



*EXECUTIVE SUMMARY*

***THE ITALIAN SME EXPERIENCE  
AND POSSIBLE LESSONS FOR  
EMERGING COUNTRIES***

*Patrizio Bianchi, Lee M. Miller, Silvano Bertini*

**NOMISMA**

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*Table of contents*

<a href="#"><u>I. Introduction</u></a> .....	4
<a href="#"><u>A. Why small-firm networks and clusters are important in emerging countries</u></a> .....	4
<a href="#"><u>B. Introductory observations concerning the reproduction of SME clusters</u></a> .....	5
<a href="#"><u>II. Italian SMEs and SME Clusters</u></a> .....	6
<a href="#"><u>A. The importance of SMEs in Italy</u></a> .....	6
<a href="#"><u>B. Competitive advantages of SME Clusters</u></a> .....	8
<a href="#"><u>C. Various models of local development</u></a> .....	11
<a href="#"><u>D. Lessons learned from Italian clusters</u></a> .....	13
<a href="#"><u>E. Methodological considerations</u></a> .....	16
<a href="#"><u>III. Public Policies for SMEs and Inter-firm Cooperation in Italy</u></a> .....	17
<a href="#"><u>A. National policies and incentive schemes</u></a> .....	17
<a href="#"><u>B. A comment on Italian regional policy</u></a> .....	23
<a href="#"><u>C. Weaknesses in policy measures</u></a> .....	24
<a href="#"><u>IV. The Role of Policy in SME Development: Possible Lessons from Italian SMEs and Related Policies</u></a> ....	26
<a href="#"><u>A. Lessons from Italian SMEs and related policies</u></a> .....	26
<a href="#"><u>B. Necessary conditions for competitive SMEs</u></a> .....	27
<a href="#"><u>C. Three types of clusters, three types of policy</u></a> .....	28
<a href="#"><u>D. Policy suggestions to create environments conducive to SMEs</u></a> .....	30
<a href="#"><u>E. The necessary role of intermediate governance</u></a> .....	32
<a href="#"><u>F. Some guidelines for UNIDO programmes for SMEs in emerging countries</u></a> .....	34
<a href="#"><u>Bibliography</u></a> .....	36
<a href="#"><u>APPENDIX 1</u></a> .....	37

## I. Introduction

The Italian industrial model is known worldwide as a successful example of endogenous development based on SMEs strongly rooted in their communities. Is it possible to achieve a competitiveness and social stability through these mechanisms elsewhere, especially in emerging countries? In this paper we try to highlight the main elements of the Italian experience and to learn some lessons for emerging countries.

### *A. Why small-firm networks and clusters are important in emerging countries*

It is safe to say that start-up firms, that is new firms, begin small. When considering objectives like industrial development and increased employment, policy often focuses on efforts to favor start-up, or small, firms.

SME networks also merit consideration because in emerging countries, or regions, interventions on the part of large firms to establish production plants in these low-cost areas have often failed. The South of Italy is full of such examples. The reasons for these problems are many, including: inadequate infrastructure to support large plants, increased traffic, drain on limited energy resources, insufficient and/or ill-prepared workers, distrust and even animosity between local workers and non-local managers.

It is in light of the above-mentioned difficulties facing established firms when they try to relocate plants in less-developed regions of Italy that leads us to assert that the idea of sustainable, long-term development is based on bottom-up growth. Small firms must grow from local roots in order to survive, and even flourish, without reliance on heavy subsidies.

Bottom-up growth based on small firms is also considered as a source of increased employment, including self-employment, and a way to incorporate actors that are traditionally excluded from economic development like women and young people.

The inclusion of more people in economic development may have various positive effects on the local economy. First of all it increases employment and contributes to making the local economy more vibrant. Secondly, a multiplicity of active participants helps ensure the social stability needed for sustainable economic development.

Numerous small firms, particularly if concentrated in the same industrial sector, or in complementary ones, also tend to increase the tendency for specialization among firms. Such specialization is seen as one of the

key factors in success of small-firm networks and clusters. In particular, specialization allows for the focused use of resources. It is plausible that areas with consolidated systems of specialized small firms are also more likely to attract foreign direct investment.

*B. Introductory observations concerning the reproduction of SME clusters*

Italian SME clusters cannot, in our view, be reproduced. That is, a cluster may not be transplanted somewhere else. The success of the cluster phenomenon is rooted in the local context, local traditions and local forms of social and economic organization. Any attempt at nurturing the development of cluster-like agglomerations of small firms must build upon the particular characteristics of the area in question.

In fact, previous approaches to industrial policy based on top-down interventions by a central authority have failed because they did not consider local history, traditions, formal rules and informal norms. This does not mean that the success of a region depends only on its history as this would lead to the erroneous conclusion that policy interventions are futile in areas that do not already enjoy economic promise. We firmly believe that it is possible to establish a productive environment by stimulating local forces to create a local institutional context providing common externalities. What we advocate is a “bottom-up” approach that builds on the specifics of the local level to create the conditions that increase efficiency and productivity of groups of firms, and to stabilize the local community in order to establish a foundation for endogenous growth.

## II. Italian SMEs and SME Clusters

### A. The importance of SMEs in Italy

Italy is known for its high concentration of small firms. In fact, within Europe only Greece and Spain have comparable average enterprise size and percentages of micro-firms (See Table 1). Although many other countries have a large number of small firms, Italy is interesting in that it is among the largest economies in the world and, yet, 98% of industrial firms have fewer than 100 employees. Almost 90% of firms have fewer than twenty workers. The average size of Italian industrial firms is seven employees.

Italy is particularly interesting in that it is unique in the European Union because of its large economy characterized by relatively high labor costs and high GDP per capita, accompanying its high incidence of micro and small firms. In fact, in manufacturing sectors, Italy registers the highest EU percentage of SMEs. Therefore, Italy has shown that in order to have a highly developed economy, it is not necessarily true that it must be based on large firms.

Italian small firms that are internationally successful tend to export high-quality goods. These are usually consumer goods, often connected to fashion industries, or other products valued for high-quality design, seen to be typically Italian. It should be noted that Italian SMEs are also strong exporters of agro-industrial and food products. Some intermediate goods producers are long-time exporters; the firms producing textiles in Prato, near Florence, constitute perhaps the most famous. The production of capital goods is also characterized by SMEs. Italy is among the world export leaders in: machine tools, textile machines, leather and footwear machines, food processing machines, agriculture machinery, packaging machines, wood processing machines, machines for ceramics, machines for metalworking. Two of the best examples of these are: agricultural machines in Reggio-Emilia and automatic machines in Bologna. Italy is also a leading exporter of highly specialized products such as small domestic appliances, eyeglasses, compasses, etc.

Table 1 - *Size-class structure by country, 1990*

COUNTRY	ENTERPRISE (X 1,000)	AVERAGE ENTERPRISE SIZE
Belgium	490	6
Denmark	170	9
France	1,980	7
Germany*	2,290	9
Greece	690	3

Ireland	130	8
Italy	3,920	4
Luxembourg	15	10
Netherlands	420	10
Portugal	600	5
Spain	2,460	4
United Kingdom	2,630	8
EU-12	15,780	6
Austria	180	12
Finland	110	12
Norway	130	10
Sweden	150	13
EFTA-4	570	12
Europe-16	16,350	6

\* Excluding the New German Länder.

Source: EIM Small Business Research and Consultancy on the basis of data from Eurostat. Quoted in European Network for SME Research. 1995. *The European Observatory for SMEs. 3rd Annual Report*, p. 47.

How is it that Italian small firms can be so competitive? The answer is found by looking at small firms not as individual entities, but as parts of groups of firms that, by banding together, are able to create what they would not be able to create as single firms. It is for this reason that the so-called “industrial districts”, or “clusters”, have been of such interest to entrepreneurs and scholars alike.

“SME clusters” refer to groups of small and medium-sized enterprises located in a relatively delimited geographic area engaged in the production of the same sort of products. Although there is strong competition among firms, often there is also a high degree of cooperation among firms in that the production processes are divided into distinct phases with separate firms responsible for different phases. Therefore, specialized small firms divide up the labor process and may group together, or regroup, depending on the requirements of the market. This model allows for flexibility and short response times that large firms with fixed assembly lines are often unable to provide. It is important to point out that firms are interdependent, but do not necessarily have relations of dependency. The small firms tend to be relatively independent even if *interdependent*.

Clusters may vary from those including only micro, small and medium firms and excluding groups containing larger firms, to those including even large firms surrounded by their own decentralized subcontractors. Some clusters are based on a single production process and others include related activities and spin-off industries. Here the term cluster is used to encompass all of these variations of geographical concentrations of small businesses.

Due to analytical difficulties, the number of districts in Italy varies according to different inquiries. However, on the basis of simple statistical indicators, ISTAT (Central Institute of Statistics) reports 199 industrial districts, responsible for 42.5% of all manufacturing employment (Table 2).

Table 2 - *Importance of industrial districts in Italy*

	NUMBER OF DISTRICTS	DISTRICT EMPLOYMENT	SHARE ON MANUFACTURING EMPLOYMENT
North-West	59	922,140	44.0
North-East	65	835,521	60.6
Center	60	405,613	43.7
South	15	58,970	7.2
Italy	199	2,222,244	42.5

*Source: ISTAT. La situazione economica del paese, 1995 Roma.*

A more conservative estimate of the number of small-firm aggregations in Italy is the list of “districts” identified under Law 317, article 36, in October 1991 (see Appendix 1). We may begin to get a rough notion of the number of locally concentrated systems of production present in Italy if we look at all those areas considered to be SME clusters, how they work, and what they produce.

#### *B. Competitive advantages of SME Clusters*

The competitive advantages of SMEs grouped in clusters are based on three aspects: specialization, cooperation and flexibility.

When firms are located in clusters, small size is less of a limit because of access to subcontractors, parts and services available outside their own walls. Firm specialization is crucial to the success of districts or clusters in that it allows small firms to focus their resources (which are often extremely limited) on what they do best (core competencies). Specialization may also help curb problems of quality control - if a firm does only one thing, it has to do it well. However, specialization does not occur automatically. Certainly, small firms everywhere attempt to concentrate their efforts in areas in which they excel. But specialization, in terms of process, results in a division of labor among firms. One firm may be specialized in a certain phase of the production process if it operates near other firms specialized in complementary phases. The

advantage of specialization is related to individual firms, but also to the cluster as a whole. The development of the cluster is accompanied by increasing specialization of technical and market competencies of local human resources. Local workers, technicians, managers and consultants often move from firm to firm; in this way the advantage of specialization belongs to the local system, rather than to a single firm. Furthermore, local infrastructure and training institutions become increasingly specialized in the cluster activity. The know-how accumulated in the local context becomes the main location factor for productive activities, even by external investors.

A cluster of firms working together in a productive system characterized by a division of labor among the members is obviously based on a high degree of inter-firm cooperation. Through a reliance on cooperation with other firms, small firms may accentuate their specialization and compensate for any weaknesses.

Inter-firm cooperation is important, not only in terms of the availability of resources, but also in terms of firm flexibility. Cooperative inter-firm relations help firms be more flexible in terms of amount of production since firms may outsource more work when there is increased demand, and less when there is a decrease. Cooperation among firms also helps firms be flexible in terms of type of production in that products can be made to order by grouping different contractors together according to the specialties required<sup>1</sup>.

This type of inter-firm cooperation requires coordination. In districts, there is often a strong presence of some form of intermediate governance structure. Governance is used here to mean the “institutional organization of economic activity” (Campbell, et. al., 1991, p. 361). Italian case studies demonstrate that such intermediate governance structures play a key role in facilitating cooperative activities among firms and between firms and institutions.

There are various levels of governance. Italian SMEs are “governed” by institutions on the level of the European Union, the Italian government (national), regional government and local institutions. Since SMEs tend to be very rooted in their local context, the focus of this paper is governance on the regional and local levels (Table 3). Intermediate governance structures are “intermediate” in that they represent numerous actors that in some way influence economic activity.

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<sup>1</sup> It should be noted that here we refer to specialization in terms of processes, not strictly in terms of product. In this sense, specialization is not at odds with flexibility.

Table 3 - *Italian Intermediate Governance Structures*

<p>Levels of Local Government:</p> <ul style="list-style-type: none"> <li>- City</li> <li>- Province</li> <li>- Region</li> </ul>
<p>Other Local, Public Organizations:</p> <ul style="list-style-type: none"> <li>- Chambers of Commerce</li> <li>- Convention/Exhibition Centers</li> </ul>
<p>Research &amp; Training Structures:</p> <ul style="list-style-type: none"> <li>- Local branches of National Research Council (CNR)</li> <li>- Local branches of New Technology &amp; Environmental Agency (ENEA)</li> <li>- Technical Schools</li> <li>- University (Public)</li> <li>- Professional Training Structures</li> <li>- Research Consortia</li> </ul>
<p>Local Business Structures:</p> <ul style="list-style-type: none"> <li>- Business associations &amp; organizations</li> <li>- Industry specific service centers</li> <li>- Business Innovation Centers and Technology/Industrial Parks</li> <li>- Public &amp; Private Firms</li> <li>- Credit Institutes</li> </ul>

Specific examples of key intermediate institutions in SME clusters could include the Parmesan cheese consortium in Parma, the local chapter of the national businessmen's association in Sassuolo - Assopiastrelle - or the Small Business Association in Reggio Emilia. The form the institution takes in the various districts differs, but the role as catalyst for cooperation is similar.

Both the organization of production and the presence of intermediate governance structures contribute to fostering the system's growth by lowering barriers to entry for new enterprises. Thanks to the local network, a new firm can start with limited capital (enough for just one productive phase, or component) and limited risk of failure (no need for creating market relationships, at least at the beginning). The

intermediate institutions and associations provide basic business support services, increasing trust among entrepreneurs and reducing administrative and legal costs. Case studies confirm this in that those areas reporting the most inter-firm cooperation are exactly those areas with strong intermediate structures which act as reference points for local small firms.

### *C. Various models of local development*

There are numerous models of local development which have often been lumped together under the label “SME clusters”. Until recently, the differences among the various types of clusters were not considered, and it was believed that all the specialized areas characterized by a strong presence of SMEs were similar, with the same advantages and the same problems. A deeper knowledge of the phenomenon of SME development has shown that, despite common aspects, SME systems are much more complex and are not fully understandable when grouped under a standardized concept of “SME cluster”.

There are several variables explaining the differences among SME clusters. First of all is size. There is no specific theory explaining the minimum size of clusters. In Italy, we can find a wide range of sizes of SME systems: from Prato, with more than forty thousand workers and nearly ten thousand enterprises, and a few other large districts (Biella, Como, Carpi, etc.), to very small SME systems with only several hundred workers and fewer than one hundred enterprises (one example is the Grottaglie ceramic sector in Apulia), but clearly constituting cases of strong local sectorial specialization. The *size* of the cluster can depend on:

1. the age of the district;
2. the extent of the related market;
3. bottlenecks in the local context, consisting of physical, administrative, or even cultural obstacles to production expansion, limited human resources, immobility of entrepreneurial and technical capabilities.

A second element of differentiation of clusters is the size of firms within them and the *relationships among local enterprises*. We can list five main typologies of local productive systems:

1. systems in which many small firms are simply direct competitors for the same product and have just a few, or no, reciprocal relationships, such as systems of monosectorial craftsmen, or sectors with low scale, but rigid productive cycles;<sup>2</sup>

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<sup>2</sup> Examples: Murano - glass products; Vicenza, Valenza Po and Arezzo - goldworking; Volterra - alabaster; etc.

2. systems of the same type, but with one, or a handful, of medium-size firms emerging as local leaders;<sup>3</sup>
3. systems based exclusively on small and micro firms with intense reciprocal relationships of subcontracting;<sup>4</sup>
4. subcontracting systems located around one, or several, large main contractors;<sup>5</sup>
5. systems based on specialized medium-sized companies and articulated in complementary businesses in differentiated market niches;<sup>6</sup>

Thirdly, the *relationships of the enterprises outside the system* must also be considered. From this point of view, we can identify:

1. systems depending on external firms, as main contractors for local subcontractors;
2. independent systems, transforming local raw materials (agro-food products), or importing raw materials (textile, metalworking, etc.), and organizing the whole production cycle in the local system;
3. open systems, able to activate external subcontractors or to invest outside the local area, and even abroad.

It is clear that, as they develop, clusters tend to pass from the first two, to the third typology.

On the basis of the variables listed above, clusters can be grouped into three main types: embryonic, consolidated and mature. Often these categories correspond to the age of the cluster - embryonic clusters being very young ones and mature clusters being older ones. However, this is not always the case. A district, despite its age, may remain in embryonic form - unable to evolve into a consolidated or mature district. Or, a relatively new district may quickly reach the consolidated or mature stages. Briefly, an embryonic cluster is one that is for the most part limited to the local/regional market and characterized by firms that work as subcontractors for large firms, often outside the local context. A cluster is consolidated when it is able to conquer a wider market, includes more, increasingly specialized firms and when it begins to acquire an identity as a cluster. Maturity of a cluster is accompanied by ability to innovate successfully within the cluster, a move toward goods which incorporate more value-added and processes of internationalization.

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<sup>3</sup> Examples: Sassuolo - ceramics; Brescia - steel, etc.

<sup>4</sup> Examples: Prato - wool textiles; Fermo-Porto San Giorgio - footwear; Cerea-Bovolone - furniture; etc.

<sup>5</sup> Examples: Treviso - knitwear; Castelfelfredo - hosiery; etc.

<sup>6</sup> Examples: Montebelluna - footwear; Reggio Emilia/Modena - machinery; etc.

Another element to consider is the location of the productive systems. SME clusters may be located in peripheral, or even rural communities, others in medium-sized towns, others within the industrial apparatus of medium/large cities. Normally, the peripheral rural systems are strictly monosectorial and concentrated on production activity, since they tend to lack qualified services and human resources; the systems located in medium-sized towns are more diversified within the same technological *filiere* and market target and, sometimes, there is a simultaneous presence of diverse productive systems in the same area; the systems located in larger towns, besides this diversification, can easily find qualified resources within the territory, due to the presence of service activities, universities and research centers, and sufficient infrastructure.

It must also be considered that a SME cluster may be isolated or may be located within a larger, regional cluster linked together by technological or market similarities. Examples include the different districts in the province of Brescia, linked to the steel and non-ferrous metals *filiere*, or the ring of districts around Florence, connected to the fashion industry, or the integration between traditional activities and sectors producing technologies and complementary products for them, as in Emilia-Romagna's "food valley" and in mature textile and footwear systems. The presence of complementary districts in the same region is an important factor for increasing competitiveness, since it facilitates the diffusion of information regarding markets and technologies, the mobility of human resources between complementary (not only similar) activities and the realization of common initiatives.

To conclude this list of factors explaining different models of SME development, it must be remembered that clusters are in continuous evolution. In the last ten years, the mature clusters tended to increase the degree of industrial concentration (often through mergers and acquisitions), to increase quality and stabilize subcontracting relationships, to reduce the number of enterprises, to diversify and innovate products, to open their external relationships at the international level (Crestanello, 1992, 1996). At the same time, other clusters are emerging, especially in the South of Italy: some starting from traditional activities, others mainly through the creation of subcontracting networks by Northern firms.

#### *D. Lessons learned from Italian clusters*

Case studies of Italian SME clusters have been examined to get an idea of the variety of possible forms SME agglomerations may take. The type of cluster is shaped by the local environment and the sectorial concentration - different products require different production processes.

The case studies examined represent the variety of models of SME-based production processes and present situations that range from the diffused production of textiles and clothing around the city of Treviso characterized by two large leader firms which control a multitude of small firms in very hierarchical

relationships, to the more egalitarian relationships present in the agro-food cluster located around the city of Parma and Reggio Emilia. In between the extremes of these two models there are those areas that are largely characterized by several leading firms that serve as “catalysts” for the growth of the area, but there are also a good number of other final firms (firms with access to final markets) and many smaller, specialized firms in various parts of the production process. Then there are the small and micro firms that work largely as subcontractors for other firms. It is important to note that relationships in these districts may be described as cooperative relationships among independent firms.

The Italian case studies have demonstrated that there are many types of SME clusters. Their characteristics vary in important ways. However, there are some common denominators in the most dynamic SME systems, and it is these factors that should be emphasized in policy considerations. These are outlined in the following remarks:

- The development of a cluster of SMEs is a long-term process. It is determined by positive market perspectives and favorable local conditions (technical know-how, social cohesion, flexible labor force, etc.). It has been demonstrated that SME natality depends on market perspectives and availability of personal assets; it is, furthermore, facilitated by the formation of local networks and common activities that lower entrance barriers and minimize the risk of investment. The need for more sophisticated financial instruments and appropriate policy action for innovation become relevant only when SMEs and the whole cluster need to consolidate.
- The competitiveness of clusters is both static and dynamic. Static competitiveness is rooted in productive efficiency, that can ensure the realization of different products at relatively low costs, thanks to the wide presence of subcontractors and component suppliers. Both product differentiation and excess of demand are factors in static competitiveness. The SME systems that correspond most closely to the strict definition of traditional “industrial districts” are populated by numerous autonomous firms. Despite the fact that there is much actual interdependency in the relationships among firms, there are relatively few hierarchical relationships. The interrelationships that do exist are considered “horizontal” in that they are among equals - each firm occupying a phase of the production process without which the other firms would not be able to function. The division of the production process among many small firms is important in that it allows firms to be highly specialized in complementary phases of production. It also helps keep entrance barriers at a minimum and therefore facilitates the entry of new actors. However, there may be several firms dedicated to the same production phase. Among these firms there is likely to be strong competition, whereas among firms at this phase and other firms up and down the production process, relationships are likely to be characterized by cooperation. It is this mix that seems to be one of the keys to clusters’ ability to compete even on international markets.

The presence of many final firms helps avoid too much concentration and too much hierarchy as it is the access to final markets that often places certain firms in a privileged position with respect to others. The dynamic advantage of the cluster is linked to technical know-how accumulation. The cluster determines a strong concentration of firms, human resources, training institutions, physical and research infrastructure, all specialized in the activities of the cluster, or in related ones. This concentration implies a lot of relationships and interaction, favoring spontaneous mechanisms of specialization, incremental innovation and enterprise creation, that make the companies and the SME clusters increasingly competitive in terms of quality.

- The control of strategic business functions may be achieved in many different ways. Sometimes, one or a few main firms may emerge in the cluster, expanding the market for the whole system. In other cases cooperatives and consortia of SMEs have been created, also with the support of local institutions. Sometimes local institutions and associations do not have a direct influence on business functions, but work as part of the external governance system surrounding the firms, improving external economies and favoring inter-firm cooperation. In some cases, especially in the southern regions, this problem is not solved and SMEs are strongly subordinated to market evolution and to their customers' choices.
- The promotion and diffusion of innovation occurs through enterprise relationships and interaction especially if a leader firm or a group of leader firms exists. An example of the individual success of a leading firm can be a powerful stimulant for innovation.
- The institutional configuration is also flexible. The emergence of a leading role is linked to specific local contexts and to differences in efficiency of local actors. At first glance, this may seem to be a weakness, but for those clusters characterized by strong endogenous dynamism, it is more convenient than a rigid scheme, since it is possible to channel bottom-up initiatives more effectively through the most dynamic and efficient organization(s). In the more mature SME systems, it is clear that intermediate governance structures play a vital role. They act as key reference points for the firms within the system and for the systems' external relationships. Their central role is achieved through the high degree of co-participation of firms in common initiatives. It is through these structures that area firms have a sense of participation in the larger SME system and this may eventually lead to the pooling of resources to meet the specific needs of the sector's firms. What this means in terms of policy will be explored in the final sections of this paper.

### *E. Methodological considerations*

In addition, it must be remembered that a district, a cluster, is a grouping of individuals, from whose interaction - both cooperative and competitive - emerges a collective action with evolutionary characteristics. Through interaction, firms establish behavioral norms that influence later behavior. What results is therefore a evolutionary process that is specific (in that each situation is different) and irreversible. It is therefore possible to identify stylized facts that represent the various evolutionary phases of districts, but each specific case must clearly be understood in its complexity. Furthermore, every external instrument designed to favor investments, create common services, promote entrepreneurial aggregation needs to be flexible enough to be adaptable to the specific situation at hand. For this to occur, the first step toward designing policy for the development of districts is an in-depth study of the local level, not only of the history and culture of the area, but also of the existing interaction dynamics among the various social actors. In fact, similar conditions may generate very different group dynamics that must be carefully analyzed as it is these rules of collective interaction that influence the developmental process of clusters.

The Italian cluster experience offers two principal methodological lessons to those wishing to act in emerging countries to promote diffused development.

1. A strong capacity for territorial and sectorial analysis, combined with the ability to analyze social interaction is required.
2. It is necessary to evaluate the results of intervention, not only in terms of firm growth, but also in terms of general development of the territory. In this way the cumulative effects of changing competencies and know-how available in the area may be fully understood. Methods of monitoring the change process should therefore be built-in to interventions so that the local-level actors will be able to effectively observe changes and make future adjustment if necessary.

The following chapter briefly presents the Italian policies for SMEs and inter-firm cooperation. In light of the lessons mentioned above, these policies are described and commented.

### III. Public Policies for SMEs and Inter-firm Cooperation in Italy

#### A. National policies and incentive schemes

On the eve of the completion of the Single European Market, in 1992, Italian industrial policy for small and medium-sized firms began to be criticized. The European Community on one hand, and economic literature on the other, underlined the fact that national interventions aimed at SMEs had been undertaken without an integrated industrial policy framework resulting in measures that compensated for (and therefore perpetuated instead of removing) the disadvantageous situations in which these firms often operate. Furthermore, initiatives targeted individual firms instead of reshaping the wider, institutional context to promote relations among firms and to create, once and for all, local conditions for growth.

The debate centered around Law 1329, 1965, better known as the Sabatini Law, the instrument most frequently used by Italian firms. In the thirty years of its existence more than 200,000 subsidies have been granted which have led to approximately 40,000 billion lire in investments. This law, aimed at SMEs that meet Community parameters, favors the acquisition of machine tools by subsidizing interest rates, allowing the buyer to pay in installments at lower interest rates (see Table 4). It has been argued that this law is aimed at individual firms, and is therefore a form of aid directed towards rewarding the banking system's practice of price discrimination on the basis of firm size, rather than being an incentive to eliminate disadvantageous structural conditions. Its critics view it as a subsidy to sustain, and therefore preserve, the non-competitiveness of the banking system that furthermore encourages simple modernization, rather than firm innovation.

Table 4 - Law 1329, 1965 (*Sabatini Law*)

**How it works:** The Sabatini Law is applied to the seller who offers an extended payment plan for a maximum of 5 years at a low interest rate; the seller presents the bills of exchange to an authorized *Mediocredito* banking institute and receives the entire amount. The bank then asks *Mediocredito Centrale* for a contribution to cover the difference between the amount received at lower interest and the amount the bank would have received at current market interest rates.

**Eligible investments:** The purchase or lease of new machine tools.

**Beneficiaries:** SMEs that correspond to Community parameters<sup>7</sup>.

**Amount:** Not more than 3 billion lire. This amount refers to the capital plus the interest on the extended payments. For each local unit, per year, the maximum of investment is 4.5 billion lire.

**Eligible operations:** Discounting bills of exchange in connection to acquisition or leasing through extended payments for a maximum of 5 years, minimum of 12 months, through a bank licensed by *Mediocredito Centrale*. Capital purchased used as collateral.

**Low-cost interest rates:** Interest rates are 8 percentage points lower than market interest rates for local production units located in Objective 1 areas and 5 percentage points less than market interest rates for eligible production units located elsewhere.

**Types of incentives:** Interest account paid to bank to cover the difference between net amount received at low-interest and amount calculated according to market rates.

**Procedure:** Applications are sent to *Mediocredito Centrale* by a member bank.

Others have expressed more positive evaluations highlighting on one hand the positive aspects that justify its success; simplicity of its procedures, its automatic concession mechanisms for subsidies, the possibility for both parties in the buyer-seller relationship to benefit; on the other its efficacy and efficiency. In particular, the efficacy of the law seems to result from the existence of an insufficiently competitive credit market and a structurally weak financial market, anomalies which the Sabatini Law attempts to correct. Its efficiency, however, is demonstrated by the numbers: a comparison of the subsidies granted and the investments made from 1987 to 1995, shows that for every lira provided by the State, 10 lire were spent for new machines. However, even the champions of the Sabatini Law admit that if these financial incentives had been accompanied by a supply of non-financial services to the firms including investment assistance, planning, innovation management, the results would have undoubtedly multiplied.

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<sup>7</sup> Manufacturing firms must have: fewer than 250 employees; annual turnover under 20 million ECU or total capital of less than 10 million ECU.

All other firms must have: fewer than 95 employees; annual turnover under 7.5 million ECU; total capital of less than 3.75 million ECU.

No firm may be owned (for more than 1/4) by any firms not corresponding to these parameters.

The legal instrument created to respond to the need for policy directly aimed at SMEs is represented by Law 317, 1991 (see Table 5). The objective of the law is “to promote development, innovation and competitiveness of small firms”, intervening not only by supporting firm investment, but also through the creation of those conditions necessary to the creation of an external environment favorable to competitive growth.

It is along these lines that, for example, the distribution of capital account payments is dedicated to creating innovation centers and those for entrepreneurial development. Additionally, the new philosophy that inspired this law includes the creation of regional development agencies, new figures of specialized financial intermediaries capable of assuming some of the risk borne by SMEs, thereby offering these firms new opportunities for recapitalization, for innovation, and to become competitive.

The introduction of participatory loans, that entail the participation of the financing organization in the economic outcome of the firm and that allow long-term credit institutes to make grants to SMEs in addition to regional development agencies, represents a first step toward the evolution of the relationship between the banking system and small and medium-sized firms. On the other hand, the underlying idea that unites the various sections of the law, transforming them into a coherent whole is the intention to promote the structural reinforcement of SMEs in a context of development, representing a move away from direct subsidies.

Table 5 - *Principal Articles of Law 317, 1991*

**Art. 2:** provides for the creation of public financial institutes for innovation and development eligible for subsidies under Article 9 (in the form of tax credits) and Article 12 (capital account contributions).

**Art. 7:** tax credits for the acquisition of “real services” (structural services to firms).

**Art. 8:** tax credits for research expenditures.

**Art. 14:** special fund at *Mediocredito Centrale* that provides interest account contributions for export under Law 394, 1981.

**Art. 17:** identifies consortia eligible for subsidies under Article 20 (capital account contributions) and Article 24 (subsidies).

**Art. 27:** contributions for mixed public/private consortia that provide technological innovation, management and organizational services to SMEs.

**Art. 29:** identifies collective credit guarantee consortia eligible for subsidies according to Article 31. The losses suffered by these guarantee funds are financed up to 30% only in the case of consortia or cooperatives that guarantee finance to SMEs.

**Art. 34:** capital account contributions for business innovation centers (BIC) promoted by the European Community and for organizations for business creation, including those with mixed (public/private) capital.

**Art. 35:** participatory loans: long-term credit institutes and public financial institutes for innovation and development may grant participatory loans for the realization of innovation or development programs directed at SMEs.

**Art. 36:** provides financing on the part of Regional governments for innovative projects regarding groups of firms located in industrial districts.

Law 317 was intended to be valid only for the period 1991-1993. It is not only still in effect, it is far from being fully implemented (the only measures currently in effect are those dealing with innovative investments). In fact, in many cases the provisions have not yet become operative. Numerous and complex implementation procedures have slowed, and even blocked, the law's efficacy.

The most sensational example is that of the industrial districts. The law provides financing of innovative projects involving more than one firm, on the basis of a "program contract" stipulated by business consortia and regional governments. The identification of the districts, a job assigned to the regions, is subject to the application of parameters and indications established in a decree of the Ministry of Industry. This decree should have been released within 90 days of the activation of the law. The identification of the districts by the regional governments, in turn, should have occurred within 90 days following the decree. The ministerial decree was issued in April 1993, more than a year behind schedule, and, as of the writing of this paper, not all the regional government deliberations have been received by the Ministry of Industry. Presumably, the lateness of the regions is only partly due to bureaucratic slowness, in that, the criteria imposed by the decree make it difficult, if not impossible, to identify industrial clusters.

Law 317 dedicates an entire paragraph to consortia and consortia involving SMEs, with the intention of filling the gaps in the national system of incentives for inter-firm cooperation. In fact, inter-firm collaboration has been present in Italy for some time now, but only in the areas of export and collective credit guarantees. In the first case, thanks to the existence of a specific legislation supporting consortia for export, in the second case completely unconnected to any form of public intervention.

Regarding this provision, Law 317 proposes wider objectives than the previous legislation, favoring not only the organizational and operative evolution of collective guarantee consortia (article 29, see Table 6), but also the collaboration among firms in other fields, in particular that of services (articles 17 and 27, Table 6).

Article 17 establishes the distribution of capital account contributions and of subsidized financing in favor of SMEs consortia “having the goal of supplying services... directed at promoting development, including technological development, and the rationalization of production, of sales, marketing and management of the consortia’s member firms”. In this way, in addition to offering further opportunities for export consortia, the legislation attempts to meet firms’ needs for services. By creating a common distribution network, utilizing assistance and financial consultancies, receiving subsidies for scientific research or for the acquisition, constitution or management of industrial estates, local conditions for development are created.

Table 6 - *The Principal Measures for Cooperation Among SMEs*

**Law 83, 1989** provides financing for SME export consortia.

*Beneficiaries:* In order to be eligible for these subsidies, the consortia must

- include at least 8 firms
- conduct business activity
- have subscribed capital of at least 2,500,000 lire.

*Types of incentives:* annual financial contributions: tax credits.

*Responsible institutions:* Ministry of Foreign Trade

**Law 317, 1991** (see Table 5)

Art. 17 identifies consortia eligible for subsidies.

*Beneficiaries:* Consortia must be comprised of small industrial firms, or small industrial firms and small service providing firms. They may take the form of cooperatives and must have the goal of furnishing services aimed at promoting development (including technological development) and the rationalization of production, marketing and management of member firms.

*Types of incentives:* capital account contributions and financial incentives.

*Responsible institution:* Ministry of Industry

Art. 27

*Beneficiaries:* Mixed capital (public/private) consortia whose goal is to furnish services for technological innovation, managerial innovation and organizational innovation to artisan firms and SMEs. These consortia must be comprised of firms and institutions, no fewer than 5, having subscribed capital of no less than 20 million lire

*Types of incentives:* capital account contributions

Art. 29

*Beneficiaries:* collective credit guarantee consortia

*Types of incentives:* Losses suffered by these guarantee funds are financed up to 30% only in the case of consortia or cooperatives that guarantee finance to SMEs.

Towards this end, the law also favors the participation of local institutions in consortia in roles of responsibility. For this policy founded on the respect and the valorization of the socio-economic

characteristics of different territorial areas, local organizations represent the key vehicles, or intermediaries, for economic development.

For similar reasons, article 27 also benefits mixed capital (public and private) consortia as long as their statutes include the objective of providing services for the technological, managerial and organizational innovation of SMEs. These consortia may have chambers of commerce, and business associations of various types, other public and territorial bodies, public development agencies promoted by the regions, and business associations as members. The main difference between mixed consortia and others is that they may also operate on behalf of SMEs that are not members.

Today, it is not possible to accurately evaluate the efficacy of these measures since bureaucratic snags have slowed the realization of the provisions. Only the aid for innovative investments has been truly operative with 80% of funds having been assigned. The funding in support of SME consortia, and other initiatives, has yet to be distributed. The comprehensive evaluation of the impact and effectiveness of these policies could be the subject of important future research.

It is not only at the national level that public policy plays a role. In Italy, regions and regional governments vary greatly. The next section explains.

#### *B. A comment on Italian regional policy*

Italy created its regional government structures in the 1970s and gave them power to act in certain, limited areas. Regions were allowed to plan and manage local territorial improvements, and had authority in the areas of craft industries, professional training, and regional financial agencies (Magnatti, 1996, p. 208). However, the regions were not given industrial policy powers: these remained completely centralized in Rome.

Regional economic policy in Italy is complicated and varied. This is true because Italy's regions are so heterogeneous, and this affects policy in two main ways. The first is that Italian regions fall into different European Union funding categories. In this way, EU policies shape regional economic policies, especially in the underdeveloped regions qualifying for European Structural Funds. In Italy, some regions fit entirely in this category while others do so only in part. Still other regions are completely ineligible for Structural Funds, but actively participate in other EU programs.

The second way that the heterogeneity of the regions affects regional economic policy is that not all Italian regions have the same powers. The Special Statute regions were given much broader powers and more autonomy in terms of expenditures than normal regions (Magnatti, 1996, p. 209). Five regions have

special statutes and extended legislative powers. These include Sicily, Sardinia, Friuli-Venezia-Giulia, Trentino-Alto Adige and Val D'Aosta. Perhaps the most important area of intervention for these regions is that of economic development.

This paper uses a classification of policy interventions first formulated in a Nomisma study of Service Centers (Nomisma, 1988). According to this classification scheme, there are four basic types of intervention:

- a) diffusion of innovation;
- b) promoting/reinforcing relationships among firms;
- c) diffusion of information and training to better the internal functioning of firms;
- d) promotion of economic growth.

Of these four types, the two that most directly relate to the discussion of policy to create clusters are b and d. Obviously the promotion of inter-firm relationships is akin to cluster policy. Less obvious, perhaps, is the more general type of intervention aimed at local development. This policy is clearly further away from cluster building, but we feel is a necessary first step in areas so underdeveloped as not to have industrial concentrations or populations of small and medium-sized firms that could be encouraged to work together. Therefore, in regions that are fairly developed and reveal concentrations in certain industrial sectors, the knitting together of firms into clusters is a reasonable goal. Policy to promote clusters thus takes different forms depending on the developmental stage in which the region currently finds itself.

### *C. Weaknesses in policy measures*

The presence of competitive SMEs in industrial districts, or clusters, is not necessarily tied to successful policy aimed at stimulating inter-firm cooperation. In fact, despite Italy's many and varied clusters, relatively few policies are directed at groups of collaborating firms. The positive cluster experiences have revealed, as have national policies, that it is crucial for firm creation, growth and cooperation, to be associated with consolidated support structures. Policies might be linked more closely to existing structures, or aimed at creating organizations *ex novo*, in order to assist in the coordination of inter-firm cooperation. Helping the creation of such institutional actors may, in the long run, make a greater contribution to the development of cluster-like areas than subsidies directed at small, individual groups of firms collaborating on specific projects.

An examination of national and regional SME policy initiatives in Italy highlights several general weaknesses:

- lack of coordination among initiatives;
- lack of monitoring and evaluation;
- policy is only effective where regional structures are already efficient;
- difficulty in identifying the appropriate level of policy making.

Each of these will be considered below.

In general, and at various policy levels, there is a lack of coordination among initiatives. Single programs may be well organized and considered successful but are often designed and implemented separately. This may lead to two types of problems. The first is one of overlap among programs with several initiatives concentrating on similar activities. This juxtaposition also tends to mean that certain areas of intervention are not adequately addressed. Lack of coordination among related policy efforts represents an inefficient allocation of human resources and funding and results in confusion and tension on the part of policy implementors and potential beneficiaries.

Ideally, problems of overlap among programs should be avoided at the outset, but they may be discovered once initiatives have already been launched. For this reason, mechanisms of continuous monitoring and evaluation should be incorporated into program design. Regular progress reports should be mandatory, including checks not only on the development of the program's activities, but also on how these activities concretely contribute to the stated objectives of the policy. Periodic assessments are especially useful if the information gathered is used to make necessary modifications in the program as it progresses.

The Italian experience demonstrates that policy tends to be most effective in those areas where local and regional institutional actors are present, well organized and dynamic. This is not surprising, but it does not solve the problem of how to successfully implement development policy in areas lacking such structures, that is, in truly underdeveloped areas. It is clear that such areas require basic institution-building intervention before policy directed at creating SMEs or SME clusters can be effective.<sup>8</sup>

Generally, there appears to be some debate about which level of government is most appropriate to design and implement policy regarding SMEs and SME cluster development. It seems that some combination of policy levels is most likely the best solution. Development policy directed at creating the institutional and market conditions for business activity in general should be coordinated at the national level, whereas more specific initiatives tend to be more effective if created and managed at a regional or local level. In this way they are more likely to be informed by thorough and accurate knowledge of the particular needs of the territory.

#### **IV. The Role of Policy in SME Development: Possible Lessons from Italian SMEs and Related Policies**

##### *A. Lessons from Italian SMEs and related policies*

The Italian model of industrialization has been determined by the combination of the evolution of the competitive environment, spontaneous adjustment mechanisms of local SMEs, and related policies at national and local levels. Is it possible to learn from this model and apply these lessons in emerging countries? Can we develop a general methodology for SME development based on the Italian experience?

These questions are not new, and the answers are not simple. Many elements of the Italian SME development process are not transferable to other countries, since they are connected with local culture, age-old social cohesion at the community level, local traditions of economic behavior and relationships in specific fields of production, trade and capital accumulation at the family level. All these elements contributed to helping local traditional economies to adjust to competitive environments and to introduce innovative elements.

Even if these elements are linked to the Italian context, the examination of this experience can teach us important lessons that can be generalized into a methodological approach for emerging countries. However, it must be emphasized that we may not, as a result, achieve the precise reproduction of Italian industrial clusters within emerging countries since the same social and economic conditions do not exist. The Italian experience shows that it is very difficult to foresee the economic results and the productive configurations of policy actions, but that there must be continuous interaction between top-down interventions and bottom-up responses. In short, the same policy actions, in different contexts, can give different economic results, because of different social, institutional and cultural features and different economic and competitive contexts. Thus, a policy approach for SME development must be flexible and dynamic, not rigidly oriented to specific results in terms of industrial organization, but open to any form of industrialization that can simultaneously ensure competitiveness, a multiplicity of economic actors, and social stability, as seen in successful SME clusters.

The lessons learned from the Italian experience show that the formation of SME systems implies:

- some necessary macroeconomic and macro-institutional preconditions;

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<sup>8</sup> This will be discussed at length in the final section of the paper.

- a differentiated set of strategies, according to the stage of development of SME systems, the peculiarities of the sector, the characteristics of the territory and its human resources;
- active local governments and intermediate institutions;
- a great variety of policy instruments and actors, with a wide range of possible combinations.

These points help outline a methodological approach for the applicability of the Italian model in emerging countries. In the following pages this approach will be presented in more precise terms.

### *B. Necessary conditions for competitive SMEs*

The development of SMEs must be considered primarily as a spontaneous phenomenon - guided, but not determined by policy interventions. The formation of SMEs is largely due to free individual choices in social and economic contexts often dominated by uncertainty. For this reason, when thinking of specific and focused policy actions, it is necessary to create favorable conditions to favor the formation of SMEs through spontaneous initiatives. In order to do this, institutional barriers to spontaneous initiatives must be removed and a positive climate in terms of market perspectives and profit expectations must be generated. These processes are influenced by actions at the macro level, both in terms of macroeconomic strategy, and in terms of institution building.

Briefly, the main conditions for the development of SMEs are:

1. the existence of an adequate institutional framework to guide the gradual liberalization and deregulation of economic activities to facilitate entrepreneurship;
2. the existence of an efficient judicial system (and of a moral code) ensuring certainty in private transactions and rapid, low-cost solutions to controversies;
3. the progressive opening of the market and regional and international integration;
4. the creation of a positive business climate and perspectives for SME growth;
5. the promotion of wide democratic participation of people and enterprises in the economic development process.

It is important to note that the macro-economic considerations mentioned here should be considered in conjunction with the more localized initiatives directed specifically at cluster promotion. Therefore, an analysis of the macro-economic situation should inform the drafting and implementation of cluster policy. Clearly, an analysis of the area targeted for intervention should also guide policy. The following section outlines three broad categories of clusters and related policy approaches.

### *C. Three types of clusters, three types of policy*

The examination of the Italian experience, reveals that almost no district originated through specific policy actions, but initiated through spontaneous mechanisms of adaptation to the market. It is also clear that industrial clusters change over time: they grow, they transform themselves, they open themselves to external relationships, they reorganize, or they decline. The role of industrial policy is one of accompanying the process of cluster evolution by guiding these processes toward specific objectives (consolidation, technology upgrading, innovation, internationalization, etc.).

This evolutionary process implies that there is no specific, or typical, policy for clusters. Since potential SME clusters do not start out in the same conditions, it is necessary to adopt differentiated policy strategies according to the development stages of clusters. In addition, the same policy actions in different contexts may lead to different results and reactions by the local environment. For this reason, it is necessary to continuously monitor policy interventions and their effects, in order to adjust them and make them more appropriate for the local industrial system; it is also evident that policy actions, in order to achieve consensus, should be designed by the various relevant actors in the local environment.

Although the policy approach must be flexible, some general guidelines, according to the different stages of development of districts, may be indicated. We can, in short, consider three different stages in the development of clusters: embryonic, consolidation, and maturity.

#### *EMBRYONIC CLUSTERS*

Areas characterized by groups of firms in the same industry, or in related industries, can be considered potential clusters. These may differ greatly, from areas populated by specialized artisans to groups of subcontracting firms working for larger firms, to branches of foreign firms located in advanced industrial estates. The likelihood that these concentrations of firms may develop into clusters depends on a complicated set of variables. Each case must be examined separately in terms of inter-relations among firms, the surrounding institutional environment, etc. If enough of the necessary conditions are met, these groups of firms may be considered embryonic clusters.

The embryonic stage is, of course, the most delicate. There are several local contexts, especially in the South of Italy<sup>9</sup> in which it is possible to individuate embryonic clusters, which are still oriented to local and regional markets, or linked to wider markets as subcontractors to external firms. Similar situations can be

found in emerging countries. The strategy for policy makers at this stage can consist in: 1) eliminating any obstacles (social, institutional, infrastructural) to the expansion of production and to the proliferation of new enterprises, 2) supporting local firms in marketing and promoting local products in new markets.

The main field of action for policy makers is that of eliminating obstacles or lowering barriers to entry. When the local market has been opened and there are local embryonic systems with some sort of specialization, a necessary first step is the removal of barriers to their expansion and to the start up of new firms. Market pressure induces firms to adjust and, before making other policies, it is necessary to create conditions for possible spontaneous responses. In this field of action, the simplification of bureaucratic procedures for authorization and control of the economic activity, the realization of basic infrastructure for industrial location, and the setting up of actions for supporting firms from the legal point of view may be included.

Additionally, financial instruments for micro-enterprises are necessary. In the Italian context the start up of new firms was facilitated by capital accumulated by rural and urban families, and by the prospective of demand growth, that allowed new enterprises to self-finance their activities. Emerging countries are often affected by poverty in the rural villages, as well as in the sub-urban areas which severely limits or eliminates possibilities for start-up firms. The start up of new enterprises, even with simple technologies, is a critical policy focus because informal financial resources are scarce and it is difficult to access institutional ones.

Finally, policy initiatives should be directed at promoting local products outside the local market, creating connections with new markets and, in this way, giving opportunities to the local system to specialize itself.

#### *CONSOLIDATED CLUSTERS*

When clusters reach a considerable size and are no longer in the embryonic phase, they need to activate mechanisms of innovation. Examples of consolidated clusters might include Montebelluna and Pesaro, among others<sup>10</sup>. Many clusters can spontaneously reach a high capacity of endogenous innovation with limited policy interventions, but in this phase effective policy action is very important. In fact, many clusters risk decline if they are not able to innovate in terms of products, processes and organization. In this phase, the problem of reducing the costs and the risks of innovation is a crucial issue. Individual enterprises cannot afford investment for innovation, since they are afraid of being rapidly imitated by local

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<sup>9</sup> For example, Grottaglie in Apulia.

<sup>10</sup> The athletic footwear cluster in Montebelluna and Pesaro's wooden furniture cluster include both a handful of international firms that have the characteristics of firms in mature clusters and a large number of firms that fit squarely in the consolidated cluster category.

competitors. The role of public policy, in this phase, is to create a common identity for local enterprises, even among competitors. Once this is established, it is easier to create common activities for research, for training and re-training human resources, collecting and distributing strategic, but neutral, information on new technologies, innovative materials, techniques for improving quality and efficiency, new markets and marketing approaches. Intangible infrastructure for technology transfer and service provision must be created.

#### *MATURE CLUSTERS*

Clusters are mature when they reach a high endogenous innovation capacity. Internationalization then becomes key. This is evident in clusters like Parma's agro-food cluster, Bologna's packaging machine industry, Prato's textile cluster or Sassuolo's ceramic tile industry. The possibilities for quantitative growth on the local level are limited; the system tends to concentrate itself on higher value-added and specialized activities and can look for external complementarities to increase its degree of specialization. It is the time for initiatives of cooperation between clusters working in different regions and even different countries, and collaboration between enterprises and institutions. It is also the moment in which it is necessary to build the modern infrastructure needed to operate in a global market: modern transportation infrastructure and telecommunications.

#### *D. Policy suggestions to create environments conducive to SMEs*

On the basis of the experience of Italian regions, and other European regions, it is clear that SMEs can grow and become competitive if they work in a conducive environment. SMEs are often weak economic actors if considered individually, but they can reach high levels of competitiveness if they work in a local environment ensuring complementarities, common activities, collective goods and institutional stability. Starting from the situation of emerging countries, a strategic plan of action to create a conducive environment for SMEs must be designed in a long-term perspective and it may include a wide set of possible actions, diversified according to the specific needs of any local context.

We can distinguish two levels of action: the first one is aimed at promoting the private SME sector in general, without any specific sectorial specialization; the second one consists in sector-specific actions, aimed at increasing the competitiveness of the cluster, promoting networks and cooperation between firms, upgrading technology and human resources, improving quality of products, etc.

The two levels are separated only from a logical point of view, and there is no given chronological sequence. Reinforcing the business environment is a necessary precondition; but it is not necessary to

wait to start with policies for competitiveness. It is necessary to study the local situation and, on the basis of this, decide which are the obstacles to be removed, the most appropriate promotion strategies, etc.

The group of actions for developing the private SME sector in general, might include:

- building up basic infrastructure on the local level, consisting in industrial areas, roads, water, electricity, telecommunications;
- providing vocational training and promoting entrepreneurship from a cultural point of view, and educating existing or potential entrepreneurs in basic managerial techniques;
- providing services to micro-enterprises of the informal sector, in order to induce them to enter the formal sector, and reducing bureaucratic costs and complexity of bureaucratic procedures for enterprises;
- privatization of state companies through industrial re-organization and production decentralization and the promotion of subcontracting, especially with foreign companies, or other large enterprises;
- providing information about incentive laws for the creation of new enterprises and for investment and providing micro-credits to design mutual guarantee schemes.

In the second group of policy actions we can include actions for:

- promoting local products on foreign markets, such as export consortia;
- supplying specific strategic human resource training for production and business processes, through technical schools and training programs;
- favoring networks of SMEs and setting up collective service activities, through sector-specific service centers;
- providing temporary management guidance and mentoring for local SMEs;
- offering adequate medium-long term financial support, in order to facilitate enterprises to buy new technical equipment, use consultancies, etc.;
- increasing the specialization and quality of infrastructure;
- creating international linkages for local enterprises, and, possibly, joint-ventures through international cooperation programs;
- attracting foreign investment in innovative and complementary activities;
- connecting local enterprises to universities and research centers and transferring the results of scientific and experimental research through technological industrial parks;
- reinforcing local identity and stimulating the circulation of information, through industrial museums and business associations;

- stimulating international cooperation between institutions and creating institutional networks at the international level.

As stated above, it is possible to combine different groups of actions in each area, according to local needs, the typology of actors, the objectives achievable with consensus by the local environment. It means that, for the elaboration of a strategy, it is necessary to monitor the local situation to decide the priorities and identify feasible initiatives; at the same time, it is necessary to monitor the effectiveness of the interventions, in order to adjust them as they progress.

Although it cannot be considered an action of industrial policy, the experience of industrial clusters teaches that industrial development proceeds together with social and institutional development. Local authorities and organizations can contribute to creating a positive environment for SME development by providing adequate social services, health care, urban planning, cultural initiatives and environmental protection.

#### *E. The necessary role of intermediate governance*

The term “governance” should not be confused with “government”. While the latter refers to formal structures that have the political/administrative tasks of running the public sphere of a given territory (State, region, city, etc.), “governance” is a more abstract concept. “Governance” refers to the processes of shaping behavior, in this instance economic behavior. A governance structure, therefore, may include governmental agencies, but may also include business associations, service centers, the banking system, cooperatives, consortia, key firms, etc. - those organizations that directly affect economic activity.

Often diverse institutions interact with firms in clusters. However, it is clear that in the most consolidated districts there is one, main intermediate governance institution that somehow acts as a reference point for all the actors within the cluster as well as for those outside the cluster’s boundaries. These structures consistently demonstrate their capacity to bring together a variety of actors, both public and private, in common activities to achieve shared goals.

Long-term observation of Italian case studies and regional policies for SMEs has shown intermediate governance structures to be crucial actors in local contexts characterized by dynamic SMEs. It is clear that for SME policy the proper level is the local/regional one (Boekholt, et. al. 1993). SMEs have a relatively limited range of action due to their limited resources. It is also true that the needs of individual SMEs, or even groups of SMEs, are not likely to be well known or understood in far-removed government structures. Representatives from such structures, or initiatives that they propose, are likely to be met with a certain degree of distrust.

Intermediate governance structures are integral parts of the local level in that they are close to firms, are accessible and are more informed about their needs. However, these intermediate structures also have contacts above and beyond individual firms and the local area. This allows SMEs to hook into structures that filter and organize both information and contacts. Intermediate governance structures may also provide services and act as an interface between local SMEs and outside actors. Examples of these structures from case studies are: the Aldini-Valeriani Museum in Bologna's packaging machine cluster, Parma's food industry consortia and the Museum of Athletic Footwear in Montebelluna. Others might include CITER in Carpi's knitwear cluster, Assopiastrelle in the ceramic tile cluster located in Sassuolo, etc.

Intermediate governance institutions are crucial to the promotion of the actions needed to make enterprises confident in their local environment and to reinforce cluster performance. Different typologies of local actors (municipalities, associations, development institutions, schools and universities, banks, etc.) can contribute to increasing trust, reducing uncertainty and, according to their specific roles and competencies, develop policy actions at the local level for the development of the cluster.

However, the efficiency of intermediate institutions is also linked to the degree of development of the cluster itself. It often happens that more developed clusters have more efficient institutional support. But what can we say about clusters in their developing stages? If the institutional context is reinforced even in emerging clusters, the consolidation/integration process among firms, and between these and the surrounding institutions, may be encouraged and accelerated.

At the same time, it is clear that excessive institutional fragmentation, even if it may produce partial positive results, leads to confusion and instability, and to the absence of a coherent development strategy for the cluster as a whole.

The reinforcement of a positive institutional environment requires: a) networking the relevant actors at the local level to avoid dispersion of resources and to increase the effectiveness of interventions and the integration of different components of the local economy within the system; b) generating local leading institutions, which act as "catalyzers", able to develop strategic development guidelines for the cluster by involving and coordinating different local actors in policy initiatives to fulfill common objectives.

This process of institutional reinforcement at the local level depends on the awareness of institutions themselves and, of course, of individuals working within them. Circulation of examples of positive experiences is extremely important for the promotion of institutional awareness and activism, especially if coming from consolidated and mature clusters, like most of the Italian examples. Actions for transmitting practices and methodologies can greatly effect the institutional and policy environment and may have an extended, favorable impact on clusters of emerging countries.

*F. Some guidelines for UNIDO programmes for SMEs in emerging countries*

Italy's clusters cannot be transferred as is to emerging countries. However, a thorough understanding of the principal dynamics associated with their formation and growth may provide lessons to be used in SME development and cluster promotion initiatives in Italy and elsewhere.

Rethinking SME policy in emerging countries involves rethinking macroeconomic adjustment policies and strategies for opening the market. Most importantly, it is clear that creating markets, and opening previously closed markets, must be done gradually and with care to avoid serious social and economic problems. The long-term nature of policy should be stressed through the gradual implementation of macroeconomic changes to avoid forcing all but the already large and/or competitive firms to close.

In fact, there is a risk in emerging countries that financial aid and development programs undertaken will greatly benefit those actors that are already among the most advanced and will not reach those most in need. This may occur because of a lack of information or simply because the neediest firms are not capable of responding adequately to available opportunities. What should be carefully avoided is the creation, or the widening, of a gap between the most innovative and international firms and those connected to traditional activities or sectors. Such a division is undesirable not only because it causes uneven economic growth, but also because it is likely to create strong social tensions that can undermine the general development process.

An environment that assists firms to grow must therefore be established. Such an environment includes local government structures, educational and research facilities, service centers, consulting firms, business and sectorial associations, chambers of commerce, an active business community, subcontracting firms, etc. These organizations are important to all firms, but SMEs are particularly in need of external goods and services because of their limited resources. When a local business environment is rich with accessible organizations, SMEs are more likely to prosper. Start-up firms are also favored in that entrance barriers are lower in a context that offers a wide variety of externalities and chances for cooperation even to its newer (or smaller) members.

It is in this vein that the presence of intermediate institutions is important. It is exactly these structures, rooted in their territory, but with regional, national and even international connections, that help SMEs be active players both locally and in wider markets. If SMEs have access to goods, services and connections provided by intermediate institutions they also benefit from an environment in which they feel an integral part. SMEs that actively participate in their surrounding environment tend to feel that they are important members of the community. When this community seems to provide them with needed externalities and

allows them voice in shaping it, a climate of trust is created that facilitates dialogue, transactions and cooperation. This is one of the key factors in the success of Italian SME clusters.

For these reasons, efforts to develop collective activities are of fundamental importance. Clearly, such activities will initially be aimed at grouping firms together to meet recognized common needs, for example guarantee cooperatives and export consortia. Through these types of structures, firms may learn to work together and may see the benefits of cooperation. Once these forms of cooperation become consolidated experiences, the way is then clear for closer, more strategic cooperative relations among firms and between firms and institutions.

Efforts to promote SME clusters in emerging countries might be organized according to the following four main steps:

1. identification of potential clusters and the design of pilot projects for their development with the help of international experts;
2. detailed analysis of economic and institutional contexts in the chosen areas;
3. reinforcement of local governance through the identification of leading institutions, training programs, decentralized technical assistance, human resource development, technical and financial support for new enterprises, and collective activities such as cooperatives and consortia;
4. the development of collaboration between clusters by linking local institutions and firms to international networks.

The examination of SME clusters and the discussion of Italian policy, both national and regional, clearly shows that it is the reinforcement, or creation, of the development environment which is perhaps the most important policy lesson to be learned from the Italian SME experience. Especially in emerging countries, where there tends to be very little by way of intermediate governance structures or SME service providers, it is important to design policies that support the formation of such organizations. These organizations are crucial also for their capacity to become “catalyzers” for inter-firm cooperation. Only in an institutional environment capable of offering stability (both social and economic) and needed externalities, can SMEs form, survive and learn to cooperate with one another.

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## APPENDIX 1

*Italian Industrial Districts - Law 317*

REGION	TOWN	SECTOR	
<i>PIEMONTE</i>	Chieri	textiles - clothing	
	Ciré	metal products	
	Forno canavese	metal products	
	Pianezza	metal products	
	Pont canavese	metal products	
	Rivarolo	metal products	
	Biella	textiles	
	Cossato	textiles	
	Crevacuore	textiles	
	Gattinara	textiles	
	Tollegno	textiles	
	Trivero	textiles	
	Borgomanero	textiles	
	Oleggio	textiles	
	Omegna	kitchenware	
	S. Maurizio	metal products	
	Varallo P.	textiles	
	Cortemilia	textiles	
	Revello	textiles	
	Canelli	basic foodstuffs	
	Valenza	gold working/jewelry	
	Monferrato	refrigeration systems	
	Cusio	faucets	
	Settimo torinese	pens, paintbrushes	
	Valduggia	valves	
	<i>LOMBARDIA</i>	Asse Sempione	unspecified
		Comasco	textiles - clothing
		Brianza comasca	textiles
		Lecchese	wooden furniture
		Brianza	industrial/agricultural machines
		Valbrembana	industrial/agricultural machines
		Valseriana	wooden furniture
		Sebino Bergamasco	textiles - clothing
Camuno Sebino		plastic products	
Valtrompia		firearms	
Bassa Bresciana		metal products	
Castelgoffredo		hosiery	
Canneto sull'Oglio		dolls	
Trevigliese		gold working/jewelry	
Casalasco		industrial/agricultural machines	
Belgioioso		furniture	
Vigevanese		footwear, footwear machines	
Lomellina		textiles - clothing	

REGION	TOWN	SECTOR
<i>LIGURIA</i>	Palazzolo S. Oglio	textiles - clothing
	Oltrepo mantovano	textiles - clothing
	Basso mantovano	textiles - clothing
	Palosco	compasses (precision instruments)
	Grumello del Monte	buttons, button machines
	Odolo	iron reinforcing rods
	Lumezzane	metalworking (kitchenware)
	Premana	scissors, knives
	Viadana	brushes, paintbrushes
	Santo Stefano	scales, slicing machines
	Gallarate	embroidery, lace
	Varese	burglar alarms
	Cicagna	slate
	Val Fontanabuona	slate
Imperia	olive oil	
La Spezia	shipbuilding	
TOTAL NORTH WEST		61
<i>FRIULI - V. GIULIA</i>	Sacile	furniture
	Maniago	knives
	Manzano	chairs
	San Daniele	prosciutto (cured ham)
	Alto Livenza	furniture
<i>TRENTO</i>	Cembra	unspecified
<i>VENETO</i>	Cadore	eyewear
	Brenta	footwear
	Possagna	pots, pans
	Montebelluna	athletic footwear
	Murano	glassware
	Vicenza	gold
	Arzignano	leather
	Bassano	furniture
	Cerea-Bovolone	furniture
TOTAL NORTH EAST		15
<i>TOSCANA</i>	Lamporecchio	unspecified
	Castelfiorentino	clothing
	Empoli	textiles - clothing
	Prato	textiles
	Santa Croce sull'Arno	leather
	Poggibonsi	furniture
	Sinalunga	unspecified
	Carrara	marble
<i>MARCHE</i>	Piandimeleto	furniture

REGION	TOWN	SECTOR
	Fossombrone	furniture
	Mondolfo	textiles - clothing
	S. Angelo in Vado	textiles - clothing
	Filottrano	textiles - clothing
	Serra de'Conti	textiles
	Fabriano	metal products
	Recanati	musical instruments
	Tolentino	textiles
	Castelfidardo	musical instruments
	Ascoli Piceno	footwear
	Macerata	footwear
	Pesaro	furniture
<i>EMILIA-ROMAGNA</i>	Cento	metalmechanics
	Sassuolo	ceramics tiles
	Carpi	knitwear
	Mirandola	biomedical equipment
	Parma	prosciutto (cured ham)
	Reggio Emilia	parmesan cheese
	Reggio Emilia	agricultural machinery
<i>LAZIO</i>	Civita Castellana	ceramics, sanitary supplies
TOTAL CENTRAL ITALY		29
<i>ABRUZZI</i>	Teramo	textiles, clothing
<i>MOLISE</i>	Frosolone	knives
<i>CAMPANIA</i>	Solofra	leather
	Salerno	tomato products
<i>PUGLIA</i>	Barletta	footwear
	Casarano	footwear
<i>BASILICATA</i>	Matera	furniture (living room)
<i>SARDEGNA</i>	Budduso	granite
	Thiesi	cheese
	Calangianus	cork
TOTAL SOUTHERN ITALY		10
GRAND TOTAL		115