focus on exports by SMEs.

Strengthening the effectiveness of SME policies

Policy design would benefit from better data collection, ...

To strengthen the effectiveness of SME policies, some further changes should be considered. The possibility of broadening the KOSGEB mandate to cover non-industrial SMEs has already been mentioned. In addition, the government should strengthen data collection and publication programmes in order to make the actions and influences of SMEs better known within the Turkish economy. At a minimum, these programmes should undertake to:

- Develop a definition of SMEs that includes SMEs in all industries and is congruent with definitions used in the European Union. The Turkish government is committed to this and is working to

complete the process in short order.

- Develop the collection and publication of business statistics according to the standards developed by EUROSTAT. This would increase the flow of data on SMEs and make it possible to look at the dimensions of the SME sector across all industries. Again, the government of Turkey has agreed to do this, and the State Institute for Statistics is working to develop the necessary changes in instrumentation and data collection practices to harmonise them with EU practice.
- Develop a capability to measure dynamic changes in the economy and in the SME sector by both size of firm/establishment and industry. The work would involve comparing micro-data on changes in employment or value added at establishment level. Tables produced from this micro-data would pinpoint sources of growth and decline by business size classes and by industry. The ability to compare business performance at the establishment or enterprise level would greatly facilitate analysis of the impact of government policies and programmes for all size groups. Since most Turkish data development processes already meet international standards this should be feasible.

Finally, the government should consider developing and using a quarterly sample survey designed to capture information about the business plans of SMEs and larger businesses for the coming quarter and compare current performance to plans made in the previous quarter. The report based on this quarterly survey would allow the government to track changes in the performance of businesses with respect to areas such as hiring, investment, price changes, exports, etc. Over time, the survey outputs can be correlated with changes in GDP. This would be helpful for the formulation of economic policies more generally.

*... from better applied
policy-analytical research,
and ...*

At the same time that the government expands the data development programme, it should undertake an extensive programme of applied policy-analytical research on the impact of the economy on SMEs, and on the impact of SMEs on the economy. This research will be greatly strengthened by the data instruments described above as they come on line, but much research can be done with information gathered from existing statistics or from sample surveys organised by size and industry. KOSGEB has established a Research and Analysis Unit

which appears to be the logical place for such an office. The charge to the office should be to examine all elements of the SME sector, rather than focusing on the industrial sector alone. The broader focus should help inform decisions on resource allocation and use in traditional KOSGEB programmes and also help with the design of programmes for industrial or other SMEs. The research office should report directly to the President of KOSGEB and to its Board of Directors.

The research office should be a policy analysis office. It should not conduct pure economic research (*i.e.* theory-focused) but should conduct applied economic research to examine the impact of policies and regulations on SMEs. Studies that are more descriptive in nature can be carried out to provide a base of knowledge and information about the role of SMEs in the economy which can be used to strengthen the analysis of policy impacts. The office should examine the full range of regulatory policies that may affect SMEs and base its work on micro-data so that the relative differences in the impact of policy can be examined both by size class and by industry. Policy analysis is not programme evaluation, which focuses more on the effectiveness and efficiency of government or private support for SMEs.

...the establishment of a programme evaluation office.

Finally, a programme evaluation office should be established, as evaluation of SME-specific programmes by an independent office would be useful. Most governments look at evaluation as a supplemental activity. Both political and bureaucratic pressures in Turkey lead to an emphasis on programme activity rather than measurement. Though the legal regulations for constituting a framework for state aid and its monitoring and evaluation exist, evaluation by a specialised office can serve to highlight ways to reinforce programmes that are effective and to redirect resources that are being used ineffectively. In any case, the function of an independent evaluation office and that of the office for monitoring state aid must remain separate.

Although data often exist to identify the number of participants, the money spent, the activities accomplished, such as hours of training or number of training events, little information is available to evaluate the success of a programme in reaching the outcome goals established for it. There are many references throughout the “SME Strategy and Action Plan”, prepared by the Turkish authorities for 2004-06, to evaluations to be accomplished, but how evaluations will be performed and who will carry them out is a subject

that requires discussion.

The complexity of some of the support being provided by KOSGEB and by other ministries and the depth and breadth of the programme offerings make it imperative to evaluate the outcomes of each activity. This is not a simple exercise, particularly for programmes such as IGEM and TEKMER that combine many services. There are effective methods for evaluating such complex programmes, but the evaluation requires both time and expert resources.

Chapter 1

MAIN FEATURES OF THE SMALL AND MEDIUM-SIZED ENTERPRISE SECTOR IN TURKEY

Size and structure of the sector

Small and medium-sized enterprises (SMEs) constitute a major part of the Turkish economy, accounting for a large proportion of the country's businesses and total employment. The State Institute of Statistics (SIS) produces no economy-wide data on SMEs, partly because these are defined differently by the various organisations involved in SME policies from one sector to another (Table 1.1). The more restrictive definitions are those of KOSGEB, the Undersecretariat of Foreign Trade and Eximbank, which only cover manufacturing; the broadest is that of the Undersecretariat of Treasury which, like the European Observatory for SMEs, covers all of the non-primary sector and uses the same size classes.

The coverage of Turkey's various national definitions is relatively narrow, insofar as – except for the Undersecretariat of Treasury – they only cover the manufacturing sector and exclude services and tourism, which are expanding rapidly. One of the SIS's top priorities is to compile and publish SME statistics based on a single definition aligned on that of Eurostat and based on European Union conventions, factoring in not only the number of jobs but also the size of their balance sheets (up to EUR 43 million) and of their turnover (EUR 50 million).

Since statistical information on Turkey's SME sector is relatively fragmentary and few time series are available, it is difficult to analyse trends over time. However, some data provide a snapshot of its relative place in the overall economy. According to the most recent estimates, the SME sector, including services, accounted in 2000 for: 99.8% of the total number of enterprises, 76.7% of total employment, 38% of capital investment, 26.5% of value added, roughly 10% of exports and 5% of bank credit. Therefore, while SMEs dominate the economy in terms of employment, they evidently operate with comparatively little capital equipment, generate relatively low levels of value added, make only a small contribution to Turkish exports and receive only a marginal share of the funds mobilised by the banking sector.

A very large share of SMEs are in the trade, crafts and industry sectors represented by TESK (Confederation of Tradesmen and Artisans of Turkey) and TOBB (Union of Chambers of Commerce, Industry, Maritime Trade and Commodity Exchanges of Turkey). As of 31 January 2003, TESK had registered more than 2.76 million trade and craft enterprises. However, turnover of firms is substantial in this sector, which is highly sensitive to swings in the economy.¹³ In the trade and industry sector represented by TOBB, the number of enterprises was estimated at 1.2 million at the end of 2003. While government activities affect these firms (revised business start-up procedures, for example, or government encouragement of the increased use of computers), there is no general policy regime for these SMEs. Some of the enterprises in TOBB are industrial

enterprises that receive government support, but the wholesale and retail trade businesses do not appear to be covered by many programmes.

Only a small share of SMEs are in the manufacturing sector. According to SIS data (Table 1.2), on 1 January 2001 there were around 210 000 SMEs (1-250 workers) in the sector (99.6% of the total number of manufacturing firms). Just over 1 million persons are employed by these SMEs (64.3% of the manufacturing total) and they accounted for 34.5% of the sector's value added. Manufacturing sector SMEs are broken down across industries as follows: metallic goods: 26.1%, textiles, clothing and leather goods: 25.6%, wood and furniture: 24.3%, food and drink: 12.7%, paper: 3.9%, other sectors: 7.4%. Furthermore, these enterprises are generally very small. The average number of people employed by SMEs in manufacturing is 4.8, but for the 95% of SMEs with employment of between one and nine, the average is 3.1.

Because of the size of Turkey's informal sector, these data underestimate the relative importance of SMEs in the Turkish economy and probably overestimate their typical size more than in the majority of OECD countries. (According to certain estimates, the informal economy could represent about 50% of the activity of SMEs.)

In geographical terms, the distribution of SMEs reflects that of the population as a whole. They are concentrated in the coastal regions along the Marmara and Aegean Seas, with 38% and 17% of the enterprises, respectively, and in Central Anatolia, with 16%. The Mediterranean coastal region (11%), the Black Sea region (9%), south-eastern Anatolia (6%) and eastern Anatolia have far less organised formal economic activity.

Table 1.1. SME definitions used in Turkey and the European Union

Organisation	Sectoral definition	Criterion for definition	Micro-sized enterprise	Small-sized enterprise	Medium-sized enterprise
KOSGEB	Manufacturing industry	Number of workers		1-50 workers	51-150 workers
HALK BANK	Manufacturing industry	Number of workers	--	--	1-250 workers
		Fixed investment amount (EUR)	550 000	550 000	550 000
UNDERSECRETARIAT OF TREASURY	Manufacturing industry, tourism, agro-industry, mining, education, health, software development	Number of workers	1-9 workers	10-49 workers	50-250 workers
		Investment amount, amount of investment subject to SME incentive certificate (EUR)	550 000	550 000	550 000
UNDERSECRETARIAT OF FOREIGN TRADE	Manufacturing industry	Number of workers	--	--	1-200 workers
		Fixed investment amount (EUR)	--	--	1 830 000
EXIMBANK	Manufacturing industry	Number of workers	--	--	1-200 workers
EU	Non-primary private	Number of workers	0-9 workers	10-49 workers	50-249 workers
		Annual turnover	<EUR 2 million	<EUR 10 million	<EUR 50 million
		Annual balance sheet	<EUR 2 million	<EUR 10 million	<EUR 43 million

Note: Assuming EUR 1 = TRL 1 700 000.

Source: Undersecretariat of Treasury, Undersecretariat of Foreign Trade, KOSGEB, EXIMBANK, HALK BANK, EU.

The small size of Turkish SMEs and their relatively modest contribution to national output stand out in international comparisons. For example, the proportion of SMEs with fewer than 100 workers is higher in Turkey than in many other OECD countries (Italy is a notable exception), and most Turkish SMEs fall into the category of enterprises with fewer than ten employees. Turkey also has the highest proportion of jobs in manufacturing firms with fewer than ten workers (34%). Furthermore, while micro-enterprises account for 95% of Turkish businesses and 34% of Turkey's jobs, they account for a scant 7.8% of production, whereas in Italy, France and Portugal, where such firms are proportionately fewer and employ fewer people, their contribution to total output ranges from 11% to 15%.

Table 1.2. Manufacturing enterprises in Turkey

Size category by number of workers	Number of enterprises		Workers (000)		Value added USD millions ¹	
	1992	2001	1992	2001	1992	2001
1 to 9	186 900	199 737	523 117	500 738	2 874	1 632
10 to 49	7 970	7 260	175 646	183 694	2 506	1 947
50 to 249	2 434	3 127	225 650	343 023	6 678	6 187
250 and over	795	912	553 626	570 083	26 952	18 988
Total	198 097	211 046	1 478 039	1 597 538	39 011	28 754

1. At the 1992 and 2001 exchange rates of USD 1 = TRL 6 841 and TRL 1 228 268, respectively.

Source: State Institute of Statistics.

Fundamental weaknesses of the sector

Insufficient know-how and low level of technology

A substantial proportion of Turkish SMEs, especially the smallest ones outside urban centres, produce for either the national or local markets. The design of their products is at times outmoded and in many cases they are produced with inefficient methods and outdated tools. To cope with the competition that will develop as Turkey becomes increasingly open, these firms will need help in the areas of technology transfer, design, management and education.

After the customs union with the EU was put in place, Turkish SMEs faced pressure to raise their technical level and acquire know-how in order to meet European competition and take advantage of opportunities in the domestic market. However, they did not fully take advantage of these opportunities for a number of reasons. First, even if rapid progress has been made in recent years, investment in information and communication technologies (ICT) remains low in Turkey (Tables 1.3 and 1.4). Second, the support policies that would have been necessary for their technological development were not available, owing to a lack of public funding. Moreover, to be fully effective, technical standards should have been raised prior to the opening of the borders. Furthermore, an unfavourable economic environment and the drop in domestic demand following economic crises in a climate of heightened competition slowed SMEs' technological development. Their lack of technical skills keeps SMEs from deriving the full benefit of any cost advantages they might have domestically or for export, notably during periods of devaluation of the Turkish lira. Finally, businesses' needs in terms of

technology do not automatically result in demand on their part, either because of a lack of resources, owing to their small size, an internal lack of understanding of their requirements or a poorly functioning market. This obviously has negative repercussions for technical consulting firms operating within Turkey that are able to provide needed support. It should be noted that small manufacturing business throughout the world are often reluctant to use technical consultants.

Table 1.3. ICT indicators

	1995	2001
Telephone mainlines (per 1 000 people)	211	295
Mobile phones (per 1 000 people)	7	302
Personal computers (per 1 000 people)	14.7	40.7
Internet users (thousands)	50	2 500 ¹
<i>ICT expenditures</i>		
Total (USD millions)	2 777	9 333
As a percentage of GDP	1.6	3.6

Note: 6 000 in 2003.

Source: Development Data Group; World Bank.

Table 1.4. Diffusion of information and communication technology

	Turkey	EU	United States	Japan	OECD
Standard access lines per 100 inhabitants (2001)	27.55	44.93	63.06	40.09	45.58
Access channels per 100 inhabitants (2001)	27.6	58.9	67.5	58.4	54.5
Mobile subscribers per 100 inhabitants (2001)	26.8	74.3	45.1	58.8	53.9
Broadband subscribers per 100 inhabitants (June 2003)	0.06	4.55	8.25	8.6	6.06
Public telecommunication investment per capita (USD, 2001)	42.0	129.87	333.66	193.84	169.23
Public telecommunication investment per access channels (USD, 2001)	152.0	212.68	493.97	331.94	310.61
Public telecommunication investment as a % of GFCF (2001) ¹	10.9	2.97	4.79	2.31	3.64
Personal computer per 100 inhabitants (2001)	2.65	27.5	81.77	38.79	39.48
Internet subscribers to fixed networks per 100 inhabitants (2001)	5	16.8	27.2	18.9	18.7

1. The very high figure for Turkey reflects the sharp fall in total gross fixed capital formation (GFCF) during the severe cyclical downturn in 2001.

Source: OECD Communications Outlook, 2003.

The low level of technology is linked to weakness in innovation. According to a recent study by the World Bank,¹⁴ several factors explain this situation:

- Turkey's R&D effort suffers from too little participation by the private sector: "The share of the business sector in total R&D expenditure is around 35%, against the OECD average of 65%, although the number of companies conducting R&D has increased between 1996 and 2000... Most of the rest of the R&D infrastructure is in government laboratories".

- “University-based intellectual potential is high, however, university-industry interactions are weak because there is inadequate funding for cooperative projects at the universities, and research laboratories and equipment are limited in some faculties.”
- “Finance for innovation and R&D is in short supply. Tax incentives have also been modest and benefit only large firms.”

Access to finance

Even if more Turkish SMEs wished to improve their technological capacity and modernise their plant and equipment, they would find it difficult to do so because of the difficulty of obtaining financing and of access to credit and equity. Less than 5% of available bank credit is provided to industrial SMEs, even though they account for 99.5% of the establishments in the industrial sector, 66.5% of employment in the sector, and 34% of value added in the sector. Given the large government deficits in recent years, and the crises of 2000 and 2001, the banking sector has been weakened considerably. Many banks choose not to make credit available to industrial SMEs, and many banks that might make such loans actually lack both the knowledge of how to make small loans and the funds to support them. The state bank, Halk Bank, which is in the process of being privatised, makes most of the loans to small enterprises. Funds to support SME development may be available from other European banks, but it is doubtful that the banking system could make effective use of such funding at this time. So far, alternative financial instruments such as venture capital, business angels and equity financing through the stock exchange are not well developed.

The policy context surrounding the SME sector

The Turkish authorities have recognised that a long-term strategy for SMEs calls for action across a wide range of policy domains, including education, R&D, government regulations, competitive policies, labour market and social policies, and a sound banking sector. These actions should address the need to create a healthier overall economic environment in which the business sector, and SMEs in particular, operate. They should strive to put SME-specific policies and programmes in place that provide the sector with the support it needs to prosper. The most recent basic objectives of policies for SMEs are outlined in the 8th Five-year Development Plan (2001-05), and they fit in with the country’s general industrial policy. The primary stated objective of this policy is to create conditions conducive to sustainable growth in a structural context of openness, enhancing industry’s competitiveness and efficiency within a competitive environment. Moreover, since the crises of 2000 and 2001, the general economic policies initiated in May 2001 and continued forcefully by the current government, represent a more consistent approach to dealing with the fundamental weaknesses of the Turkish economy. They aim at achieving a more stable and higher growth path by restoring sound public finances, reducing high and fluctuating inflation rates, restructuring and strengthening the weak banking sector, and harmonising many policy elements with EU rules, thereby resulting in a better environment and a healthy, competitive SME sector. With regard to SME-specific policies, the stated objectives are to increase their productivity, their share in value added and their capacity to compete internationally.

The authorities' approach to achieving these objectives is in line with the guidance for SME policies set out in the Bologna Charter and the European Charter for Small and Medium-sized Enterprises. In light of the SME sector's weaknesses, attention is focused especially on three areas:

- *Financing*: Increase SMEs' share in the overall volume of bank lending; deploy structures that would enable SMEs to make more and better use of financial instruments such as venture capital and partnerships in financial or real estate investments.
- *Non-financial support*: Develop communication and interaction among service providers, SMEs, trade organisations and government agencies in order to improve the quality of services rendered and expand the number of SMEs receiving them.
- *Technology*: Raise the technological level of SMEs via training programmes and support for R&D to underpin the development of firms' technological infrastructure.

The actions to be undertaken in these three areas essentially focus on education and training, creation of new enterprises, enhancement of SMEs' capacity to take advantage of technology and legislative and regulatory problems.

Education and training

An essential goal is to develop the teaching of necessary skills at all levels to encourage the spirit of enterprise and develop vocational education, along with training and advisory services. These actions need to be undertaken in close co-operation with public bodies, the private sector and academia, especially in the least developed regions. Moreover, information for SMEs will be needed in the realm of technology, management and benchmark policies.

Initial education must be pursued and rounded out with vocational training that will enable SMEs to meet their skilled labour requirements. Vocational training programmes have to adapt to shifting needs resulting from technical and technological change. Lifelong learning to tailor workers' vocational skills must be developed as well.

Creation of new enterprises

An important objective is to simplify the new enterprise creation process and reduce bureaucratic red tape. The creation of new businesses should also be spurred by the development of information agencies and a strengthening of their co-operation with these start-ups. Lastly, budget-funded support programmes to facilitate job-creating activities need to be expanded. In order to ensure the development and long-term survival of new technically and economically competitive businesses, entrepreneurs need access to information about many issues that affect the business environment and their markets from the outset. They need strategic development plans and access to market research. It is important to give the smallest enterprises, which make up the majority of Turkish SMEs, access to the support that can compensate for the operational resources they lack.

Enhancement of SMEs' capacity to take advantage of technology

A core aspect of the SME development strategy in Turkey is the development of their capabilities in terms of technology, innovation and communication. The strategy must be elaborated at a number of levels and should include technology dissemination and transfer and collaboration by the various firms and services involved in research on or

application of technologies, and by academia and industry in particular. Turkish SMEs need easier and more frequent access to training, consultation and support in the area of R&D in order to improve the quality of their products and bring them into line with legislation on technical standards and European regulations. To implement these strategies will require greater support for the creation of technological and industrial development areas, along with fostering the creation of clusters of local and regional businesses and communications networks. Efforts to develop the use of Internet networks in the areas of technological data exchange, vocational training, dealings with government and online commerce will need to be strengthened.

Legislative and regulatory problems

It is necessary to avoid conflicts of interest between general legislation and regulations and measures applicable specifically to SMEs. For example, laws designed to improve supervision of the informal economy may be perceived by the many SMEs concerned as a constraint and a source of rigidity. Similarly, the recent increase in social contributions has been conducive to hiring undeclared workers. Competition policy needs to be strengthened to eliminate unfair competitive practices, and SME-related regulatory reform must be part of overall Turkish regulatory reform. With the enactment in 2001 of the national programme for adopting the *acquis communautaire*, Turkey has made a commitment to fundamental regulatory reform, which has gathered pace with the adoption of the economic transition programme. Both programmes serve to bring Turkey's regulatory structure in line with international standards. Beyond the regulatory reform, special measures are being implemented to allow SMEs easier access to sources of financing and special aid systems.

Chapter 2

STRENGTHENING THE BUSINESS ENVIRONMENT IN WHICH SMEs OPERATE

Turkish SMEs have evolved in recent years in a generally unfavourable business environment marked by sharp fluctuations in GDP, two recessions, high inflation, exchange rate instability and the introduction of stringent adjustment policies. The sharp fluctuations in GDP over the past ten years (1993-2003) ranged between +8.4% in 1993 and -7.5% in 2001 and led to an average GDP growth rate of only 2.1% per year, a rate essentially identical to that of the European Union but, in view of the Turkish growth potential and the needs of a growing population, far too low. The average inflation rate, as measured by the GDP deflator, exceeded 50% a year, with a peak of more than 100% in 1994. The effective exchange rate of the Turkish lira depreciated by about 65% a year over the 1993-2003 period (Figure 2.1). Large fluctuations in inflation and domestic demand and extremely high real interest rates, even on government debt, had a strong adverse effect on the possibilities for SMEs to remain competitive. Large firms were better placed to manage the negative effects owing to a stronger capital base, partly by refinancing abroad at much more favourable interest rates or by finding export outlets.

Since the early 1980s, the elaboration of structural policies and regulatory reform have had a significant impact on the overall framework in which SMEs operate. The recurrence and magnitude of domestic economic crises and pressures from the international environment, in particular the conditions laid down by the International Monetary Fund and the World Bank, as well as the conditions attached to Turkey's candidacy for membership of the European Union have made such reforms imperative. Their essential goal has been to ensure a shift from widespread substitution of national products for imports to an open and competitive market economy. While a number of the programmes put in place, such as reductions of subsidies and price controls for public enterprises, were only indirectly relevant to SMEs, liberalisation of the foreign-exchange and foreign-trade regimes concerned them directly.

After the first wave of liberalisation in the 1980s, the introduction of the customs union with the European Union in 1996 and the adoption of the EU's common external tariffs for manufactured goods were major steps that triggered a sharp reduction in tariff barriers and greatly altered the competitive environment in which SMEs operate. The share of foreign trade has risen sharply, and the sum of imports and exports now represents about 50% of GDP, with a large increase in the share of manufactured products.

The financial system

The failings of the Turkish financial system have contributed to the economy's poor performance in recent years, notably to the banking and foreign-exchange crises of 1994 and 2001-02 and the failure of the 1999 stabilisation programme. Since the liberalisation of capital movements in 1989, and owing to the inability of the government to keep the

budget situation under control, private banks have been instrumental in financing the public sector’s rising debt, at high real interest rates. With the banks financing public debt, too often with insufficiently hedged foreign capital, credit available for the productive sector contracted.

Figure 2.1. Main economic indicators

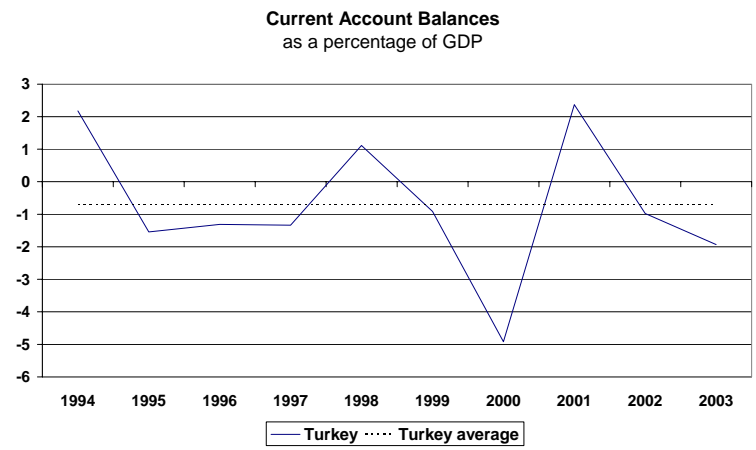
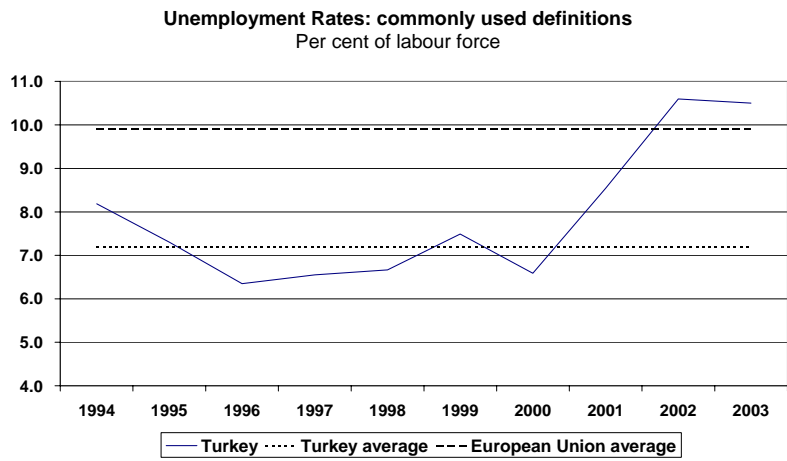
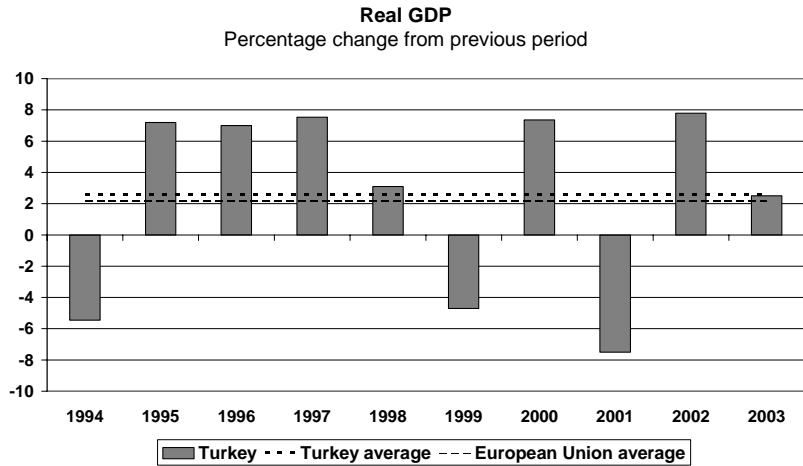


Figure 2.1. Main economic indicators (cont'd.)

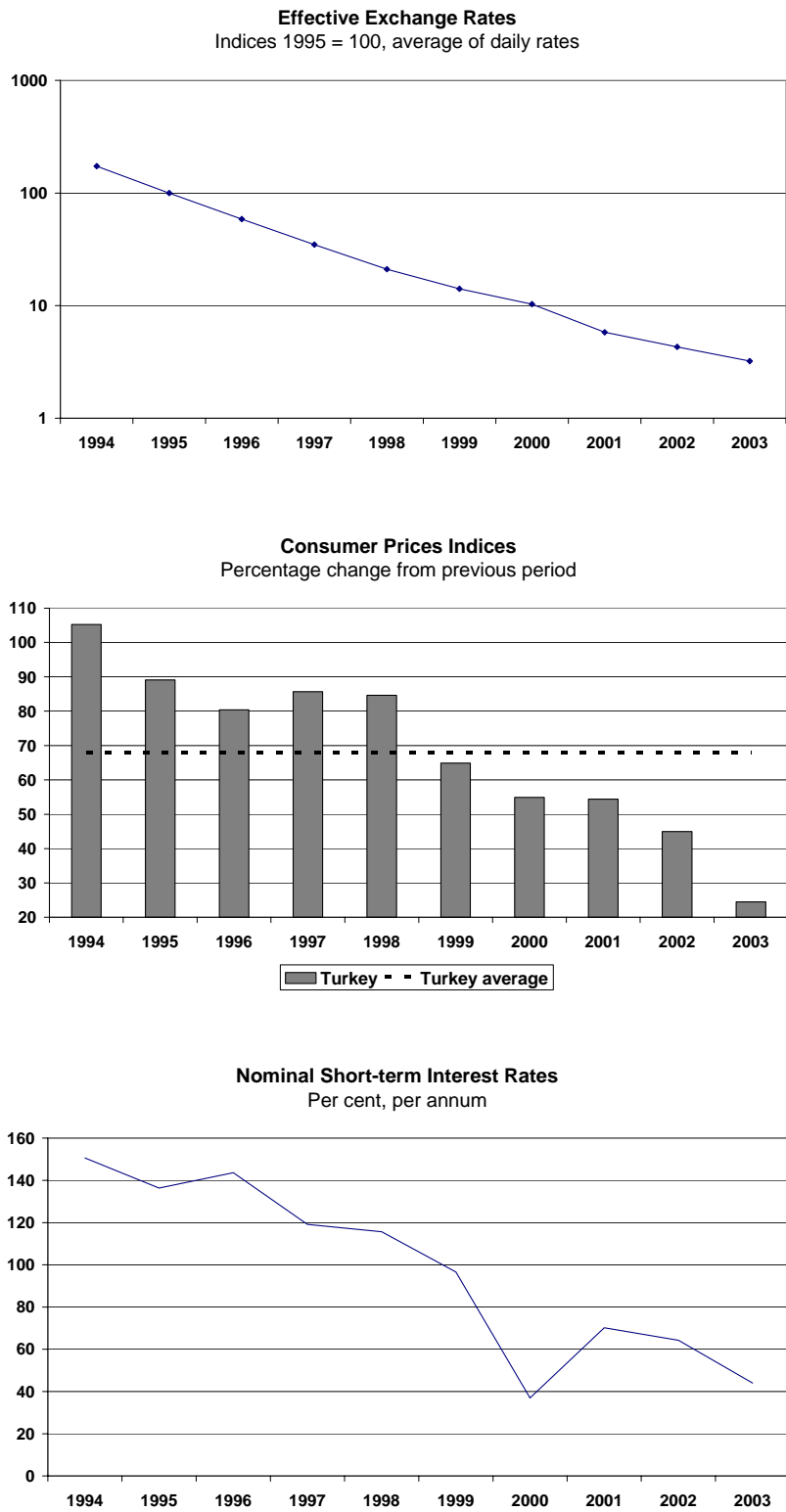
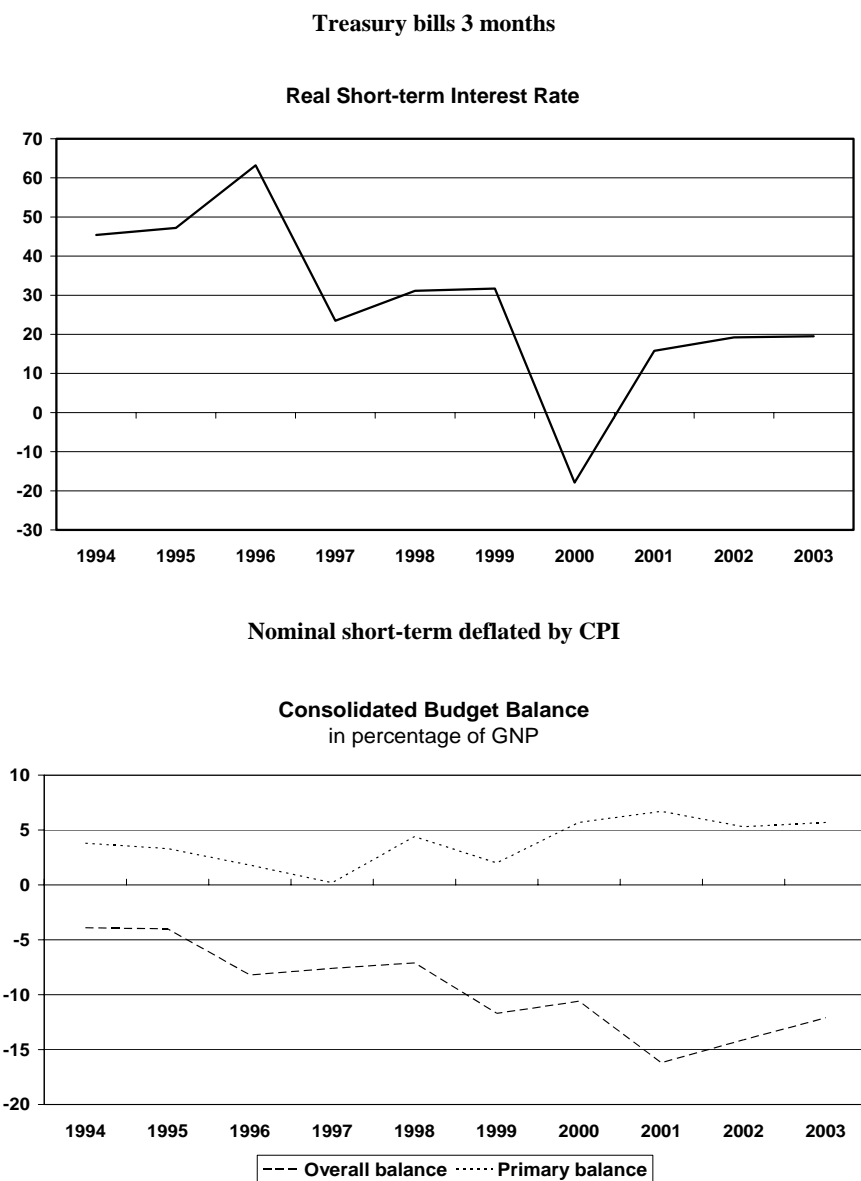


Figure 2.1. Main economic indicators (cont'd.)



Source: OECD.

The financial and banking crises of late 2000 and early 2001 had direct and indirect adverse effects on SMEs. The crises were triggered by the financial problems of small and medium-sized banks that had funded their long-term investments with short-term borrowings, assuming that interest rates would decline. However, the swelling current account deficit and delays in the privatisation scheme prompted a rise in rates, forcing these banks to sell their government debt and triggering a crisis of confidence in the entire banking system and among foreign investors. This led to a cash crunch, large rises in interest rates and a drop in lending to the economy. The volume of credit to the private sector shrank by nearly 15% in real terms between early 2001 and mid-2002.

Further operating to the detriment of SMEs was the tendency of the biggest banks to give priority to large firms, with which they tended to have cross shareholdings, while small and medium-sized banks had links to their own established networks of customers. As a partial remedy, the government intervened to assist small businesses, including those in the agricultural, construction and SME sectors, through public banks (the Halk Bank for SMEs), which offered unhedged subsidised loans. These quasi-budget transactions resulted in heavy losses for the public banks, thereby aggravating the problems of the financial sector.

The Turkish financial sector started on the road to major reform in 1999, when new banking legislation was enacted. Its primary objective was to align the regulatory and supervisory regime of Turkish banks with international standards. This legislation created a new independent regulatory body – the Banking Regulation and Supervision Agency – which took over the supervisory missions previously exercised by the central bank and by the Treasury. Among the aims of this law and the implementing decrees and amendments that immediately followed were to:

- Expand the authority of the Banking Council in respect of bank licensing and decisions regarding the takeover of failed banks.
- Strengthen the prudential system, especially as regards rules for loan loss provisions and establishment of the various banking ratios on a consolidated basis.
- Increase the personal liability of bank shareholders and officers in the event of mismanagement or misuse of bank assets.
- Align deposit guarantees on European standards.
- Require banks to set up internal control and risk management systems.

Because of the financial crisis of 2001, banking sector rehabilitation was speeded up (see Box 1). The Banking Sector Reconstruction Programme was launched in May 2001 with three main objectives:

- To restructure, reorganise and privatise public banks.
- To effect a rapid closure or restructuring of the banks administered by the Saving Deposit Insurance Fund.
- To reinforce the private banking sector.

To meet these objectives, a new banking law entered into force at the end of May 2001. A new Central Bank Law was also enacted at the same time, assigning the central bank the major objective of ensuring price stability, while bolstering its independence.

Box 1. Bank sector restructuring

The banking system underwent substantial development in the 1990s, with rapid increases in the number of establishments, the amount of their assets and their profits. Nevertheless, the transformation was marred by major problems. Many small banks, whose essential role was to finance the non-bank activities of the groups that owned them, were not very profitable because of their size. The state-owned banks accumulated losses because of their service obligations (“duty losses”), and in general the banking system was highly dependent on the wide spread between the lending and deposit rates. The cash crunches of November 2000 and February 2001, and the ensuing recession, exacerbated the banking system’s imbalances and prompted the authorities to put nine banks under the control of the Saving Deposit Insurance Fund (TMSF).¹⁵ In May 2001 the state-owned banks and banks supervised by the TMSF were shored up by the floatation of Treasury securities in an amount equivalent to 31% of GDP, thus increasing the public debt. To preclude the emergence of any new losses, the subsidised loans granted by the state-owned banks will have to be financed from the budget and no longer through duty losses. Moreover, the deposit rates offered by the state-owned banks and TMSF banks will be capped at a level below those paid on Treasury bills, thus eliminating unfair competition with private banks. In addition, measures were taken to bolster the balance sheets of public banks and make them more transparent. An operational restructuring of those banks was undertaken as well, cutting jobs by about 37% between 1999 and 2002 and reducing the number of branch offices by 28%, inter alia by closing Emlak Bank, whose assets and liabilities were transferred to Ziraat Bank. Banks administered by the TMSF also underwent extensive reorganisations that cut their staff and branch offices by more than half. Private banks also embarked on a process of reform. A bank recapitalisation plan was announced in February 2002, covering 26 of the leading private banks (after a strict audit of their positions). Moreover, the prudential regime for banks was strengthened, their short-term foreign currency positions were limited to 20% of their capital, and banks were required to do more to diversify their credit risks. Programmes to restore risk coverage ratios through injections of equity were largely completed.

The banking system was partially consolidated and its losses capitalised, with the banks’ own risks and risky loans scaled back. Open positions in foreign currencies were transferred to the government and kept at a low level. One of the objectives of the restructuring was to establish a core of increasingly efficient and profitable banks around which smaller banks would continue to operate with rehabilitated balance sheets and management.

Initially, the reform of the banking and financial system had adverse consequences for SMEs. In the wake of the measures to end Treasury financing of duty losses on subsidised loans to tradesmen, artisans and start-ups by specialised public banks (Ziraat Bank and the Halk Bank) – loans that benefited SMEs – the banks imposed retroactive and unilateral interest rate increases that triggered repayment difficulties and a sharp drop in the volume and use of available credit.

In 2002, in conjunction with the economic reform programme and an economic recovery, banks began to introduce special loan programmes for SMEs on more favourable terms. The reduction of demand for funds by the public sector may induce banks to seek more business by lending to the private sector, which should benefit SMEs. It is important that competition between lending institutions bring interest rates down.

A voluntary business debt restructuring programme was launched in May 2002 by the Banks Association of Turkey and the leading industrial groups. This so-called “Istanbul Approach” programme concerned 304 businesses, 96 of which were medium-sized enterprises (100-250 workers), and restructuring agreements were concluded with 66 of the medium-sized firms employing a combined total of over 10 000.

Despite the restructuring under way, the financial sector does not seem to be fully meeting the needs of SMEs. While banks have begun to introduce activities aimed at small businesses, the firms in question still feel that they have great difficulty in obtaining resources on reasonable terms. In the short term, this leads to demands to compensate by providing additional resources to the Credit Guarantee Fund (see below) in order to make it fully operational. Over the longer term, it is necessary to develop the non-bank parts of the financial sector so that the system is more able to provide risk capital to a wider range of borrowers.¹⁶

Public sector reform

Despite the opening up of the Turkish economy since the early 1980s, the public sector has continued to play a major role in economic life. State intervention, dating back to long before the 1980s, has taken the form of protection of a large number of economic sectors, in particular through a far-reaching redistribution policy, the economic and social objectives of which have not always been well defined or coherent. The direct interventions of the state in the private economy have had a serious negative effect on private initiative and the dynamics of competitive markets. Since inadequate attention has often been given to the financing of these interventions, the state has been the major source of the Turkish economy's macroeconomic and financial instability.

Turkey's efforts over the past 20 years to open up its economy to international competition, in respect of both the goods and services market and the financial market, have not been accompanied by radical reform of its public sector institutions. Two types of institutions – public economic enterprises (KITs) and state banks – have been used to carry out redistributive activities, for the most part without budget financing, thereby risking their competitive position as the economy opens to international competition. At the same time, the state has made use of off-budget funds not subject to parliamentary review (full guarantees for foreign loans to public enterprises, repayment of non-negotiable debts of banks or public enterprises and duty losses,¹⁷ and revolving funds). Despite its active role in the economy, the public sector has been unable to deliver its economic policy objective of increasing per capita income and wealth, in particular by raising participation rates and cutting unemployment. Its efforts have worked against the development of a large SME sector that is competitive on national and international markets and able to create new products and develop new markets.

Between 1999 and 2000, the government undertook a structural reform of the public sector. The main goals of the reform were to:

- Increase the decentralisation of the public sector by bolstering the financial autonomy of local authorities.
- Enhance the transparency and efficiency of the budget process by eliminating duty losses and reducing off-budget and revolving funds.
- Strengthen governance in the public sector, increase transparency and cut back on overstaffing.

Taxation is an important area in which public sector reform affects SMEs. Measures have been implemented to broaden the tax base and to ensure that taxes are collected more effectively. This involved expanding the use of tax identification numbers in real estate transactions and banking and financial activities. The aims of the measure were to reduce tax evasion and unreported activities by computerising tax offices, introducing

management information systems, setting up regional information and audit centres and establishing a system to track unpaid taxes.

These various measures ought to simplify SMEs' dealings with the tax authorities. The Income Tax Law introduced a number of simplifications into the dealings between taxpayers and government. As part of the effort to improve the business environment of which SMEs constitute a part, a law enacted in April 2003 considerably simplified tax procedures so as to encourage investment. The investment incentive system has been simplified and some of the tax-based incentive measures have been incorporated into the general tax system. In this context, the investment allowance, which was previously one of the incentive measures, is currently provided automatically at a rate of 40% to all investors who purchase or produce fixed assets with a value of over TRY 5 billion used in production and subject to depreciation. As a result, the obligation to have an incentive certificate to benefit from exemption from certain taxes, duties and fees was also abolished from 1 January 2004 (Table 2.1).

Table 2.1. Distribution of SME incentive certificates by year

EUR thousands (for columns 2 through 5)

Year	(1) Number of SMEs	(2) Investment loans	(3) Operation loans	(4) Total loans	(5) Fixed investment	(6) Number of employees
1997	1 155	91 647	18 375	110 022	175 770	14 974
1998	1 171	53 588	13 270	66 859	114 159	12 117
1999	1 695	57 786	37 786	95 573	130 681	10 222
2000	1 229	37 757	26 242	63 999	85 479	5 587
2001	246	4 253	3 223	7 477	14 026	674
2002	390	14 188	5 552	19 740	46 418	1 498
2003	147	5 918	2 041	7 961	19 681	517
Total	6 428	265 141	106 492	371 633	586 218	45 589

Note: The supply of certificates was severely affected by macroeconomic situation. Following the crises of 2000 and 2001, the number of participating firms decreased significantly. The program reached very few SMEs even in the years with larger loan totals.

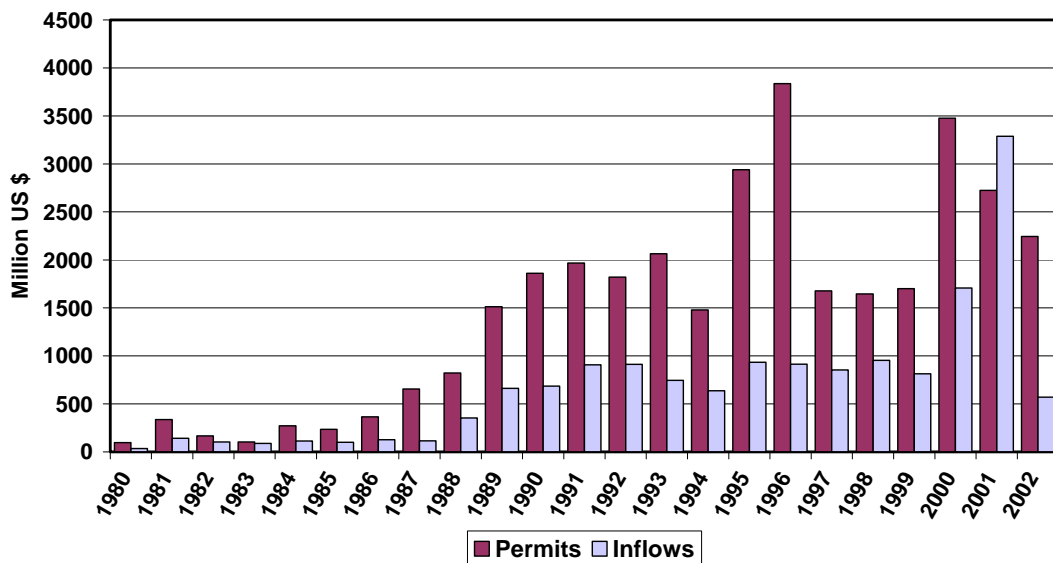
For SMEs to prosper in a favourable business environment, public sector reform must continue. The programme of privatisation of state-owned enterprises should be reinforced to relieve the state of its role as entrepreneur and to reorient its resources and activities in the economy towards its supervisory and regulatory roles. Tax reform, by further broadening the base, should continue to reduce some of the distortions introduced by the recent budget tightening which, given the size of the informal sector, have adversely affected many SMEs. While budgetary restraint will be key to consolidating public finances, it will be important to protect priority areas such as education, health and important investments in infrastructure. Achieving this will require rigorous evaluation of all public expenditure programmes, including support for SMEs.

Creating a climate more conducive to investment

Further rapid development of the Turkish economy requires high levels of investment. This is likely to require the availability of financial resources from outside the financial system. It is also desirable that new investment should be accompanied by advanced technology and modern know-how. This is one reason why Turkey should

encourage substantial inflows of foreign direct investment (FDI). A second reason is that building links with large foreign enterprises often offers opportunities for indirect exports, by finding a niche in the global value chain of production while leaving marketing to large enterprises. This is often the most effective way for SMEs to access global markets. In Turkey, however, FDI inflows, measured as a percentage of GDP, are relatively low (between 1992 and 2002, FDI averaged USD 990 million a year, or about 0.5% of GDP, compared to an average of 2-5% in EU accession countries) and tend to be less than the authorisations granted.

Figure 2.2. Foreign direct investments in Turkey



Source: Undersecretariat of the Treasury.

While unstable political and macroeconomic climates may have contributed to the weakness of FDI, a degree of discrimination against foreign firms, difficult bureaucratic procedures and an unfavourable legal environment have also been obstacles. However, a law liberalising the legislation on foreign investment, which should substantially improve the situation, entered into force in June 2003. This law defines FDI and foreign investors according to international standards (a natural person of foreign nationality or a Turkish national residing abroad, or a foreign legal entity or institution making a direct investment in Turkey). Foreign investment is defined as the creation of a new company or an affiliate of a foreign company, or the acquisition of an existing firm, either directly or via the equity market if the amount involved is equal to at least 10% of the shares or voting rights. This law repeals the prior obligation to obtain a permit from the General Directorate of Foreign Investments. Henceforth, foreign investors are treated like Turkish investors. They are guaranteed against expropriation and may freely transfer profits or dividends, and sell or liquidate all or part of their investments, licensing rights, etc. Foreign investors established and registered in compliance with the Turkish Code of Commerce may purchase property, subject to the same rules as Turkish nationals. Lastly, foreign staff may be employed by foreign firms. The Undersecretariat of Treasury compiles data on foreign investment and the relevant policies. Over time, these more

favourable conditions will create – once experience has been accumulated and markets are convinced that access is in fact easier – a good climate for much greater international investment, not least in competitive medium-sized enterprises, probably with strong employment effects.

The general scheme of investment assistance implemented by the Undersecretariat of Treasury works identically for local enterprises and for foreign ones. Specific elements vary depending on the location and size of the firm as well as the nature of the investment. Location criteria define three categories: developed regions, first-priority development regions and normal regions. Investment assistance takes a variety of forms: exemptions from customs duty, VAT exemption for machinery and equipment imported or purchased on the domestic market, and credit allocation from the budget. The “investment allowance”, which is the type of assistance most appreciated by businesses, and the “exemption from certain taxes, duties and fees” were previously among the incentive measures offered under the General Investment Encouragement System. The investment allowance, which is a form of corporate tax deduction, has been automatically available since April 2003 and the exemption from certain taxes, duties and fees, which are levied on transactions relating to the process of obtaining investment credits through banks, has been available automatically since January 2004 and thus no longer carries the obligation to have an incentive certificate. Loans from the budget are aimed essentially at investments by SMEs, R&D, environmental protection, regional development and investments in priority technology areas and technology development zones. SMEs are eligible under all of the provisions of the investment encouragement programme and also benefit from a number of special measures, focused especially on technology investments (see Chapter 3).

The procedure for creating and registering new businesses was streamlined and accelerated in the wake of the new legislation adopted in June 2003. The previous procedure, which entailed 19 steps and a minimum of two and a half months, was replaced by three steps that can be accomplished in one day by submitting a file to the business registry after the by-laws have been recorded. The other formalities (publishing the by-laws in the *Business Registry Gazette* and filing with the municipal or tax authorities) can be dealt with later.

Labour market

SMEs are directly concerned by all policies and regulations affecting the labour market. Measures to raise activity rates, enhance human capital or expand the formal sector without sacrificing flexibility directly impact SMEs. Given the relative importance of SME employment, changes specific to the SME sector have immediate repercussions on the labour market. Overall, the Turkish labour market has positive features for employers. It offers SMEs comparatively low labour costs and relatively little wage rigidity, the latter enhanced considerably by the existence of a large informal sector. While it is difficult to measure average working time because of the extent of the informal sector, it is estimated to be quite high, at about 2 300-2 400 hours a year, compared to an average of 1 650 hours in the European Union.

In contrast, employment and labour force activity rates are low, but a healthy SME sector should improve the situation. Activity rates are around 75% for men and 28% for women, for a combined average of 51.5%, versus nearly 70% on average for the OECD countries in 2002. The reported unemployment rate, which was about 6.5% in the latter half of the 1990s, spiked sharply with the 2000-01 crisis and settled at around 11% in

2003. Women's activity rate is very low, and they constitute the majority of unpaid workers. Indeed, more than 50% of women in employment (about 5.5 million) are unpaid family workers, mostly in the agricultural sector (see Box 2). Self-employed women account for only 11.6% of working women, compared to 29.5% for men.

Box 2. Women and entrepreneurship in Turkey

Men account for 73% of the formal labour force and women for 26%. Women are less likely to work in the private sector (16%) and even less likely to be business owners in businesses with employees (3.4%). More than 50% of women in employment are unpaid family workers; most are in the agricultural sector. As a vocation for women in Turkey, entrepreneurship has been held back by factors such as a patriarchal society, traditional gender roles, lack of education and lack of experience in the labour force. For rural women, there are few role models or women entrepreneurs who can act as mentors for younger women attempting to begin a business. Women contemplating business ownership are also restrained by the same factors that impede male entrepreneurs, including lack of assets and lack of access to credit. Women entrepreneurs are more likely to be hindered by lack of education and work experience.

Turkey is committed to increasing entrepreneurial opportunities. This commitment should be expressly stated as a goal for women. Better data are needed to track the role of women in the economy, particularly to measure their changing role as Turkey's population continues to shift from a rural to a more urban setting. Research on the changing roles of women in the society should help to identify the variables that hold back women as entrepreneurs and help identify programmes and activities that can increase their role in business, innovation and entrepreneurship.

Better access to credit would clearly help women interested in entrepreneurship. Given that women-owned businesses are likely to be newer and smaller than businesses owned by men, some form of mini-loan programme focused on women might help to increase the number of women working as self-employed individuals (self-employment is the smallest form of entrepreneurship and a training ground for business owners) or as members of a business formed with other women. Examples of such loan programmes include the Grameen Bank in Bangladesh, and similar programmes throughout Latin America and the Caribbean. Similar models can also be found in the United States and in Canada.¹⁸ Support for the loan process and technical training for new women business owners about banking and about better business management are important. KOSGEB has shown a real ability to examine and adapt business support programmes to help Turkish entrepreneurs. An examination of mini- and micro-loan programmes around the world should lead to one or more models (one urban and one rural, for example) that can be used to support entrepreneurial opportunities for women in Turkey.

The discussion of loans highlights the need for complementary activities to help women become successful entrepreneurs. Better access to basic education, the introduction of entrepreneurship in the school curriculum as a vocation for both women and men, better information about successful women business owners, and better information about opportunities for business ownership can all be useful in helping women entrepreneurs. Many countries have introduced the concept of "mentoring" in which a successful woman business owner serves as an advisor to a new woman business owner. This type of outreach could easily be accommodated in KOSGEB or in TOBB or TESK. Establishing a women's commission in business associations, chambers of commerce and chambers of professions could also help with mentoring, and with bringing women's business issues to the attention of the government and the business community.

Labour market policy seeks to boost employment and reduce joblessness in a number of ways. Active policies are intended to help actual or potential workers to be better prepared for the long-term needs of a competitive economy, in both industry and services, by raising their skills, especially in the areas of technology and ICTs. In the short term, however, policies have been geared heavily either towards compensating for redundancies resulting from privatisation or offsetting the immediate effects of the crisis and restructuring through assistance in finding new jobs. Such programmes are administered through the Unemployment Insurance Fund or as part of the Privatisation Social Support project of the Turkish Employment Agency or KOSGEB.

In addition, action is being undertaken to improve the general conditions under which the labour market operates and to tailor legislation to ILO (International Labour Organisation) and European Union standards. These deal with part-time work, flexible working hours, institution of a workers' guarantee fund in the event an employer becomes insolvent, improved information for employees, and enhanced workplace safety and health. Laws are also being drafted to abolish the worst working conditions for children, regulate the work of children under 18 years of age and introduce fairer provisions for the payment of maternity leave.

Education policies

Given its demographic structure, Turkey has considerable human-capital potential, although one that is inadequately exploited because of the population's low level of education (Table 2.2). The weakness of the education system penalises the entire economy and feeds through to a low labour productivity rate. SMEs that require well-trained employees suffer particularly, as big companies can usually more easily attract workers with better education though higher salaries and better working conditions.

Turkey's need to create jobs for its new cohorts of young people prompted the government to introduce a major reform of the education system in 1997. The main goals of the programme were to extend the duration of compulsory schooling from five to eight years and to raise enrolment rates to 100% in primary school, 75% in secondary school and 37% in higher education by 2005. The programme also includes introduction of a school transport system in sparsely populated rural areas, along with free textbooks and meal subsidies for children from the poorest families. Its implementation has required a major financial effort, with budget outlays for education currently hovering around 4% of GDP, up from an average of 2.7% in the first half of the 1990s.

The programme encountered start-up and development difficulties, including quantitative and qualitative bottlenecks for teacher recruitment and a lack of classrooms. In addition, in the poorest rural regions, some 1 million youngsters aged 6-14 were working at the beginning of the 1990s. This reduced the school attendance of primary school pupils whose parents put the immediate benefits of this unpaid work ahead of longer-term prospects for higher living standards. In spite of these difficulties, the results have been very good, although Turkey's performance still remains well below the OECD country average.

In addition to boosting primary school attendance rates, Turkey must also improve and expand secondary education. The age group that began primary school at the time of the reform in 1997 will begin secondary school in 2005, the year in which the number of years of compulsory schooling is to be increased to 12. The authorities will thus be confronted with the arrival of a greater number of secondary and technical school

students and a lengthening of the time spent at school. In addition to the larger student population, the migration of populations from rural to urban areas necessitates an increase in construction of schools in cities. A special effort will also have to be made to train, recruit and manage teachers, both in the areas of general education and foreign languages and in the realm of vocational education in industry and services, more particularly in those geared towards information technologies.

Table 2.2. Indicators on education

Relative size of school-age population, 2000 <i>As a percentage of total population</i>			
	5-14	15-19	20-29
OECD mean	20	10	19
	13	7	15

Population having attained at least upper secondary education <i>Percentage by age group</i>			
	25-34	35-44	45-54
Turkey	30	24	19
OECD mean	74	69	60

Population having attained tertiary education <i>Percentage by age group</i>			
	25-34	35-44	45-54
OECD mean	10	8	9
	18	16	14

Illiterate population by sex, aged 15 and over (percentage)			
	Total	Males	Females
1990	22.1	10.8	33.5
2000	14.9	6.5	22
2002	13.9	6.0	22

Public expenditures on education as a percentage of GDP		
	1995	2000
Turkey	2.4	3.5
OECD mean	5.2	5.4

Source: OECD, *Education at a Glance*, 2003.

At the university level, tailoring supply to the demand for highly skilled workers also poses a problem. The ratio of university graduates to the total labour force rose from 5.7% to 7.3% between 1995 and 1999, and the corresponding ratio for secondary school graduates climbed from 12.6% to 13.2% over the same period. In addition to the effort to increase the number of graduates, qualitative adjustments to education in response to the economy's needs are necessary, in particular by increasing the number of university graduates in fields for which demand is greatest and the supply weakest (ICTs, machinery manufacturing, chemicals). In contrast, the traditional sectors of construction and agriculture record a significant excess of graduates in relation to potential demand.

Innovation policies

Innovation policies designed to facilitate the commercialisation of scientific and technological advances can benefit SMEs. In Turkey they were first initiated in the 1960s with the creation of the Scientific and Technical Research Council of Turkey (TÜBİTAK), the purpose of which was to prepare and co-ordinate implementation of science and technology policies in Turkey. Pro-innovation policies were developed during this period, despite frequent financial constraints. It was in 1983 that the government strongly emphasised the need to increase spending on R&D and to set priorities. That same year saw the creation of the Supreme Council for Science and Technology (BTYK), chaired by the Prime Minister, with TÜBİTAK serving as secretariat. The main orientations of science and technology policies were defined in a series of documents prepared in the 1990s,¹⁹ which led *inter alia* to the introduction of the national innovation system to put in place the resources and institutions needed to develop activities in the area of science and technological research and to apply the findings to economic activity. In 1997, BTYK put the emphasis on original innovation systems, their dissemination, stimulation of innovation activities and supplying support for the innovation activities of SMEs.

In conjunction with preparation of the 8th Five-year Development Plan (2002-05), the specialised science and technology committee formulated a major programme for implementing innovation policies over the period 2003-23, the Vision 2023 Project. The project seeks to enlist a broad spectrum of private and public organisations, universities and non-governmental organisations in its steering group. Four major themes will be the subject of special projects: the National Technology Foresight Project, the Technological Capabilities Project, the Researcher's Inventory Project and the National R&D Infrastructure Project. The findings of these four sub-projects will be used to frame Turkey's new science and technology policy.

The determination, preparation and implementation of innovation policies require the implication of a large number of public bodies and a handful of private ones. As noted above, the BTYK makes policy in the area of innovation; policy is formulated and proposed by TÜBİTAK. BTYK also formulates action programmes for policy implementation. Parliamentary committees and public bodies (the Undersecretariat of Treasury, the Undersecretariat of Foreign Trade, the State Planning Organisation, and KOSGEB in respect of SMEs) are also involved in policy implementation. Government agencies are in charge of implementing innovation policies through financial support, training, consultations, etc. Regional private and public organisations and networks and partnerships also help put government decisions in the realm of innovation into practice.

The main government programmes of direct financial support for industrial R&D projects are carried out by the Technology Development Foundation of Turkey (TTGV) for long-term subsidised loans, for example and by the Technology Monitoring and Evaluation Board, located within TÜBİTAK (TÜBİTAK-TİDEB), for subsidies. SMEs account for 73% of firms receiving project support from TTGV and for 70% of TÜBİTAK-TİDEB's portfolio. TTGV is a non-profit association whose mission is to distribute World Bank funds allocated by the Treasury to finance R&D, and it assumes the credit risk involved. The funds at TÜBİTAK's disposal to finance R&D projects are provided by the Undersecretariat of Foreign Trade and are part of the budget. Funds to support the technological development of SMEs are distributed by the Ministry of Industry and Trade via KOSGEB. The total amount of these funds is set annually in the budget.

Competition policy

The desire to scale back the state's role in the economy, particularly in connection with privatisation, and the forging of ties with the European Union, have prompted the Turkish government to implement policies to promote competition. Adoption of the *acquis communautaire* has played an important role in the development of these policies. The Law on the Protection of Competition, which is inspired by provisions of the European Union treaty, was adopted in 1994. The competition authority, set up in 1997, plays a very important role in ensuring and promoting open, competition-oriented markets. It is also involved in the privatisation process, especially as regards the regulation of network industries.

Because they are so numerous, small in size and dispersed throughout the country, SMEs are not directly affected by the Law on Competition. However, it is of utmost importance for the viability of SMEs to safeguard against monopolistic tendencies and to ensure a high level of competition in all markets. Implementation of competition policies therefore has a beneficial impact on SMEs, as well as on the economy as a whole, by ensuring that the market works more effectively. Making it illegal to enter into anti-competitive agreements, form cartels or abuse dominant positions protects the public interest and thus the interests of SMEs. The reforms introduced or envisaged – especially in the ground transport sector (opening up to international competition) and telecommunications (in which regulations still in effect already give great importance to market forces) – can only strengthen the environment in which SMEs operate. In the financial sector, however, the granting of subsidised loans or loan guarantees to SMEs could be considered to hinder competition, even though the measures are intended to rectify the market's inadequacies vis-à-vis SMEs.

Chapter 3

SME-SPECIFIC POLICIES

A large number of public bodies are involved in framing and implementing SME-specific policies.

- The Undersecretariat of State Planning Organisation (SPO) formulates long-term development programmes as well as annual programmes that include policies for SMEs. It performs a co-ordination function between public and private bodies in order to implement these policies as effectively as possible. It also oversees policy supervision and makes adjustments if necessary.
- The Ministry of Industry and Trade is the primary authority for defining SME policies and implements policy through its associate body, KOSGEB. KOSGEB, whose role is to implement SME policies with the aim of supporting their growth and development in Turkey, carries out the necessary development and support programmes for the following functions: developing SMEs' technological skills, improving their training and information levels, providing appropriate financial mechanisms and improving their managerial infrastructure.
- The Undersecretariat of Treasury is responsible for state aid to SMEs' investments, while the Undersecretariat of Foreign Trade helps deploy programmes to foster the creation of SMEs.
- Business organisations such as the Union of Chambers of Commerce, Industry, Maritime Trade and Commodity Exchanges of Turkey (TOBB) and the Confederation of Tradesmen and Artisans of Turkey (TESK) also play an important role in implementing these policies.
- Financial bodies lend support in the form of loans and guarantees to SMEs. They include the Halk Bank, the Union of Credit and Guarantee Cooperatives for Tradesmen and Artisans of Turkey (TESKOMB) and the Credit Guarantee Fund, Inc. (KGF). Other institutions provide SMEs with support and services in the areas of technology, scientific and technical research, etc.²⁰

The general framework and the core context for integrating Turkey's pro-SME policies into an international framework can be found in the programmes and objectives described below.

BEST Programme

Following up on the recommendations of the report by the Business Environment Simplification Taskforce (BEST) set up at the Amsterdam European Council in June 1997, the European Union instituted an action plan to foster SME entrepreneurship and competitiveness. This action plan, in which Turkey has taken part in its capacity as an aspiring member, is based on the sharing of best practices among countries and has been deployed in the areas of education and training, access to capital, visibility of support services, public administration, and employment and working conditions.

European Charter for Small Enterprises

In 2000, the European Council meeting in Feira, Portugal, approved a European Charter for SMEs which sets forth both the reasons why such firms should be considered especially important and the reasons why the Council is determined to assist them. Turkey and the other applicant countries subscribed to the Charter at the April 2002 conference in Maribor. It extends to ten areas covering almost the entirety of actions to be undertaken in connection with a medium-to-long-term SME development strategy: education and training for entrepreneurs; facilitation of the start-up process; better legislation and regulation; skills training; improving online access; getting more out of the single market; improvements in taxation and financial matters; boosting SMEs' capacity for innovation and technology; support for e-business and technology firms; and stronger, more effective representation of SMEs' interests at national and international events. By adopting the Charter, which they consider the foundation of their long-term strategy for SMEs, the Turkish authorities pledged to take concrete steps to develop programmes and projects in the areas concerned and to provide the necessary funding. The policies implemented and results obtained in the areas covered by the Charter are reviewed in annual reports.

Multi-annual Programme for Enterprise and Entrepreneurship and in Particular for Small and Medium-sized Enterprises (2001-05)

This programme calls for an array of measures in the areas specified in the Charter for Small Enterprises. KOSGEB co-ordinates Turkey's participation in the Community programme, which is the first in which Turkey has taken part, for approximately EUR 4.5 million. Within this multi-annual programme, Turkey's priorities are the following areas of action:

- Sharing of experience, creating synergy among bodies that promote SMEs, fostering co-operation between institutions, harnessing dormant resources and steering them towards areas in which they are needed.
- Emphasis on internationalisation of policies and European strategies.
- Establishment of 12 Euro Info Centres.
- Study of SME support policies, projects, best practices and successful solutions within the European Union in order to acquire know-how in this area.

Under the programme, Turkey aims to learn about and rapidly deploy the financial instruments and mechanisms – relating to seed capital, venture capital, guaranteed loans and “business angels” – developed by the European Union to support knowledge- and technology-based and innovative businesses.

Objectives of the Lisbon summit

In order to achieve the major growth objectives for 2010 that were set at the March 2000 Lisbon summit in respect of income, productivity and employment, a strategy was formulated, one of whose goals was to create an environment conducive to the creation and growth of innovative businesses, and especially SMEs, through specific measures set forth in the European Charter for Small Enterprises, to which Turkey subscribed.

Bologna Charter

As an OECD member country, Turkey signed in June 2000 the Bologna Charter on policies for SMEs, in which it agreed with the other signatory countries “to work together and within international organisations to improve the complementarity of bilateral and multilateral initiatives to foster global SME partnerships and enhance the availability of financial and non-financial instruments to promote SME development”.

As part of the SME support process, an SME Strategy and Action Plan was adopted following the decision of the High Planning Council on 10 November 2003. The Plan must be taken into consideration as support strategies are formulated. The implementation of the Plan, which was prepared within the framework of pre-accession, is one of the priorities of the Small and Medium Enterprise Chapter of the 2003 Turkish National Programme for the adoption of the EU *acquis*. The Plan was prepared by the “SME Study Group” which is composed of organisations which set out the essential strategies for SMEs. The purpose of the Plan was to state the framework of existing policies and programmes clearly and to identify the activities that fall within their scope; to express clearly the respective responsibilities of public and private organisations; and to identify a set of required actions and projects. While the SME Strategy and Action Plan concerns the long term, a specific Action Plan covers the period 2004-06. To help with its implementation, a Consultative Committee has been envisaged that would involve private-sector representatives working with the State Planning Organisation (SPO) to monitor and evaluate the Action Plan. All of the activities and programmes discussed below are part of the Action Plan.

In line with the general approach to EU SME policy, Turkish SME policy is better seen as industrial development policy. The general goal of the Turkish government is to raise productivity in the SME industrial sector. This goal is to be accomplished through various mechanisms, including an increase in the share of total credit (both public and private) going to SMEs; an increase in the level of technology used by SMEs; and an increase in the quality of products produced by SMEs. The government has instituted many programmes to support these policy goals.

Several other factors affect the likely success of the Turkish government’s approach to supporting SMEs, which presumes that the government can identify those sectors of the industrial economy that will be successful in responding to increasing competition from SMEs in the European Union. The marketplace will ultimately determine which industrial sectors are most adaptable, however, and it is not certain that the sectors chosen for support by the Turkish government will be the sectors chosen by the marketplace. The government’s relatively significant support to relatively few businesses also presumes that the government can identify the businesses most likely to succeed when given support. It appears that KOSGEB, the agency that runs or supervises many of the government’s complex programmes, does use competitive tests to determine which firms are to be given access to support. This should minimise the selection problem.

In view of the very small average size of Turkey’s industrial SMEs as compared to those in the European Union, government support should be concentrated on firms with good prospects of surviving without longer-term support in national and international markets. Many very small firms may be limited to competing only in local markets where they may more easily survive. This is particularly true for those in remote and less industrialised regions that are less exposed to competition from abroad or from bigger domestic firms.

The government's approach also can be said to focus primarily on the supply side of the market rather than the demand side. This is frequently the case for government programmes. Once the weaknesses of SMEs are identified, it seems sensible to focus resources on overcoming weaknesses or deficiencies by supplying more of the resources that will help SMEs to do so. The implicit presumption in this approach is that there is a demand for such resources and that SMEs will take advantage of the enhanced supply of government services. One question for KOSGEB, the government's leading supplier of support activities, is why the services being supplied by the government are not more readily available in the private sector.

Government financial support for SMEs

Government financial support for SMEs is based on the presumption that capital markets cannot serve the needs of smaller enterprises without government intervention. The inability to provide smaller firms with access to credit is primarily due to the effects of the fiscal policy that has resulted in recent years in severe budget deficits, expansion of the money supply and inflation. In this situation, banks have chosen to invest primarily in government debt which pays high real rates of return. The loanable funds available after investing in government debt go primarily to larger businesses. Turkish officials estimate that less than 5% of loanable funds are made available to industrial SMEs. To expand the amount of credit available to SMEs, the Treasury has made funds available to several banks (primarily Halk Bank and the Industrial Development Bank, but several other banks have now been added). Loan parameters are established by agreement with the banks, but the banks underwrite the loans and take responsibility for defaults. The fiscal crises in 2000 and 2001 resulted in an increase in defaults on loans (12% of loans in 2002, compared to a normal rate of about 5%). To keep the banks operating, large transfers of funds from the government budget were required. The Halk Bank has been forced to retrench (reducing from around 800 branches to 550) and is being prepared for privatisation. KOSGEB has signed protocols with two public banks, Vakıfbank and Halk Bank, to supply soft loans to SMEs in order to resolve their short-term cash-flow problems. The loans are accorded by banks, but the enterprises' applications are approved by KOSGEB. Under these protocols, 1 605 enterprises received a total of EUR 70 million, which is a small share of overall bank loans.

The government also provides support in the form of repayable subsidies directly to industrial SMEs participating in the IGEM and TEKMER centers operated by KOSGEB. These subsidies are mainly used for investment in equipment and technology. So long as these subsidies are repaid their budgetary cost is limited to the interest cost of financing them until this occurs.

The government provides extensive loans for the establishment of small industrial estates (SSIE) or organised industrial zones. Roughly two-thirds of the industrial estates are privately funded, but the government continues to provide funds for new ones, despite what appears to be significant excess capacity in many existing estates. The government may believe that demand for space in such estates will increase rapidly, particularly if Turkey is admitted to the European Union. Building large industrial estates requires both money and time. The government's support may seek to ensure that delays in this area do not become a constraint on more rapid growth.

Exemptions are provided to SMEs for investment in machinery and equipment. In this context, the investment allowance that was previously one of the measures in the investment incentive system implemented by the Undersecretariat of the Treasury

(Table 3.1), is currently provided automatically at a rate of 40% to all investors who purchase or produce fixed assets used in production and subject to depreciation with a value of more than TRY 5 billion. SMEs that fall within the scope of the State Aid Programme to SME Investments, which is implemented by the Undersecretariat of the Treasury, can also receive an exemption from certain import duties and from payment of value-added taxes on investments in equipment. Because these tax offsets lower government tax receipts, they create a conflict with the general goal of balancing government expenditures against tax receipts. Larger businesses are also eligible for some of the same types of tax relief, so SME sector does not receive preferential treatment as a result of this programme.

Strategic issues in government financial support for SMEs

The government faces a major strategic decision with respect to the financing of SMEs. Much of its current financing policy is based on market failures or on a bias introduced by the weaknesses in government fiscal and monetary policy. As efforts continue to control government expenditures and reduce inflation rates, the government will be obliged to limit further its current SME financing programmes to reach its goal of balancing the budget. This may make it difficult for a number of SMEs to maintain sound balance sheets, but at the same time the banking sector should start to act as a major supplier of loans to SMEs. In addition, brighter growth prospects resulting from more stable economic policies may also improve the business situation of many SMEs.

The government must also decide what programmatic activities are needed to complete the structural changes introduced in the banking sector in recent years. Banks are now more closely supervised and are held to stricter standards regarding reserve requirements and other operating ratios. However, most banks have had little experience in working with smaller businesses and are unfamiliar with the problems associated with underwriting small business loans. The government could improve the SME lending market through training of both bank loan officers and SME owners regarding principles for lending to SMEs. Business owners must be taught how to prepare a good financial plan and how to submit a loan request to (one or more) banks. Bankers must learn to evaluate SME loan requests by understanding the differences between small and large enterprises in a given industry. Smaller enterprises will generally not have either the collateral or cash flow of their larger competitors, and they will be more dependent on the management skills of the enterprise owner. Banks can learn to deal with these differences. Good examples of the special skills and knowledge needed for bank lending to SMEs are available in both Europe and North America. It is recommended that KOSGEB should assign high priority to reviewing successful SME lending models as a basis for the design and implementation of a major training activity in support of both banks and SMEs.

The government could consider developing an expanded loan guarantee programme based on the model supported by the World Bank and the German Development Programme. This guarantee programme appears to be effective because the Board of the Credit Guarantee Fund subjects the loan packages submitted by banks to thorough due diligence. Banks soon learn the standards necessary to ensure that a guarantee is forthcoming. This discipline helps to train bank loan officers to provide their own effective due diligence review of loan applications. With careful oversight, better loans are made, and there is little draw against the guarantee fund. Small fees can be charged to firms receiving guarantees, and these fees may be sufficient to keep the guarantee fund from being depleted.²¹

Very small businesses in many countries find it extremely difficult to obtain small loans for start-up purposes or for early-stage expansion of their businesses. Banks note correctly that the transactions costs associated with reviewing a very small loan request mean that the bank cannot make money even if the loan is successfully repaid. One method for overcoming this problem has been used in the United States to support the growing number of women entrepreneurs starting businesses. This mini-loan programme provides participating banks with a supply of funds to be loaned and pays banks a fee that covers the time and expenses related to making a small loan. Loans are made at market interest rates or at slightly higher rates (usually not more than 3% above the competitive market rate for private loans). As loans are paid off, banks are allowed to lend the money again. Women business owners were originally allowed to borrow up to USD 20 000 using this type of loan. SBA has also provided similar support for loans up to USD 50 000 or USD 100 000 in some cases. One of these programmes allows banks to make loans with low levels of documentation to customers that have had an ongoing relation with the bank. These low-documentation loans are popular with both banks and SMEs.

Business start-up processes

Plans to improve business start-up processes include several areas of proposed activity. For the most part the proposed activities are logical extensions of programmes already organised and implemented by KOSGEB, with support primarily from the Confederation of Turkish Tradesmen and Craftsmen (TESK) and the Union of Chambers of Commerce, Industry, Maritime Trade and Commodity Exchanges of Turkey (TOBB). The proposed activities are described below.

Employment and recruitment

Employment support programmes are operated by KOSGEB through the 28 Enterprise Development Centres (IGEM) and 11 Technology Development Centres (TEKMER).²² Both the IGEM and TEKMER centres provide a combination of technical and managerial assistance, including counselling regarding the hiring of employees with the special skills needed to increase capacity in the businesses operated in co-operation with the centres. Funds are provided to cover partial reimbursement of skilled personnel for periods ranging from 12 to 18 months. The support covers approximately 70% of salary costs in the developed regions of Turkey. Enterprises in less developed regions receive support for 80% or 90% of salary costs.

Employment assistance is only one of many services provided by TEKMER centres. They also provide financial support for equipment purchase and the purchase of materials, access to services (*e.g.* testing), technical, financial and managerial consulting assistance, information services, training programmes and acquisition of software for R&D activities of technology-based companies. Since employment support is only one aspect of a complex subsidy and support system, it is difficult to establish how useful employment support is for SMEs which benefit from it. Company interest in employment support is clear, but there is little evidence to indicate how well the employees hired are utilised. The fact that more than half of the workers supported through this activity appear to stay with the companies after support ends indicates that many of the workers are useful in the longer term.

KOSGEB has straightforward regulations regarding maximum salaries to be paid under the programme, and the programme appears to be well administered by the centres.

Table 3.1. Firms supported by the Enterprise Development Centres and the Technology Development Centres 2002

Type of support	Number of firms supported
IGEM	
Consulting services	2 928
Laboratory services	6 472
Training	5 870
Quality improvement	224
Other project support	4 175
TEKMER	
R&D support	140

Source: Undersecretariat of Foreign Trade.

Supporting new start-ups

KOSGEB also has several programmes to support entrepreneurs with new start-ups. The general goals of these programmes include informing entrepreneurs about the investment environment, providing sector-based plans and market research, and help with business planning and the strategic approach to business growth and development. Much of this information is provided through KOSGEB centres, including the IGEM and TKEMER centres. The centres also provide financial incentives to encourage entrepreneurial start-ups. These incentives may include up to the equivalent of EUR 10 000 in Turkish lira for support of both fixed investment and operating expenses. Capital provided for fixed investment (up to EUR 8 000) must be paid back, while capital for operating expenses (up to EUR 2 000) does not have to be repaid. More extensive support is provided to technology start-ups, with up to 85% of costs (up to EUR 70 000) for production of materials, equipment and prototype products. If prototyping is completed and KOSGEB believes that the product can be produced successfully, KOSGEB may provide up to an additional EUR 30 000 for the hardware needed to ensure quality production. Programme support must be paid back over a four-year period, usually with a one-year grace period and partial payments over the following three years. Start-ups in developed regions are expected to pay back more quickly, while firms in less developed areas are given longer grace periods and lower paybacks in early years. An additional amount (up to EUR 25 000) can be provided on a non-payback basis for counselling support, support for R&D applications and publishing of R&D findings, for leasing space in a technopark, and for export promotion purposes.

Another element of KOSGEB support for entrepreneurship is provided through KOSGEB's Centre for Entrepreneurship. This organisation provides information about entrepreneurship and about the range of potentially viable opportunities identified by market research which it has conducted or sponsored. These findings are disseminated through KOSGEB's network of IGEM and TEKMER centres and common use facilities and through the networks of small industrial estates and organised industrial zones.

Training for start-ups

KOSGEB also provides educational support to both new and existing firms. The general aim of the training programmes is to increase the international competitiveness of the enterprises that form the core of the economy. The training programmes are also intended to increase the supply of qualified personnel who are aware of and able to use and apply modern technology to the production process. The training is delivered under two types of training programmes. General educational programmes are produced and delivered through KOSGEB facilities and deal with basic managerial and technical issues. More specialised training is provided by a variety of public and private professional organisations on topics not included in KOSGEB courses. KOSGEB provides funding for 80% of the costs of general education programmes, and up to EUR 4 000 per firm for procurement of specialised training. The support ratio for such training varies by type of region; firms in developed regions are eligible for 70% coverage and firms in normal regions receive up to 80%. Firms in the least developed regions receive support for up to 90% of expenses. Prior to approving support, KOSGEB must determine that the specialised training is appropriate to the company's needs, and the training must meet criteria specified by KOSGEB. The Ministry of Education also provides vocational training (Table 3.2).

Table 3.2. Vocational courses of the Ministry of National Education, by year

Academic year	Number of provinces	Number of vocational training centres	Number of vocations	Number of students and trainees	Number of instructors
1996-97	80	312	80	196 591	4 089
1997-98	80	321	89	267 074	4 122
1998-99	80	326	89	226 644	4 759
1999-2000	80	330	89	218 576	5 084
2000-01	81	342	109	248 496	4 640
2001-02	81	345	109	250 000	5 165

Source: Ministry of National Education.

One-stop centres

A final element of the strategy for support of new start-ups is the proposed development of "one-stop centres" to provide information to both new and existing businesses. Information is the key word in this proposal. One-stop centres have been developed in other countries at many levels of government. They appear to have problems for carrying out bureaucratic actions, as these often require special knowledge (public health rules, building codes, etc.) that is located in more than one part of the bureaucracy. However, they have been found to be very effective at disseminating information about the bureaucratic processes that all businesses must deal with. In addition to information, the centres can provide application forms for various permits or licences and can act as networking agents, providing information about the availability of both public and private support services. Care should be taken to ensure that referrals are made in an even-handed manner and that no favouritism is shown to certain vendors or other providers of services. A referral should not be made to one bank, for example, when several banks that may support the entrepreneur requesting information are available. The entrepreneur should be given information about the full range of sources of help. Some

one-stop centres limit their assistance to dealing with bureaucratic requirements; others choose to be a more general source of information.

Strategic issues in supporting business start-ups

Information regarding the return to KOSGEB's IGEM and TEKMER programmes is not readily available. These programmes should be evaluated closely to determine the return on the investments made by KOSGEB and whether such investment is the most effective way to develop an "entrepreneurial culture". At the present time, Turkey lacks the financial infrastructure to support start-ups. Even if the infrastructure was in place and funds were sufficient, banks are usually reluctant to fund start-ups because the entrepreneur usually has no established track record and business start-ups are inherently risky. Entrepreneurs also generally lack sufficient capital to be used as collateral. Most businesses even in the more highly developed countries are started with the entrepreneur's own funds or with investment capital or loan funds provided by families and friends.

Turkey may lack the funding mechanisms mentioned above, but it does have the beginnings of an organised venture capital system. Venture capitalists generally raise capital through public or private stock issues (private issues are made only to "sophisticated" investors who meet certain wealth requirements) which are then disbursed through a company that specialises in supporting start-ups or early-stage expansion firms. Only about one in 200 firms meets the investment criteria specified by these firms. Such companies usually require an expected compound growth rate of 25% or more a year for at least five to seven years. They expect that one of every two investments will fail and the invested capital will be entirely lost. To provide SMEs with effective access to financial resources, consideration is being given to setting up an SME stock exchange. The necessary legal basis, which envisages the SME stock exchange as a joint stock company, was initiated by the Capital Markets Board (CMB) in 2003. The establishment of the exchange is still under consideration, and the process is being furthered through close co-operation among the Ministry of Industry and Trade, CMB, KOSGEB, TOBB, financial institutions and representatives of SMEs.

However, numerous questions are to be answered regarding how many businesses in Turkey would qualify for such an exchange, or even whether there is sufficient market interest to warrant attempting to start it. This latter question should be explored by the Economic and Strategic Research Centre recently established within KOSGEB. The introduction of Venture Capital Investment Trusts (VCIT) which will issue shares to sophisticated investors is a new concept. New legislation allowing such VCITs was passed by the CMB in March 2003. This also allows VCITs to be established and operate under less strict conditions than previously. The new legislation has attracted the attention of market participants and initial interest is promising. Prior to the new legislation, there were only two VCITs, but it is now expected that more will be established.

The KOSGEB Economic and Strategic Research Center might also examine the effect on private financial markets of KOSGEB's support for SMEs through the IGEM and TEKMER centres. While anecdotal evidence suggests that these programmes have supported a number of successful start-ups, the subsidy element of these programmes may work to reduce the need for capital and consequently for funding from private financial institutions. One policy option for KOSGEB is to divorce the financial aspects of these programmes from their technical assistance aspect. Firms could apply for technical assistance but would have to obtain financing from banks or from other private

sources. There is no question that SME owners would like public subsidies to support their start-up activities. A critical question for businesses receiving such support is whether or not they can survive after the eventual cut-off of support. This is yet another question for the Strategic Research Centre, or for programme managers in KOSGEB.

Given the general lack of sources of private funding for business start-ups, the extensive support provided by the Turkish government through KOSGEB and related programmes may be the best available way to support start-ups. The approach is expensive, however, and lacks some of the safeguards found in the private sector to limit financial support to businesses clearly destined to fail. KOSGEB must carefully evaluate the benefits of the expenditures it makes through its various centres to participating enterprises. It might use a case study approach provided that the firms to be evaluated are selected on a truly random basis. A sample of 30 or more firms should provide a reasonable basis for such an evaluation.

Training and certification issues

Occupational standards and certification

Some important concepts have been introduced as part of KOSGEB's general approach to educating qualified personnel and entrepreneurs. One is the establishment of an occupational standards examination and certification system. This sort of competitive "standards" examination should ensure that entrepreneurs produce quality products at reasonable prices, without the need to certify knowledge through some administrative mechanism. Such systems organised through guilds and chambers of industry are in place in some European countries with long histories of quality workmanship. Turkey's chambers of industry approach would seem to be a basis for the development of such a system. The system would require that those opening new businesses document that they have received occupational training related to their field of activity. This would ensure that new start-ups are created by informed entrepreneurs with appropriate knowledge of the relevant industrial sector. To this end, occupational training will have to be comprehensive and of high quality. It is unlikely that KOSGEB or the Ministry of National Education could develop or carry out the many specialised curricula needed to provide this training. TESK and TOBB and other industrial organisations might be better placed.

There are some inherent weaknesses in this approach to entrepreneurial training. First, in a rapidly changing world, the training is likely to lag advances among real-world local or international firms. This may be particularly important for Turkey which is attempting to catch up with practices and standards in the rest of Europe. The training might also inhibit new entrepreneurs from introducing new ideas or methods not previously sanctioned or approved by the industry. If the entrepreneur is to be successful, the new business must meet a market test. If it cannot produce and sell at a price that will cover long-run costs, it will not survive.

The Turkish government, working with interested private organisations, is attempting to deal with the development of occupational standards using credit supplied by the World Bank. This credit has been used to create a consortium of public and social partners.²³ To initiate the project, the participating organisations signed a national protocol on preparing vocational standards and building a system related to the implementation of standards. Approximately 250 vocational standards were prepared under a sub-project on examination and authentication, and an examination questions data bank based on these standards was formed. Representatives from the general public,

employers and employees worked together on the project. The Vocational Standards Commission which was formed under the project is continuing its work, although the project period has come to an end. The project had called for the formation of an institute which would complete the work before the project deadline. A draft law that would authorise this work and enable the creation of a Vocational Standards Institute was prepared and forwarded to the Office of the Prime Minister, but the law was not passed before the end of the project period. For the occupational standards system to be implemented, this legislation should receive full consideration. Additional work scheduled to be completed under the original occupational standards project by the MEGAP (Strengthening the Vocational Training and Education System in Turkey) and involving both the Ministry of National Education and private interests is on hold pending the legislation.

Market provision of entrepreneurial training

There is a question of who is to pay for the occupational education envisioned by KOSGEB. It is expensive to develop a strong educational curriculum and even more expensive to deliver it. Individual small businesses generally cannot afford to provide this type of training (through apprenticeship programmes, for example), and they are reluctant to support an industry approach that may train competitors who can compete with and harm their business. One way around this issue is to leave it to the market to support this kind of vocational training. A good example is the many private chefs' training schools in the United States. Students finance their training at these schools (sometimes with government support through scholarships or loans) and generally enter the restaurant or hotel business as employees. Many of the chefs eventually start their own businesses with a competitive advantage obtained through education and experience. Several US universities have developed similar curricula to train administrative managers for hotels and restaurants. This training is highly valued by hotel and restaurant owners, and the students can recoup their investment in education relatively quickly through work in the hotel and restaurant industry. As with chefs, once these individuals have gained sufficient work experience, they may start their own businesses. Many of the small industrial estates and the organised industrial zones operated in Turkey also organise apprenticeship or other training activities to improve entrepreneurial knowledge and skills.

Occupational standards examinations may sound appealing but may entail excessive bureaucracy. Possession of a certificate is no guarantee that a business start-up will succeed. Requiring that a certificate must be obtained before starting a business will raise the cost of starting a business and limit market competition. Consumers provide a much more impartial test of the capability of a business owner, and this evaluation process works at no cost to the state. An alternative might be to make the occupational standards examinations optional, which – if the standards are really quality-oriented – could have the positive effect of convincing consumers and would-be business owners that the standards contribute to better outputs

KOSGEB is also considering certification of private individuals who provide management consulting and technical assistance services to SMEs. The goal of this certification is to ensure that the professionals providing such services are properly trained and capable of providing useful assistance. Several countries have similar systems. Japan has a Certified Small Business Consulting programme that calls for an additional year of specialised training following receipt of a Master's of Business Administration degree, plus some years of experience working with or consulting to smaller enterprises. The United States has recently started a similar programme operated

by the Small Business Development Centres Directors Association. This certification programme has been developed after approximately 20 years of experience operating small business development centres. Turkey's experience with the IGEM and TEKMER programmes might facilitate the building of a productive certification programme

Other training activities

Vocational high schools and universities can work with lower-level schools to provide a general entrepreneurial curriculum to help build an entrepreneurial culture. These vocational training centres can also provide skills training in some fields (cooking, hair cutting, mechanical training, etc.) that can be combined with an entrepreneurial curriculum to give students the desired set of occupational and entrepreneurial skills. Indeed, an entrepreneurial segment might be added to every skill curriculum so that graduates can examine possibilities of work as an employee or as a business owner. This type of training does not require certification since students can make their own decisions regarding the addition of entrepreneurial training. KOSGEB or the Ministry for National Education can encourage them to add entrepreneurship training without having to introduce a bureaucratic certification programme.

KOSGEB through its Centre for Entrepreneurship can systematically review and document successful businesses and business practices in other developed or developing countries. This is a logical element for inclusion in the KOBINET project. KOBINET can use the information about best practices as a way to lure business owners into making more extensive use of the Internet. As business owners become more comfortable with the use of the Internet as a source of business information, they can be encouraged to try entering e-commerce through the facilities provided by KOBINET.

Preliminary plans call for the provision of additional or expanded training in a number of subjects such as personnel management practices, identification and use of best technology, and project and technology management practices. Many of these subjects can be included in the general training provided through the KOSGEB's IGEM and TEKMER centres. Similar training could be developed and delivered on an industry basis by the chambers of industry, notably TESK and TOBB. It might be useful to ask why they do not already provide such training. One answer is that they may not see this activity as necessary since membership in these bodies is mandatory and dues are guaranteed. However, if training adds value to the membership, active and extensive training activities would be desirable, although there is a question as to whether government resources would be needed to increase these bodies' provision of training to their members. TESK and TOBB and their membership should make their own judgment about participating in training. Since training courses can be developed and tested individually, it should be possible to develop successful programmes if a reasonable share of businesses in a given industry is interested. If SME owners do not choose to participate in such training, it may be because they believe that it does not add sufficient value to their operations to justify the cost. KOSGEB could look at the relative success of firms that participate in training compared to firms that do not. If training is useful, then the enterprises that participate should be more successful over time than those that do not participate.

Development of SME support services and technology and innovation capacity

KOSGEB envisions expanding many of its support services programmes, as well as increasing its interactions with and support of services to be provided by professional organisations. In addition to certifying individuals who provide consulting services, KOSGEB also envisions standardised consulting services to be provided by private organisations that have been accredited by KOSGEB and operate under its supervision.

The expansion of at least some KOSGEB support services programmes is sensible. These programmes, particularly the IGEM and the TEKMER centres, are based on best practice models from Europe, Asia and North America. Their combination of services and support provides broad support to new small businesses and to SMEs looking to improve their production, marketing and export capabilities. Small enterprises can receive management and technical assistance, access to capital, space, and R&D and management training. They also receive assistance in recruiting and managing personnel and some help, in the form of subsidies, for hiring especially skilled workers. The total support package in both types of centre is expensive but probably effective. One question for consideration in the proposed expansion is whether the basic centre models can be adjusted to provide the necessary services at a lower total cost per company served.

Increasing technology support

Much of KOSGEB's programming and services provision gives special attention to helping industrial SMEs to increase their technological expertise. The TEKMER centres, for example, clearly focus on helping firms to carry out successful R&D projects, utilising available support from universities, larger firms and technological resources throughout the world. As noted earlier, TEKMER staff can provide consulting assistance to lead firms through the process of analysing technical needs and accessing and using available technical knowledge and resources. This expert consulting can do much to help expand the market for technical consulting and engineering services, provided that the TEKMER consulting staff act as guides to outside resources and not as service providers *per se*. Teaching SMEs how to access such services and helping business owners/managers to gain confidence in using technological services may be the most important function carried out in the TEKMER centres. The TEKMER centres can help to build better relationships between SMEs and technology service providers. This networking can be carried out for businesses that do not participate in the full range of TEKMER support activities, and it may be cost-effective to expand the consulting assistance activity to firms outside the TEKMER sites. The IGEM outreach could also be expanded to a broader variety of SME sectors through counselling, with referrals to outside management consultants as needed. Computer processing and information and communication technology are useful to almost all SMEs with any desire or capability to expand their businesses or improve their functioning. Technology use applies to all businesses, not just to a select few industrial businesses.

One strategy that could be explored by the government is establishing more useful interaction with Turkish universities. University business schools have provided vast amounts of services to SMEs in many countries, often with support through government-sponsored small business development centres that provide outreach and co-ordination with university management specialists.²⁴ Turkey has begun to develop such interaction by placing business incubators and IGEM or TEKMER centres at or close to universities. A complementary approach might be to take some university experts to off-campus sites

close to clusters of SMEs. This outreach function is highly developed in parts of Europe and North America so that good models are available for consideration by KOSGEB or other Turkish authorities.

Creating innovative SMEs

In the SME Strategy and Action Plan, KOSGEB states that “Raising awareness about research, technological development and innovations in SMEs” is a major goal. This includes two objectives: “Encouraging SMEs to invest in technology by showing them the benefits of research, technological development and innovation in order to give them a sustainable competitive edge” and “The creation of innovative SMEs”. These goals would be accomplished through interaction between KOSGEB, TUBITAK, TTGV, TOBB and the universities. No specific projects aimed at accomplishing these objectives are identified in the plan. Some of the existing programmes operated by KOSGEB already target these objectives, however, although the support is limited in terms of the numbers of businesses covered. Innovation is generally defined not only as the conceptualisation of a new product or service (or a greatly improved product or service) but also as the successful bringing of the new product or service to the market. Since the technological requirements for a new product or service may be exceptionally complex and unique to each individual innovation, it may be more productive for the Turkish government to support the second part of the innovation process, *i.e.* bringing the new concept successfully to the market. Marketing a new product or service requires planning, finance, advertising and market research, production and control capabilities, and knowledge of wholesaling, retailing and pricing. Many of these are skills that each successful business owner has to have or has to learn. All can be taught, and the government can provide advice on how and where to learn more about them. Clustering new business development close to universities or to large businesses may be sufficient to generate innovative thinking. The government can then help business owners move this thinking through the development process so that it can be successfully marketed.

KOSGEB also has a goal of increasing co-operation among SMEs, large-scale enterprises, universities, professional organisations and public institutions/organisations. It proposes to reach this goal by increasing the flow of advisory services from these organisations through “development of incentive mechanisms and instruments enabling SMEs to make use of information and experience accumulated by universities”, by further developing the TEKMER centres and increasing outreach (also using “incubators without a wall”) and by involving chambers of industry in the process. Part of this goal may be accomplished by using Innovation Relay Centres (IRC), two of which have already been established, and incorporating them in the EU-IRC Network. One objective is the development of one-stop centres offering advisory services on technology and innovation. These are likely to be very difficult to staff given the potential range of technical questions that centre personnel may be asked. If the centre focuses on management information and training, it may be able to help innovators to move their product to market more easily.

One may question why many of these activities are not already being accomplished by organisations such as TOBB and TESK. They should be identifying the best technology and best practice on a routine basis, and sharing this information through training events, seminars and conferences for its members. Industry organisations in North America and Europe seem to do this well. Another simple technique that may work well is to organise groups of smaller enterprises to sponsor speakers on specific

management or technology issues. In the United States this approach has worked well in introducing smaller enterprises to the use of information technology and microcomputers.

Government support for small-scale industrial estates and organised industrial zones

The IGEM and TEKMER centres provide a large bundle of services, owing to the inability of private markets to provide these services, which is compounded by SMEs' resistance to seeking out needed services in the marketplace. The bundling of services helps to overcome failures in several markets. It is possible that the government's approach to overcoming market failures actually contributes to their development. For example, it appears that capital markets do not provide sufficient usable space for small enterprises in the absence of extensive government credits for developing small-scale industrial estates (SSIE) and organised industrial zones (OSB).²⁵ Many of the existing estates (Table 3.3) and zones appear to have excess capacity. While 505 000 employees could be employed in the estates operating in 2003, only 400 000 positions were filled. The existence of such excess capacity would tend to lead to lower rents and discourage private capital from providing good industrial space. While the government is providing subsidies for industrial space, the market appears to be able to support commercial space requirements with few apparent problems. It is possible that the government could unbundle the provision of manufacturing space from both the IGEM and the TEKMER centres, thereby freeing up resources for other forms of assistance or lowering the government's financing needs. The government could also consider a policy, as found in many countries, of ending support to the development of small industrial estates and organised industrial zones, leaving this activity completely to local administrations or to private funding. This would be consistent with the government policy of tight control over fiscal expenditures.

In many countries, smaller businesses seem to be adverse to hiring outside experts. This may be due to entrepreneurs' lack of knowledge about the availability and efficacy of such services, or it may be due to the entrepreneurs' belief that they do not know how to contract for such services or to control the delivery of and the evaluation of such services in an acceptable manner. The TEKMER centres, for example, help smaller firms to accept technological services and R&D support by acting as consultants for the small firm, helping it to identify needs, find qualified providers and contract for and supervise the provision of services. The provision of consulting help through a government programme can overcome the reluctance of the typical small firm owner to seek help in the open market. If the government restricted its assistance to this helping function, small business owners would be more willing to use outside service providers. There is no reason to restrict the analytical support now offered through IGEM and TEKMER centres to firms that are located in the centres.

This type of consulting and contracting assistance can be unbundled from the centres and delivered to a much broader spectrum of SMEs. Such services can also be financed independently of the centres. In the United States, technology development centres are very similar to the TEKMER centres except that they restrict themselves to the analysis of production problems and the design of solutions. In most centres, the analytical and contracting function is provided at little or no cost to the recipient firm, but the private contractors that actually solve the identified problems are paid directly by the participating firm.²⁶

Table 3.3. Small industrial estates completed

Years	Number of estates at end of year	Number of workplaces	Employment potential
1960-95	262	62 113	386 080
1995	273	63 640	395 222
1996	289	65 326	405 388
1997	291	70 747	437 864
1998	294	71 722	443 714
1999	306	72 130	446 162
2000	313	74 121	445 000
2001	349	81 453	488 000
2002	358	82 797	496 000
2003	372	84 313	505 000

Source: Ministry of Industry and Trade (These data are only for those small industrial estates that have used loans from the Ministry.)

The IGEM centres also provide management assistance to manufacturing firms. While industrial firms may have more complex management problems than some non-industrial firms, it is likely that the provision of management assistance to the full spectrum of SMEs might help firms in all sectors to improve their management and become more competitive. To the limited extent that broader management assistance is made available to non-industrial SMEs, it appears it takes place through the chambers of industry or civil society organisations such as foundations. KOSGEB does appear to play a role in encouraging and co-ordinating such activity, but this does not appear to be a priority of the government. Yet, non-industrial SMEs account for the vast majority of businesses in Turkey. If Turkish industrial enterprises are to market and service their products either within Turkey or abroad, they will need the assistance of finance firms, shipping firms, insurance firms, marketing firms, including advertising firms, and wholesale and retail firms. Many of the firms producing or seeking to produce such services could profit from expert managerial and/or technical assistance. This assistance is currently provided within the IGEM centres, but it could also be delivered to firms throughout Turkey. There is no need for technical and managerial assistance to be delivered only within an expensive residential model(s). At a minimum, outreach could be extended to provide training in business planning and financial planning to SME start-ups. If KOSGEB worked with university and private sector experts to develop the needed training curriculum and support materials, these materials could be delivered to business start-ups through TESK, TOBB or other private organisations.

The IGEM and TEKMER programmes appear to be well run,²⁷ but the services provided through these programmes could be unbundled and delivered through mechanisms that make vital consulting or counselling support available to many more businesses.²⁸ In addition to consulting, formal training could be provided to a broad spectrum of businesses so that they are able to develop their own business, marketing and finance plans independently, as well as develop more functional expertise in functions such as site location, pricing, accounting (or working with accountants), process and inventory control systems, etc.

KOSGEB plans call for expanded service delivery and for higher quality and more diversified service delivery. However, the manner in which these improvements are to be made was not discussed in the planning process. However they are accomplished, such

improvements will require large amounts of additional funding. KOSGEB is currently funded through a call on a portion of the profits of the state banking system, supplemented by funds from the national budget. The provision of government funds has helped to overcome the volatility experienced when funds only derived from state bank profits. Expansion will require that the budget increase its contribution to KOSGEB. This may prove difficult as the government maintains strong discipline over fiscal expenditures.

Standardising and accrediting business service organisations

KOSGEB is considering the standardisation of business consulting services, along with the provision of training for freelance consultancy organisations, the accreditation of consulting firms (or consultants) and the ongoing supervision of consulting organisations. For some managerial functions, standardisation can be accomplished successfully. Expert consultants can help any business prepare a professional and useful business or marketing plan, for example. However, many consulting functions do not lend themselves to standardisation. Industrial engineers may be experts in chemical processes, electrical processes, mechanical systems, production line processes, hydraulic systems or process control systems, for example. It is therefore extremely difficult to specify what an “industrial” engineer’s expertise involves. Some management or other professional functions are also difficult to standardise. While all accountants provide basic accounting services, many chartered accountants specialise in one industry. Even in very highly standardised accounting systems, conventions and practices vary from industry to industry. It is not clear how government supervision of service providers will provide better information about quality and ability than the marketplace. Appropriate legislation and regulation must be considered to establish proficiency standards and minimum quality requirements for consultancy firms, depending on the type of support services they provide.

The government envisions increasing resources, programmes and co-operation with professional organisations and chambers of industry to provide SMEs with better support services. Before considering such plans in detail, it might be useful for the government to evaluate existing programmes to identify which activities best help to make businesses more productive. The evaluation could be supervised by the Strategic Research Centre in the Office of the President at KOSGEB. However, staffing limitations preclude having much of the work done by the office staff. Given the lack of evaluation materials, and the lack of policy research and analysis on SME support activities, as many as 30 analysts (including support staff such as statisticians, survey design experts, and information technology staff) would be needed to help Turkey move effectively towards the EU model.

Internationalisation and export promotion

Increasing exports and the number of SME exporters are important goals of the Turkish government. The government envisages an extensive array of educational programmes and extensive subsidies through direct subsidy or tax relief. It plans to emphasise quality of products and quality of production processes so that more Turkish products meet international standards. A good example is the increasing interest of Turkish firms in achieving EU-ISO quality standards. There are numerous references in the SME Strategy and Action Plan to identifying sectoral trade models in other countries

that can be adapted or emulated in Turkey. This may prove difficult since there are few successful models.

Exports may be important to the welfare of the Turkish economy, but there is an important question as to whether SMEs are an appropriate focus for the expansion of exports. Some SMEs in some sectors may be successful exporters, but most SMEs produce for the internal market and turn to external markets only when the internal market is saturated.²⁹ As the Turkish market continues to develop, more and more small industrial businesses will direct their primary production towards meeting demand from larger Turkish businesses. Turkish SMEs that produce high-quality components and sub-assemblies for larger Turkish manufacturers could help the latter to become more competitive in international markets. In the more highly developed countries, larger firms are now often no more than assemblers of parts and sub-assemblies produced by a variety of SMEs. The automobile industry is a good example. The export of automobiles is attributed to the large manufacturer, but much of the manufactured content in an automobile comes from smaller industrial firms. This phenomenon appears to be occurring in the Turkish automobile industry. As noted earlier, improvements in contract law and dispute resolution, as well as technical advances in the use of computers and related technologies by SMEs may decrease vertical integration within Turkish industry as larger Turkish businesses outsource non-core business activities to smaller firms. This will improve large firms' competitiveness and increase total exports. It will also intensify competition in many industrial or service sectors within the economy.

By their very nature SMEs focus on niche markets or on markets with highly variable demand.³⁰ They are not large enough to build standardised products able to compete with those of large firms.³¹ If a small high-tech firm does create a product that can be sold in large quantities around the world, the firm should be encouraged – for example through special programmes of the chambers of commerce and industry or by means such as the Internet or e-commerce – to find a large Turkish firm that can purchase production and distribution rights and operate on a worldwide basis more effectively. SMEs can also make use of the foreign trade capital companies and foreign trade sectoral companies established under Turkish law.

The government can make available large amounts of market information about foreign requirements and standards. This information can be targeted to smaller enterprises to help them focus on increasing sales through exports. The government is attempting to provide this information on a sectoral basis, but it is difficult for the government, or for anyone else for that matter, to identify which sectors have the capability, over time, to try to expand. It is also extremely difficult for the government to produce the enormous variety of information needed to support SMEs in many industrial or services sectors. Many existing Turkish government export support programmes are supply-side oriented. The government can furnish information, but it cannot force SMEs to process this information or respond to it in a productive manner. Providing subsidies through the tax system can help encourage exports, but this hurts government tax collection and produces exports that may last only as long as subsidies continue.

Expenditures by Eximbank (the export credit agency) might be more productive if they were focused on larger manufacturing firms or on Turkish construction firms that can meet demand in other countries. It should be understood, however, that much of what Eximbank does reflects a government subsidy to business, or more correctly to foreign purchasers. The argument is made that Turkey must have its Eximbank, which provides subsidised financing for exports, because every major competitor country has such a

bank. However, few Turkish products are so large that they cannot be financed relatively easily in the importing country.³²

Increased exports are a sign of the increasing integration of the Turkish economy into the world and the European community. The government has a strong interest in doing many things to support the export sector, but some of the projects suggested in planning documents are likely to add more to government costs than to exports. It is one thing for the Turkish government to develop product standards based on those of European or other developed countries. This information can be disseminated at low cost using modern communications technology such as the Internet. Government attempts to monitor or supervise the management of private companies to ensure that quality standards are maintained is likely to be non-productive, unless the government can develop superior management knowledge and skills in the quality control area. This is unlikely to happen. On the other hand, government efforts to supply information or co-ordinate the production of information by industry and professional groups may be helpful to firms seeking to export.

Turkish development plans call for careful reviews of export support activities in other countries to identify best practices and programmes. Programme development should proceed cautiously until these studies are completed by KOSGEB.

Expanding local and regional clusters

The plan for business support activities in 2003-05 also calls for expansion of the local and regional cluster programmes. Clusters would be formed within organised industrial zones, industrial zones and small-scale industrial estates. Specific project plans call for the support of a Fashion and Textile Cluster Project, and for establishing centres of excellence for the automotive, footwear, leatherwear/fashion and furniture industries. Turkey has extensive experience with building clusters of smaller enterprises in specific industries and should be able to extend the concept in new directions. Perhaps the only caveat is that existing clusters should be evaluated to identify their strengths and weaknesses before carrying out the expansion. A project proposal for cluster analysis and modelling in organised industrial zones and small-scale industrial estates has been submitted to the EU by the Ministry of Industry. KOSGEB is also envisaging a major project to study if successful clustering projects can be initiated in the industrial sectors. Another project related to the development of clusters in developing areas is to be supervised by the State Planning Organisation and the Ministry of Industry and Trade with the co-operation of numerous ministries and outside organisations such as TESK and universities.

Facilitating communication between small enterprises and other institutions

KOSGEB envisages facilitating a wide range of communication networks in 2003-04. It plans to do this with the co-operation of the Undersecretariat of State Planning Organisation, the Undersecretary of Foreign Trade (DTM), TOBB, and TESK. The only project mentioned as part of this activity is the setting up of 12 EU information centres. KOSGEB can probably identify a number of ways in which they can facilitate information flows between enterprises and institutions. Market failures sometimes prevent the collection or dissemination of data by private providers, particularly if they cannot ensure that the information can be protected as intellectual property subject to use only after payment of a reasonable fee. Governments can greatly facilitate data production and dissemination in

these cases by collecting and publishing data made available to SMEs at no fee or at a very small fee. The KOBINET project can play an important role in this process. Government ministries can also provide more information to support SMEs through their Web sites.

The better communication capability made possible by the Internet can facilitate access to information, but the incentive to seek out and use information has to come from the businesses themselves. One approach would be first to establish whether Turkish businesses are systematically not using important information and then to ask why the information markets fail to operate. There is considerable evidence that access to the Internet greatly facilitates the search for answers to many business questions. Since much of the information on the Internet is in English, or some language other than Turkish, language training might be a useful adjunct activity for the Ministry of Education.

Increasing the flow of non-financial services

Increasing the quality and scope of non-financial services appears to be an important goal for KOSGEB, which is working with TOBB and TESK in this respect. If non-financial services are not being provided, the reason(s) for the failure have to be identified prior to preparing activities to increase the flow of such services. One crucial reason for lack of supply is lack of demand. An examination of SME practice in other countries may confirm that very small businesses (fewer than 50 employees) are very reluctant to bring in outside consultants, particularly if they have to pay the market rate for such services. Overcoming this reluctance may be very difficult. Lowering the price of services (through subsidies) may help to overcome this reluctance. Developing activity standards for service providers and conducting accreditation work may help, although it is likely to constrain the supply of service providers and raise the price of services. KOSGEB might do better to educate SME owners/managers about the availability of non-financial services and the value of such services (through case studies and examples).

Improving policy co-ordination among government institutions and bringing TOBB and TESK into the legislative development process are important goals of the plan. The leading role for both of these activities is placed with the Ministry of Industry and Trade. No project activities are identified in the draft plan. Actions described in the SME Strategic and Action Plan include strengthening the KOSGEB General Assembly and improving the legislation by suggestions concerning draft laws, decrees, etc. One alternative method of ensuring better policy co-ordination within the government is to consider creating a high-level SME advocate position (or small office) within each ministry or major government organisation. It would be the responsibility of each advocate to identify policies and procedures that might have significant effects on SMEs so that these could be reviewed properly within each organisation and co-operatively with KOSGEB and outside professional organisations where appropriate. A similar approach has been used successfully in the United States.

Chapter 4

POLICY EVALUATION

Turkey's active SME support policy has led to the formulation and/or implementation of numerous programmes in recent years. Among the inspirations for and sources of these programmes are the best practices and successful accomplishments of other countries. As noted above, the essential goals of these policies stem from those being pursued for industry as a whole, as specified by the SPO.³³ The strategies and action plans for attaining those objectives are set forth in the *SME Strategy and Action Plan*. KOSGEB supports SMEs directly in 22 areas so they can start up and develop in a manner consistent with policy objectives.³⁴

At a time of extremely tight budgetary constraints, the need to optimise resource allocation among the various programmes of varying sizes will force SME policy makers to prioritise carefully. They will have to evaluate programmes both before they are formulated and adopted (*ex ante*) and to measure the effectiveness of existing programmes (*ex post*) in order to assess their relevance and to compare the cost-effectiveness of the use of resources. To judge relevance and effectiveness requires an evaluation of the justification for the programme, an analysis of its economic effects, including the incentive effects on SMEs and on markets that support elements of SME activity, and an examination of the implications for both resource allocation among programmes and for the choice of policy instruments.

Programme managers responsible for implementing or co-ordinating SME policies, whether in KOSGEB or elsewhere in government, may have more narrowly focused interests relating to the evaluation of the efficiency of the programme, including factors such as quality of service, responsiveness to SME needs and effectiveness of service delivery. Programme managers are also concerned with some aspects of policy evaluation, for example, a comparison of the effectiveness of their programme with other SME support programmes or policies. Responsible managers are constantly asking whether their programme model can be made more effective or efficient and what changes in programme design, scope or operation will increase efficiency or effectiveness. Although the evaluation needs of policy makers and programme managers may differ, the evaluation process in each case may be complementary.

Across government as a whole, the evaluation process should address both the direct and indirect effects of each programme, as well as the effectiveness of programme implementation, using evaluation methods and tools such as cost-benefit analysis, economic impact analysis, econometric analysis, peer review, surveys of programmes or programme instruments, and case studies. For existing programmes, evaluators may want to examine programmes retrospectively, providing an *ex post* view of the effects and efficiency of the programmes. However, for planning purposes, an *ex ante* approach will provide for better monitoring of existing programmes and for improved planning of policies and programmes.³⁵ Because of the complexity of many SME support activities, several evaluation methods might be used in combination to provide better results. These different methods might include both qualitative and quantitative approaches.

The OECD has provided a framework for evaluation which identifies a number of strategic questions which evaluations should address (see Box 3). In addition, the OECD has also produced recommendations³⁶ which specify the following:

- The evaluation methodology should be designed at the same time as the policy or programme so that the necessary data and acceptance by the relevant parties of the evaluation procedures and criteria can be secured.
- There is a need to ensure the take-up of the evaluation results at the highest possible level of policy making, encouraging public discussion of evaluation results and ensuring a response to the evaluation results from policy makers.
- Evaluation should be user-oriented, serving the information needs of the different programme participants and clients.
- Evaluations should use a combination of methods to satisfy different information needs.
- All programmes, rather than selected programmes, should be subject to evaluation.
- Major evaluations must be undertaken with independent but informed assessors. Nevertheless, the involvement of the programme teams, both policy makers and deliverer, is vital.
- Evaluate all programmes using the most sophisticated techniques feasible, taking into account the need to be cost-effective. In practice, more approximate approaches will be necessary when assessing smaller programmes.

The question of who undertakes these evaluations is important, as it is necessary to bear some potential conflicts in mind. Ideally, those undertaking the evaluations should be independent of those responsible for the programmes, as in any audit role. At the same time, a key role of evaluation is to contribute to continuous policy improvements, and the evaluators need the active co-operation and involvement of both policy makers and deliverers. This may be more difficult to achieve if the evaluator is viewed as an “outsider”. Thus a balanced approach must be found.

A Monitoring and Evaluation Department has been established at KOSGEB. To monitor and evaluate the efficiency and productivity of KOSGEB’s service activities and support, the department is assigned the following functions: monitoring services, activities and support of all units in line with KOSGEB goals, policy and strategy; evaluating and interpreting the results; preparing the relevant work for required measures; carrying out activities to better co-ordinate and apply programmes in a correct and timely manner and work for sustained co-ordination between national organisations and KOSGEB units. The overall aim is to improve the performance of the service and support units in line with KOSGEB’s strategy, principles and priorities.

KOSGEB has already adopted a new method for analysing SMEs. Focusing on the potential and the needs, an analysis is carried out and reported on at the enterprise level. This method also helps to overcome the implied mismatch between the supply of and demand for SME support programmes. The analysis is carried out at the enterprise level by KOSGEB experts.

Box 3. An OECD framework for evaluation

The need for a common framework and the potential for mutual learning through comparison of policy practices inspired the OECD Industry Committee's Working Party on Small and Medium-sized Enterprises to develop guidelines that would allow for the international comparability of SME programmes. These are intended to facilitate the assessment of SME policies and programmes in the context of overall government policies and enable the identification of best-practice policies. The framework does not aim to analyse different evaluation methodologies, tools or techniques, but instead targets the examination of the justification and effects of policies and programmes.

According to this framework, programmes should be evaluated with regard to their efficiency in a number of areas, including:

- *Appropriateness*: Is the programme addressing an important objective and can this be related to a clearly identified market failure?
- *Superiority*: Is the programme more effective than other policies, programmes or instruments that would reach the same goals?
- *Systemic efficiency*: How does the programme interact with other programmes, and to what extent does its efficiency depend on conditions created by other government actions?
- *Own efficiency*: Is the programme cost-effective in achieving its particular objective?
- *Adaptive efficiency*: To what extent have results from evaluations been fed back into policy design and implementation, and does policy design ensure a degree of flexibility in responding to unpredictable changes?

Source: *OECD Small and Medium Enterprise Outlook*, 2000 edition, pages 27-28.

However, creating a department in KOSGEB does not reduce the need for an independent evaluation. In particular, the ability to look more broadly at the whole system of SME support policies and to bring evaluation results and recommendations directly to the political level would be desirable.³⁷ Any duplication of work has of course to be avoided. One possible approach would be to set aside 1% of programme monies flowing through KOSGEB or through other ministry SME support programmes for programme evaluation. The evaluation office should report to the Office of the Prime Minister, since the results will affect many ministries, as well as KOSGEB. The evaluation group should be made up of staff with advanced social science credentials, similar to those found in the Research and Analysis Unit proposed for KOSGEB. At a minimum, staff should consist of economists and sociologists, augmented by psychologists (expert in questionnaire design) and statisticians. Outside experts should be hired as necessary to augment the skills of the permanent staff. The evaluation team should be brought into the design phase of any new project. Control groups or data collection plans can often be initiated more effectively if the design of the data collection process is made an integral part of the programme activity.

For example, when looking at a complex programme such as IGEM, one way to set up a control group is to approve twice as many participants (compared to the spaces available) during the application review. Half of the approved participants can then be selected randomly as participants. The other half provides the control group. Enterprises in each group are monitored using a case study approach. Goals for participants must be carefully specified, and interview techniques should be used from time to time to measure progress towards the goal. Similar measurements should be made for firms in the control

group. This process is time-consuming and expensive, but it can help KOSGEB and the Office of the Prime Minister (or the State Planning Organisation within that Office) to judge the effectiveness of programme design and implementation.

It will take time to build a professional evaluation capability. The evaluation function is complementary to the economic research function that KOSGEB is initiating. Research can be used to support the efforts of the evaluation group by providing benchmark studies of what is happening to SMEs and industry sectors throughout Turkey. The research office can also provide independent policy analyses to the evaluation unit which may provide conceptual help in measuring programme efficiency. When examining the policies underlying a programme, the evaluation office may find that their work overlaps that of the research office. This should not be a problem, since these offices should maintain close links. In cases of complex policies, it may be useful to have both the research office and the evaluation office provide independent judgments of the policy regime. The third leg of the evaluation/research process is production of data by the State Institute of Statistics. While much of what the SIS does is circumscribed by the requirements established by EUROSTAT, the survey techniques for collecting data can be used to provide answers to supplemental questions prepared by the research or evaluation units.

Annex A

THE EXPANSION OF THE SMALL AND MEDIUM INDUSTRY DEVELOPMENT ORGANISATION'S RESPONSIBILITIES

In January 2003, KOSGEB started a re-organisation process based on a principle of “continuous change” for developing its services. In this process:

- The productivity and efficiency of the existing KOSGEB supports have been analysed.
- Best practices aiming to serve SMEs by equivalent organisations in developed countries have been scrutinized.
- Recommendations from 600 SME-related organisations in Turkey have been taken into consideration.

Consequently, KOSGEB now takes responsibility for the following functions:

- Developing SMEs' technological skills.
- Improving SME training and access to and use of information.
- Providing appropriate financial mechanisms for SMEs.
- Improving SME management infrastructure.

To help accomplish this, KOSGEB has introduced a service policy that includes:

- Providing qualified and readily available services to SMEs in order to help them produce their goods and services to high quality standards, at low prices, and using advanced technologies.
- Helping to eliminate all of the obstacles that the SMEs might confront while competing in the domestic and foreign markets.

Following the reorganisation, the number of KOSGEB supports has been increased from eight to 38 under 22 headings. Bureaucratic procedures have also been reduced and simplified.

KOSGEB allocated TRL 160 trillion (approx. USD 33 million) to the support services in 2003, which corresponds to 86% of its budget. The number of SMEs that have benefited from this amount is about 10 000.

KOSGEB is the main force working to support SMEs under the European Charter for Small Enterprises, endorsed by Turkey on 23 April 2002. As noted in Chapter 3, the Charter calls for support in ten major areas. KOSGEB is to act as producer or co-ordinator for many of the activities designed to reach these goals.

KOSGEB also performs a wide variety of research, analysis, planning and programme support functions including: regional and sectoral analysis, regional and sectoral development programmes, small industry regional operation plans, investment and management consultancy, entrepreneurship support systems, research and analysis for building a suitable environment, support for business start-ups, programmes and projects for special target groups, sector and country analysis, foreign capital/mutual investment consultancy, advertising support, and inter-business co-operation programmes. These functions include: the provision of marketing services; quality control assistance; machinery and equipment support; technology development; training; information supply; access to quality workspace; other consulting services; assistance in participating in domestic and international fairs and exhibitions; supplying software and related publications; publication of R&D results; promotion of products and services; employment; patent, useful model and industrial design services; preparation and maintenance of an electronic commerce Web site; and preparation of R&D documentation.

KOSGEB appears already to have taken several important strategic decisions which are in conformity with the following suggestions:

- Identifying the policy issues that are appropriately described as SME support policies, including conducting the research and analysis needed to identify SME support requirements.
- Obtaining high-level government support for the work needed to develop appropriate legislation and implementing regulation, and work with the State Planning Organisation to co-ordinate needed development activities.
- Developing a sophisticated evaluation programme that examines not only the efficiency and effectiveness with which programmes are delivered, but also examines the broader issue of whether a given support programme should be provided by the government or by private market forces. The latter evaluation should look at the effects of government provision of services on the provision of similar services in the private sector.
- Based on programme evaluation results and the availability of budget funds and skilled manpower, considering scaling back the number of programme activities supported.

The KOSGEB programming approach has been basically changed to transfer activities to the private sector as far as possible. This change has to be put progressively into practice in the future with a view to encouraging SMEs to compete and to finance themselves without government support.

Despite the wide range of its activities, KOSGEB supports the SME sector (across all industry sectors) in a limited manner. Its information acquisition, production and distribution activities (through KOBINET, for example) could reach out to and support large numbers of smaller enterprises. Most of its programming is still narrowly focused on supporting medium-sized industrial enterprises, with some support going to smaller business start-ups.

Notes

1. Research in the United States indicates that service industries, heavily populated by smaller enterprises, are often now more capital-intensive than small industrial businesses. This change appears to have occurred as smaller enterprises applied new computer and communication technology and software to improve their productivity and their share of services to individuals and businesses. Technology use is important to all elements of the SME sector.
2. Many countries have conducted evaluations of SME financing programmes. Examples may be found in the *OECD Small and Medium Enterprise Outlook 2000* Edition.
3. There is a tendency to blame the market failures on the government deficit and the resulting issue of government bonds, which drain the supply of private saving, preventing banks from making worthwhile business loans. But the causes may lie much deeper within the regulatory and supervisory structure of the banking system, which allows, or may even encourage, banks only to serve large borrowers.
4. In the United States, a similar site set up by the federal Small Business Administration (SBA) now receives over a million inquiries a day from business owners seeking information about SBA programmes and other government services and regulatory requirements.
5. The only readily usable statistics concern the industrial and manufacturing sector. The State Institute of Statistics is planning to use the findings from the 2002 business census to produce a one-volume breakdown of businesses of all sizes across all sectors of the economy.
6. It is at this level that it is logical to consider extending government support to non-industrial SMEs. Clearly, most small firms in Turkey would benefit from better management practices, increased use of ICT, and the application of these technologies to finance, process and inventory control, marketing and shipping. A good illustration of the advantages to be derived from these measures is provided by the Indian export market which has benefited greatly from the services available under the support programme for online marketing both within India and to Western markets.
7. It is at this level that it is logical to consider the placement of KOSGEB staff in TESK and TOBB offices throughout the country. KOSGEB staff could provide counselling, and could organise and/or deliver training in basic management, marketing and financing methods.
8. They may be able to respond, but only with higher production costs. If their plant and equipment are already fully utilised, it is difficult to increase output. They also find it more difficult to adjust to supply changes, given the extensive use of “just-in-time” delivery processes, which are intended to minimise the amounts of parts and raw materials inputs held at any one time. An interruption in supply flows can bring production to a standstill very quickly.
9. Large businesses will often buy out SMEs that have pioneered new products in niche markets. In advanced economies, small industrial firms may lose some of their competitive advantage

as larger industrial firms exercise their competitive advantage by using computer-driven machinery to produce smaller production runs at competitive prices. This is likely to happen in Turkey.

10. Somewhat surprisingly, even an industry that is dominated by larger businesses that can reap scale economies and cut prices may have numerous small or medium-sized enterprises that produce similar outputs. Most industries have a dichotomous size distribution, with a cluster of large firms and a cluster of small firms. In some industrial sectors, groups of large, medium, and small enterprises can be found.
11. Part of this value comes from the ability of smaller enterprises to produce variations on standard outputs which allows them to meet demand in a niche market that is too small for the large firm. The competitiveness of SMEs also is due to the fact that a product is more than a set of physical characteristics. Smaller firms set themselves apart by providing additional services such as on-site maintenance, quicker delivery or a better product. When Henry Ford, the entrepreneur who introduced the automobile production line, said that you could “have any colour you want on your automobile, as long as it is black”, he provided the stimulus for the opening of the first small automotive paint shop. There was a demand for cars painted a colour other than black, and it was small businesses that identified this demand and provided painting services. When it became clear that there were sizable numbers of buyers who wanted something other than black cars, Ford developed the capability to paint cars in a variety of colours. The original paint shops then shifted to repainting cars after collisions or to providing customised colours not available from Ford.
12. An increase in the capability of small industrial firms, or small service businesses for that matter, may help larger businesses to export more successfully. On the production side, the gain would be from more productive smaller firms producing sub-components and assemblies that would lower the cost of completed large firm outputs. On the service side, small firms can facilitate export transactions through assistance with shipping, insuring and marketing. The gain in export terms would be significant, even though the underlying improvement is due to industrial or service SMEs.
13. In recent years, firms going out of business as a share of new start-ups has fluctuated as follows: 1999, 26%; 2001, 84%; 2002, 95%.
14. Turkey Knowledge Economy Assessment Study, February 2004.
15. The Saving Deposit Insurance Fund is responsible for liquidating insolvent banks. It was set up in 1983 under the auspices of the central bank and was then transferred to the Banking Regulation and Supervision Agency when the Agency was created in June 1999.
16. For a more general discussion of the issues, see “Financing Innovative SMEs in a Global Economy”, prepared as background for the second OECD Conference for Ministers Responsible for SMEs in Istanbul, 3-5 June 2004.
17. Subsidised loans to SMEs by the state Halk Bank, insofar as the Treasury did not pay the interest due.
18. There is some confusion as to what constitutes a micro-loan or a mini-loan. In Bangladesh a micro-loan, made to a group of women working co-operatively, may be as small as EUR 50 or EUR 100. In the United States, a mini-loan to a woman business owner may be as much as USD 20 000 to USD 25 000. In less developed countries, the targeted loan programme may feature an extensive training component to help women become familiar with banking practices and making repayments. In more developed countries, women are usually more

knowledgeable about banking practices and loan repayment obligations, and more attention is paid to bundling management counselling and assistance to the loan process. Payback in most countries has been very good, and these programmes have grown both in number and in size in recent years.

19. TÜBİTAK, *Turkish Science and Technology Policies, 1993; Impetus on Science and Technology*, 1995.
20. The other bodies lending support to SMEs are: the Scientific and Technical Research Council of Turkey (TÜBİTAK); the Technology Development Foundation of Turkey (TTGV); the Turkish Standards Institute (TSE); the Turkish Patent Institute (TPE); and the Turkish Accreditation Agency (TURKAK).
21. In the United States, the US Small Business Administration (SBA) issues guarantees backed by the full faith and credit of the federal government. Banks that are new to the programme must submit all loans for review by SBA loan staff, but as banks gain experience and show that they can perform the expert review of SME loan requests, they are assigned a quota of guarantee funds and assign guarantees as they see fit. Over time, SBA has lowered the percentage of a loan that is guaranteed (from 90% to 100%, initially, to 75% today). An essential element of authorising banks to make their own guarantee decisions is the random sampling of guaranteed loans by SBA auditors. The programme has been in effect now for over 40 years and has been increasingly successful. The stable monetary and fiscal policy situation in the United States over most of these years has greatly facilitated the use of SME loan guarantees.
22. These figures are for 2001 and may have changed as plans call for expansion of all of these programmes.
23. These are the Ministry of Labor and Social Security (CSGB), the Turkish Employment Organisation (ISKUR), the Ministry of National Education (MEB), the Static Planning (DIT), TESK, TOBB, the Confederation of Employer Associations of Turkey (TISK), the Confederation of Trade Unions of Turkey (TURK-IS) and the Foundation for the Promotion of Vocational Training and Small Industries (MEKSA).
24. The United States pioneered such a programme in the early 1970s in an attempt to use campus managerial and engineering expertise to help SMEs. Business schools enthusiastically supported the process but engineering experts were less supportive, probably because they could obtain outside consulting contracts without the assistance of a government programme. There are approximately 1 200 small business development centres in the United States today. They focus on management counselling, marketing and finance. Generally speaking, almost all activity in these centres is focused on educating and training small business owners to help them meet their business management, marketing and finance needs. Most centres do not provide access to funds, but they train businesses to complete loan packages to be taken to private banks.
25. According to the Ministry for Industry and Trade, a significant proportion of existing small industrial estates were not supported by government loans.
26. The state of Minnesota (United States) also pays for private contractor support. It provides an exceptionally wide range of services to SMEs. In a few states, the technology development centre may offer to carry out the contract on a reimbursable basis, but in almost all cases the centre restricts its support to analysing problems, designing solutions, finding capable outside contractors and supervising outside contractors when asked to do so. The fact that the actual improvement work is done by private contractors minimises conflicts between the

government's industrial engineers and the consulting firms actually carrying out the contract. From the consulting firm's point of view, the assistance provided by the government to the small firm helps the consulting firm to market its services. Rather than interfere with the private market for technology consulting, the government reinforces the effectiveness of the private market. At the same time, the government engineers are helping small business owners to understand how they can better use technology to improve their businesses.

27. It is difficult, however, to evaluate the success of these programmes because they bundle so many services through one delivery mechanism. A case study model with random selection of cases can be used to provide some useful evaluation information. Evaluation will be discussed in more detail below.
28. Consulting is the provision of expert knowledge or action to overcome a problem facing a business. Counselling refers to advising a business, but leaving the business to apply its own knowledge and skills to the actual problem. A consultant would prepare a business plan for an enterprise; a counsellor would point out that a business plan is needed, suggest appropriate training (or provide such training), and leave it to the business to prepare the plan. A counsellor may criticise the finished plan, but not complete it for the business owner.
29. This is likely to be particularly true in Turkey where the internal market is relatively large. As Turkey grows, more small firms will focus on production for the internal market.
30. Large firms are built to capture scale economies that lower the price of the firm's output. To capture scale economies, plants of large companies are built to operate at full capacity on a steady basis. When there is a random downturn in demand, much of the large plant's capacity would not be utilised. This would drive up production costs and prices. Smaller firms often thrive in markets where there is uncertain or fluctuating demand, and they often specialise in adjusting output to meet changing demand. Many of these variable demand markets are local or regional markets and reflect local tastes and local economic conditions.
31. High-technology products may be an exception. A new product or service produced by an SME and protected by intellectual property rights may be able to compete successfully on world markets. But small industrial firms often lack the ability to finance or market on a large-scale basis. Successful high-technology firms, therefore, are often forced to license production and distribution rights to larger firms, or be bought out by a larger firm. Neither of these outcomes is bad for the economy, although in both cases much potential profit may flow to licensing or purchasing firms located outside Turkey.
32. This is almost certainly true for the European, Asian and North American markets, but less true in developing country markets. Turkish firms may be able to expand exports to developing countries more easily than to more developed countries. In this case, government-supported financing may be more critical. The cost of providing subsidised interest means that benefits to Turkish exporters are partially offset by aid flows to foreign purchasers.
33. Office of the Prime Minister, State Planning Organisation, *Industrial Policy for Turkey (Towards EU Membership)*, 2003.
34. Ministry of Industry and Trade, KOSGEB: Support Programs 2003.
35. An extended discussion of evaluation methods and approaches can be found in the OECD *Small and Medium Enterprise Outlook*, 2000 edition, pages 25-39. In the framework of the OECD Bologna Process, the methodology for evaluating SME policies has been further reviewed in depth. See "Evaluation of SME Policies and Programmes", prepared as

background for the second OECD Conference of Ministers Responsible for SMEs in Istanbul, 4-5 June 2004.

36. Quoting from page 28 of the *OECD Small and Medium-sized Enterprise Outlook 2000*, “In addition, evaluation methodologies should be clearly stated, evaluation schemes should include cost-benefits frameworks; quantifiable, measurable criteria should be used to determine success when possible, the counterfactual scenario should be used as a way of describing what would have happened in the absence of a programme or policy, and the results of evaluations should be fed back into the programme design, in order to improve it. Generally, the last has been the weakest aspect of evaluation practices.”
37. The United States provides an example. The US Small Business Administration has an Inspector General, whose staff conducts both programmatic and fiscal audits and evaluations within the agency, and is subject to investigation by the General Accounting Office, which is an arm of the US Congress and which conducts programmatic evaluations as requested by the Committees of the Congress to support their oversight of the Executive Branch.

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