



SUPPORTING SMALL BUSINESSES IN DEVELOPING COUNTRIES: WHICH PROGRAMMES WORK AND WHY?

This briefing paper summarises the main findings and recommendations from the report 'Supporting small businesses in developing countries: which programmes work and why?' published in May 2016.

The report examines how governments and donors can better promote 'business enabling environments' so that small and medium-sized enterprises (SMEs) can contribute to inclusive economic development in developing countries. It focuses on 'what works' and contains a literature review of support for SMEs plus three case studies from our experience as NGOs. It is hoped that the study will inform decision making to ensure policies focus on what SMEs really need.

Despite substantial literature on business development, remarkably little is known about which SME support programmes work and why. There is significant funding of SME support programmes by multilateral development banks, international financial institutions, bilateral donors and governments. However, much of this support is focused on two areas: providing financial loans to SMEs, and advocating general reforms to



Photo: Dried hibiscus petals produced by members of the Hibiscus cooperative in Nicaragua. Christian Aid/Paula Plaza

the investment climate, which mainly benefits larger enterprises, including multinational companies, rather than SMEs. Other support programmes are often neglected.¹ The report challenges these approaches and suggests alternative support policies.

The report focuses on SMEs, not micro-enterprises (sole traders with only a few employees). SMEs are regarded here as businesses with 10-100 employees (small) and 101-250 employees (medium). The nature of SMEs varies greatly, ranging from small manufacturers - for example, of furniture, metal parts, clothing or machinery - to service providers, such as restaurants, consulting and computer software firms. They include rural, as well as urban, businesses, notably farmer cooperatives and producer organisations, often involving smallholder farmers.

Three main areas make up the **business enabling environment**:²

- The formal rules, laws and regulations that governments, at all levels, impose on workers, markets and private businesses, such as tax legislation, property rights, employment law, labour rights and trade rules.
- The informal behaviour, customs and norms that determine business conduct and shape how markets work - and where governments can only have an indirect impact.
- Public investment in infrastructure and provision of public goods and services by the government, such as health and education provision, transport and water management.

THE IMPORTANCE OF SMEs

SMEs are critical to promoting inclusive economic development and poverty reduction. They constitute a **vast number of businesses and employ a large number of people** in developing countries. It is estimated that there are approximately 400 million SMEs (defined as those with up to 250 employees) in low- and middle-income countries,³ which account for around 60% of GDP in low-income countries.⁴ The UK's Department for International Development (DFID) notes that SMEs (again, with up to 250 people) employ an average of 66% of the permanent, full-time workforce in developing countries.⁵

There are 8-10 million formal **SMEs owned by women** in developing countries, which represents roughly a third of all formal SMEs (with up to 250 employees).⁶ Thus, supporting women-led SMEs is critical to promoting inclusive economic development. However, as a World Bank evaluation notes, relatively little SME assistance has focused on women.⁷

SMEs are also vital to inclusive economic development since they can provide **basic goods and essential services** to poor and excluded people. They frequently produce light consumer goods – such as food, clothes and wood products – to meet household demand. The UN's Economic Commission for Latin America and the Caribbean notes that promoting SMEs is 'a cornerstone for achieving greater social equality'.⁸ **Job creation** is key to economic development and some studies suggest that enterprises with fewer than 100 employees, and young enterprises (those less than two years old), have the highest job creation rates.

CHALLENGES FACING SMEs

Effective policy making should recognise the challenges to growth identified by SMEs. The biggest constraints to SME growth include a lack of access to finance, lack of access to electricity and technology, political instability, an inadequately educated workforce, and corruption.⁹ SMEs often face difficulty in defending their interests in bargaining with suppliers and lobbying for policies that are in their interests, especially compared to larger firms. Women-led SMEs face greater, and sometimes different, barriers to those led by men: women nearly always have less access than men to assets, credit, services, markets and information about new technologies.¹⁰ Finally, the business regulatory environment is particularly important for SMEs, because SMEs tend to have fewer resources and staff to handle regulatory matters.¹¹

Existing support for SMEs

Governments can support SMEs in various ways, by promoting:

- **policy or legislative measures** such as credit, technical assistance and fiscal incentives
- **business development services** such as training, advisory services, information, and technology transfer.¹² For rural enterprises, **extension services and marketing support** can be especially valuable
- **targeted technical assistance**, information and advisory services, and finance to specific enterprises¹³
- **value chain programmes** whereby SMEs are linked to large corporations as suppliers or distributors¹⁴
- **procurement and local content programmes** whereby governments and/or large companies source inputs or services from domestic SMEs.

Governments promote SME support policies in virtually all countries in Asia and Latin America and many countries in Africa. Few spending figures are available, but Latin America is estimated to allocate less than 0.1% of GDP to SME support programmes.¹⁵ While many programmes are successful, some suffer from having a multiplicity of objectives and a lack of coordination, often with no single government department coordinating SME promotion policies, leading to duplication.¹⁶ Some governments lack the capacity or expertise to promote effective SME policies.

Figures on **donor support to SMEs** vary widely. The Organisation for Economic Co-operation and Development (OECD)'s aid database calculates that donors provided US\$1.7bn in aid for 'business support services' in developing countries in 2013.¹⁷ However, the World Bank states that it, alone, provided around \$3bn a year in support to SMEs during 2006-12.¹⁸ All the multilateral development banks have programmes that address SME access to finance and 16 European development finance institutions make direct investments in enterprises, including SMEs. Donors have moved away from providing direct support to SMEs. The World Bank's Doing Business project advocates reducing government regulation of business to support domestic SMEs. However, considerable research shows that the indicators used in the project are not the major constraints to private sector activity in developing countries.¹⁹

Large corporations can also help SMEs grow by providing training in management, business planning, marketing and quality control and by

promoting technology and knowledge transfer and investment in infrastructure.²⁰ Studies suggest that multinational companies are increasingly developing their own local content policies to support local SMEs, motivated by the desire to establish enduring partnerships with local suppliers.²¹

IMPROVING BUSINESS ENVIRONMENTS

Several lessons learned from SME support programmes emerge from the literature and experience:

Proactive government policies are needed, not simply regulatory reform of the business environment.

Considerable evidence, especially from Asia, shows that successful economic development has mainly been due to proactive policies by the state. In contrast to the 'low government regulation-approach' taken by most donors – such as Doing Business and the 'investment climate-reforms approach' focused on facilitating foreign investment – SME development is likely best supported by a 'high government support-approach'. Here, policies can include providing strategic guidance to companies, targeting specific investors, time-bound subsidies and trade protection, differentiated tax incentives, export promotion, R&D funds, and information services.²²

Local-level policies are critical, and support policies should be based on local needs.

It is not only the business environment in the capital city that is important, but the environment in other areas of the country, including rural areas. Local authorities can play crucial roles in SME project implementation, financing and monitoring. Using local service providers to deliver business development services is more economical and ensures sustainability after the life of the project.²³

Governments should step up public procurement and local content policies and enshrine these in legislation.

Public procurement policies can have major positive impacts on poor people and local economic development. They can provide valuable market opportunities for SMEs if they stipulate sourcing from smallholder farmers or small enterprises for supplies needed in schools, hospitals and other public institutions,²⁴ as demonstrated in the case study from Brazil in the full report. Local content policies can require foreign and domestic investors to source their goods and services from domestic SMEs, boosting

local economic development. African governments, especially, could do much more to increase their procurement and local content policies; currently, only a few have explicit local content policies in place, though the number is rising.²⁵

Value chains need to be improved to benefit SMEs.

Promoting SMEs by linking them to large companies in value chains has become a common support mechanism in recent years. This can facilitate the transfer of technology, knowledge and skills, improve SME business and management practices, and increase access to finance and markets.²⁶ Governments can assist SMEs to negotiate better terms with larger contractors and provide legal assistance and model contracts, tackle the power of supply chains and the anti-competitive behaviour of large companies within them.²⁷ Improving value chains often means promoting inclusive business models. In agriculture, many current value chains are undermining farmers through exploitative relationships, notably through unfair contract farming arrangements and large-scale land acquisitions or land grabs.

Governments must promote a step change in support to women-led SMEs.

Women tend to be marginalised in society and the economy, so supporting women-led SMEs is essential for promoting inclusive development. Yet support programmes for women entrepreneurs rarely address the major constraints to female enterprise growth, such as concentration in low-productivity and low-growth activities, and the role of institutions and behaviour in discriminating against women. Women-led SMEs must pay to hire help whereas men-led SMEs can often exploit the unpaid work of women in family businesses. Support programmes need to engage with government institutions and chambers of commerce to reform legal frameworks that constrain female entrepreneurial activity.²⁸

Tax policies must be progressive in taxing more heavily those actors who have the greater ability to pay and also representative in terms of bringing voices of all sizes and shapes of individuals and companies when policies are set.

In many developing countries, governments effectively favour large companies in their tax policies. At worst, governments lose massive revenues from tax exemptions, the main beneficiaries of which are often large companies. Many countries have differentiated tax rates for companies, with lower rates or exemptions for enterprises below a certain size while closing down

small businesses for the slightest delay in paying local taxes. In some countries, for example in East Africa, taxes based on turnover are common, and provide an alternative to profit-based accounting.²⁹ Countries could also adopt a more pro-poor tax policy by reducing taxes on SMEs which, while profit-orientated, also provide goods or services to the poor, such as social enterprises.

Policies that combine different types of SME support tend to work better than single policies.

The need to combine policies, rather than regard any single policy as a magic bullet, is a common finding in the literature on SMEs. For example, the impact of providing non-financial business development services is increased if dovetailed with access to finance initiatives.³⁰ CAFOD's Thinking Small work similarly found that successful NGO projects to support micro-entrepreneurs and small businesses did not focus on one improvement, but tackled all factors affecting the viability of poor businesses – economic, social, political and human. CAFOD's rural livelihood projects not only identified market opportunities and supported viable economic activities, but organised communities to build and maintain local roads, generating shared ownership, social capital and political voice, plus essential local infrastructure.³¹

Access to finance must be more comprehensive.

Some finance programmes for SMEs tend to have a narrow focus, simply providing credit lines to companies; yet access to credit is only one of the financial services that SMEs need. Health insurance or, for farmers, weather insurance, may be just as important but these are often unavailable or unaffordable, with women-led SMEs again most disadvantaged.³² The inclusion of savings instruments in financial packages can often better address the risk mitigation needs of SMEs. Provision of financial services should be complemented with financial literacy education.³³ Governments should prioritise SMEs in providing access to finance. A key is to promote systemic reforms to help build the capacity of countries' financial sectors to supply SME credit demand.³⁴

There is a need to improve worker and management training on human rights and labour conditions.

Labour conditions and skills affect a society's ability to create jobs, especially jobs that are well paid and improve firm productivity. The importance of management training is recognised in the literature on supporting SMEs.³⁵ The UN

Economic Commission for Africa, for example, calls for enhancing management and business development in Africa through training and development programmes and the creation of SME Development Centres.³⁶ There is a growing literature evaluating the impacts of business training. Combining entrepreneurship training with access to finance tends to work better than standalone interventions. Programmes for young people are more likely to have positive results.³⁷

Appropriate infrastructure must be provided – including in rural areas.

Lack of electricity is often identified as a constraint to the growth of SMEs. Also important are good roads and transport services, access to water and irrigation, telecommunications, storage facilities and toilet and hygiene services. These infrastructure and public services need to be provided within a 'thinking small' framework that targets the needs of small businesses; too often, these services are size-blind.³⁸ Many governments prioritise urban areas for infrastructure investments, yet improvements in rural infrastructure are critical to farming cooperatives and rural enterprises. More, and better, feeder roads are especially important in rural areas, linking farmers to markets.³⁹

The voice and influence of SMEs in policy making must increase.

It is critical that governments actively consult with SMEs and involve them in policy making, and that there is support for organising SMEs into associations. Business associations, including Chambers of Commerce, are often dominated by large companies, which subsequently have the ear of government. SMEs can often partner with trade unions and civil society organisations to strengthen their bargaining position.⁴⁰

Curbing corruption has particular benefits for SMEs and should be addressed.

While improvements in the fight against corruption help businesses of all sizes, some policy measures have particular relevance to SMEs. As Denmark's aid agency DANIDA has noted, certain funds could be made available to allow SMEs to take legal action to claim damages caused by corrupt practices involving public officials.⁴¹

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