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1 Introduction and Overview

Homi Katrak and Roger Strange

Since around the 1960s, the governments of many of the developing countries have been concerned to promote their small-scale enterprises (SSEs). The rationale for helping those enterprises could be summed up neatly in the often-heard saying ‘small is beautiful’. This view arises for a number of diverse reasons, which have tended to differ from one country to another. However, the more well-known reasons have included the following:

- SSEs offer greater opportunities for employment;
- they are the ‘seed bed’ out of which larger enterprises grow;
- they are independent and can help the dispersion of industry away from the urban areas; and
- they can help to restrict the market domination of the larger enterprises.

The policy instruments used to help the SSEs have also been quite diverse. These have included credit facilities (to meet set-up expenses and some operating costs); subsidies for the purchase of some inputs; advice on technological upgrading, production and marketing; reservation of certain items for exclusive production by the SSEs; and exemption from certain regulations and taxes.

Now, while the arguments for helping the SSEs have considerable appeal, they also raise a number of important questions. Some questions are mainly of a practical nature, while others are concerned with the overall rationale of SSE policies.

Any policy to support SSEs needs to consider an initial practical question: What criteria should be used to distinguish SSEs from other (medium and large) enterprises?¹ This question is important in particular for the government agencies that administer support policies. There is a choice of input-based or output-based criteria (for example, number of employees, value of physical assets, and value of sales). However, all these criteria require a cut-off point in order to distinguish SSEs from other enterprises. But this creates a problem. If different enterprises use different types of technologies, and/or produce

different quality/price products, the grouping of 'small' enterprises may alter between the various criteria. In the event, in the absence of any a priori guidelines, decisions about cut-off points have sometimes been influenced by the lobbying power of pressure groups. An alternative criterion rests on certain characteristics of the enterprises. For example, SSEs would be those enterprises that have family ownership and employ only family members. This criterion would avoid the problem of the cut-off points. But there may instead be a problem of defining 'the family'. The obvious inference from this brief discussion is that no one criterion is unquestionably better than the others. This may well explain why different countries (and even different agencies within a country) have tended to use different criteria.

A second important question concerns the overall objective of SSE support policies. Should those policies be designed to help mainly the SSEs? Or should they have a broader perspective, namely to help SSEs enhance the country's overall economic welfare? The former objective would emphasize mainly the benefits and needs of the SSEs, while the latter would also be concerned with those enterprises' competing and/or complementary relationships with medium and large enterprises.

In past years, when many developing countries had implemented regulatory and protectionist policies, considerations of efficiency and competition were not always of major importance. Instead, the objectives of national self-reliance and of promoting particular industries and types of enterprise were of greater interest. Policies towards SSEs and medium and large enterprises were often influenced by the lobbying efforts of their respective pressure groups. The relationships between the different types of enterprise were usually not taken into account.

This economic background gave rise to three types of problem for SSEs. First, some of the claims made for these enterprises were based on empirically untested grounds. Second, some other claims were seen to be conflicting with each other. And third, government support for SSEs was offset by some policies to help other enterprises. Each of these problems is well known, and is thus only given a brief mention here.

One of the major claims for the SSEs concerned their employment potential. This claim was based initially on the belief that these enterprises have higher labour requirements (per unit of output) than do other enterprises. However, empirical research has shown that SSEs do not always have higher unit labour requirements. Moreover, even where they do have higher unit labour inputs, the underlying reason

could be that they are less efficient in the use of both labour and capital, and/or because they are exempt from labour union pressures that face the larger enterprises. The important implication is that higher labour intensities *per se* are not an argument for supporting SSEs. A further point is that SSEs' employment potential depends also on their level and growth of output, and these aspects may compare unfavourably with the medium and larger enterprises.

The second of the problems is that some of the claims for the SSEs could be conflicting with each other. Consider the argument that SSEs are independent, and so can be located in geographically dispersed areas, far from large urban centres. If those SSEs were to sell their output mainly in their small local markets, they would have limited sales, and hence limited employment potential. On the other hand, if they aimed to sell in the large urban markets, they would have a location disadvantage *vis-à-vis* some of their larger competitors and consequently would not be able to check the market domination of the latter.

The third problem was that government support for SSEs was sometimes neutralized by other policies that were aimed at helping the larger enterprises. Tariffs and other barriers to competing imports may have helped larger enterprises in particular, because their products are closer substitutes for imports (than are the products of SSEs). Consequently, import restrictions may have caused some shift of resources away from SSEs and towards the larger enterprises.

Recognition of all these problems has led to research into new roles and policies for the SSEs. There is now greater interest in those enterprises' contribution to overall economic welfare, both via improvements in their own efficiency, as well as through their competing-complementary relationships with medium and large enterprises. These issues have acquired considerable relevance recently, as many countries have introduced wide-ranging economic reforms, shifting away from the earlier inward-looking and regulatory policies to a more outward-looking and market-orientated approach.

The chapters in this volume address a number of the issues raised above. Some of those issues have been relevant during the years of the inward-looking regimes, and continue to be so, while others have emerged with recent economic reforms. Part I is made up of three chapters examining major concerns about SSEs' contribution to overall economic welfare, namely efficiency, immiserizing growth, and pollution. Part II contains five chapters, which look at some more recent concerns as SSEs face increased competition. These concerns are about growth and survival, as well as the need to mobilize

government support. Parts III and IV discuss the important roles of industrial clusters, and technological upgrading. These are two of the strategies that may help SSEs compete with foreign enterprises, as well as against their larger domestic rivals.

The chapters in Part I provide a critical perspective on the idea that 'small is beautiful'. In Chapter 2, John Weeks investigates the relationship between the size of production units and efficiency. He finds little empirical support for the view that small enterprises in manufacturing are relatively employment-generating, or that small enterprises represent a more efficient response to market conditions than do medium and large ones. Rather, he notes that wages in small enterprises typically are lower than in medium and large ones, and concludes that there would be no change in employment even if wages in the latter fell to the level of the former. Thus he questions the wisdom of small enterprise development, unless it can be shown (and here he draws attention to the paucity of the required data) that small enterprises possess dynamic advantages.

In Chapter 3, Roger Strange and Jim Newton also sound a cautionary note about the merits of small-enterprise development. They draw on the experience of the silk industry in China to show how reform and liberalization during the 1980s gave rise to a massive increase in the numbers of small reeling plants and silk processing factories. This expansion in capacity led to a collapse of the world silk market, and to the subsequent immiserization of the Chinese industry. The role of the state in the demise of the industry is critically examined, and lessons are drawn for countries wishing to promote the development of SSEs in export-orientated industries.

Nandini Dasgupta, in Chapter 4, focuses on the environmental impact of the growth of small-scale enterprises. She notes that there is now recognition not only that pollution by small-scale industries is a problem, but also that the poor typically suffer more than the better-off because of the proximity of low-income housing to clusters of small, polluting industries in many cities in developing countries. She argues that a fundamental difficulty in providing a solution lies in the conceptualization of the environmental problem, and that the ability to deal with the problem varies with the size of the enterprise. Thus she concludes that a technocratic approach is inadequate, but that an interactive and participatory approach may prove to be a more fruitful means of implementing cleaner production strategies.

The chapters in Part II address the effects of market competition on SSEs. In Chapter 5, Qing Gong Yang and Paul Temple examine the

role of entry and exit processes in the context of China's gradualist industrial reforms, particularly during the latest phase of transition to a socialist market economy. They conclude that competitive selection processes operate, for small firms and collectively owned enterprises (COEs), in a manner consistent with a private market economy, and that the probability of exit for these firms has increased with the reforms. In contrast, they find that no such processes appear to operate for state-owned enterprises (SOEs), nor has this situation changed in the most recent phase of reforms. They conclude that competitive selection in China is not in fact providing a sufficiently important substitute for corporate governance mechanisms based on ownership.

Homi Katrak, in Chapter 6, considers whether India's economic liberalization policies, introduced in 1991, have had a beneficial, or a detrimental effect on the growth of SSEs. He suggests that some aspects of liberalization might have favoured the SSEs, while others were more likely to help the competing larger enterprises. His analysis focuses on those products that compete with the output of the larger enterprises, rather than those where the relationship is complementary (for example, under subcontracting relationships). He concludes that the SSEs' growth was significantly lower in the product groups where they initially had a lower output share, and was also lower when the growth of the competing larger enterprises was higher. But the effect of competition from the larger enterprises was dampened somewhat by liberalization, to the benefit of the SSEs.

In Chapter 7, Alan Mulhern addresses the causes of the relative decline in the importance of small and medium size enterprises (SMEs) in the manufacturing sector in Venezuela since 1960, and their absolute decline since the late 1970s. Venezuela's economic system has been characterized by two attempts at 'transition' to a modern economy: the first in 1958 at the start of its democratic system; and the second in 1989, when it attempted to bring into being an open free-market economy. Mulhern highlights structural barriers in manufacturing, and a lack of efficiency and innovation efforts by the SMEs, as the key economic determinants of the decline, which he attributes to the deeply exclusionary nature of the economic structure. Furthermore, he suggests that the decline of the SMEs highlights not only an economic problem in Venezuela, but also the wider political problem that a genuine transitional economy requires a participative economic democracy with access for everybody to the productive resources of the economy.

In Chapter 8, Subrata Ghatak, George Manolas, Costas Rontos and Iohannes Vavouras consider the possible effects on Polish SMEs of

accession to the European Union (EU). They note that Poland underwent one period of rapid economic transformation during the 1990s, and that a second period will be required as the country faces up to the challenges ahead. The chapter contains the results of a questionnaire survey of Polish SME owners/managers about the perceived impact of EU accession on their enterprises. This reveals that the majority of Polish managers were optimistic, but that there was considerable variation in the degrees of optimism between firms from different locations, in different industries, and with different characteristics. These results provide the basis for the authors to put forward a number of policy initiatives which they maintain should help Polish SMEs not only to survive, but also to prosper in the environment of increased competition in the Single European Market.

Berhanu Kassayie looks at another European country, Bulgaria, in Chapter 9, and considers the impact of reform and liberalization on the establishment and expansion of manufacturing SMEs. He finds that the emerging small manufacturing sector was founded primarily on spin-off start-ups from large SOEs during, and in the period immediately following, the initiation of system reform in 1990. The rate of new firm entry appeared to slow down in the aftermath of the introduction of the 'shock therapy' of reform institutionalization in 1992, compounded by inconsistencies in reform implementation. Furthermore, he detects a tendency towards larger new manufacturing start-ups in Bulgaria, concurrent with the beginnings of institutional transformation, and suggests that this has been effected through favoured access for the larger 'small' enterprises to equipment and external finance. He also concludes that reform has had a positive impact on the expansion of existing firms, and that this impact has been stronger for the larger 'small' firms.

The chapters in Part III consider the role of clusters in the development of SSEs. In Chapter 10, Mark Holmström investigates the extent and limits of co-operative networking between SSEs in the electrical and electronic industries in Bangalore, the 'real' services (for example, advice, training, testing) provided by public-sector bodies, and the use that firms make of them. He takes a very positive view of industrial clusters and the associated 'flexible specialization' that allows the firms to achieve 'collective efficiency', and to overcome the disadvantages of small size. He then considers the lessons that may be learned from Bangalore's experience of the promotion of industrial districts, not just in India but also in other developing countries, and emphasizes the need to build trust if such initiatives are to succeed.

Henry Sandee explores the performance of Indonesia's small-scale industries, before and after the Asian financial crisis, in Chapter 11. He points out that government policies in Indonesia were biased towards larger firms in various ways during the period 1986–96, and that initiatives to foster SSEs had been both limited and not very successful. But this changed in the aftermath of the crisis, which the small-scale industries weathered rather better than their larger counterparts. At a governmental conference in December 1999, the need was identified for a more conducive environment for SSEs, for the rationalization of assistance to small firms, the strengthening of support services, the privatization of programmes, and for institutional capacity building.

In Chapter 12, Manuel Albaladejo considers the determinants of competitiveness in SME clusters, citing evidence from five clusters in Latin America. He laments the varied growth experience of these clusters, which he ascribes to the increasingly dynamic nature of competitiveness in global markets. Few clusters in developing countries have been able to compete with innovative and high-quality products. Albaladejo identifies not only the 'cluster-level' determinants of competitiveness associated with the 'collective efficiency' approach, but also the 'firm-level' and 'country-level' factors that are also required. He concludes that clustering on its own does not guarantee economic success, but that policies designed to strengthen inter-firm co-operation should be combined with government interventions at the national level, and with specific schemes to build up the technological capabilities of SMEs.

Finally, Part IV contains two chapters on the issue of technological upgrading. In Chapter 13, Ganeshan Wignaraja explores the relationship between firm size and the acquisition of technological capabilities, using data from a sample of firms in the garment industry in Mauritius. He constructs a 'technology index' for the firms, and identifies not only firm size but also technical manpower, employee training, and external technical assistance as important determinants. He further demonstrates that export performance is related to size and to technological capabilities. The large firms appear to have acquired the requisite competitive capabilities to produce to the high standards of price, quality, delivery and so on demanded by foreign buyers, but the SMEs have not reached the same levels of achievement. He suggests that supplier linkage programmes and the provision of business development services might be useful ways of incorporating SMEs into effective clusters around the large enterprises, so improving their capabilities.

And, in Chapter 14, Richard Duncombe and Richard Heeks assess the potential contribution of information and communication technologies (ICTs) to small enterprise development. They report the findings from a questionnaire survey of current information practices and needs in formal sector enterprises in Botswana. The survey first mapped current enterprise information systems, finding that there was a strong reliance on informal systems. It also mapped current information needs. They conclude that information gaps are certainly an issue for small entrepreneurs, but may be less important than (but intertwined with) the needs for other resources such as finance, skills and new markets. Where information services merit improvement, changes to informal, non-electronic systems must be considered alongside changes to formal ICT-based systems. Interventions, whether by entrepreneurs or support agencies, must also be differentiated.

Note

1. For some purposes, SSEs and medium-sized enterprises may be aggregated as small and medium-sized enterprises (SMEs). For other purposes, a finer categorization may be appropriate. In Chapter 9 of this volume, for example, the distinction is made between 'micro' enterprises, 'medium-small' enterprises, and 'small' enterprises.

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