# Tom Alweendo: The use of small and medium size enterprises (SMMEs) to reduce poverty

Keynote address by Mr Tom Alweendo, Governor of the Bank of Namibia, at the opening ceremony of the 6th African Development Finance Conference and SMME Awards, Cape Town, 20-21 October 2004.

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Chairperson, Ladies and Gentlemen,

It is a pleasure to be with you this morning. I consider this an honour and a privilege to be invited to give the keynote address to this distinguished gathering of academics and policymakers. I would like to thank the organisers for inviting me to speak at this important conference.

At the beginning of the new century, the global economy woke up to the reality of the need to rid the world of poverty, promote human dignity and equality and achieve peace, democracy and environmental sustainability. That realization found expression in the Millennium Declaration which gave birth to the Millennium Development Goals (MDG). The MDGs focus on a core set of values that developing countries must achieve by the year 2015 in order to better their present living conditions and launch themselves on a path of sustainable growth. Among others, the MDGs aim at eradicating extreme poverty and hunger, promoting gender equality and empower women, combating HIV/AIDS, malaria and other diseases, and ensuring environmental sustainability.

The reduction of poverty is regarded as central to the achievement of the MDGs and has been given a lot of attention by policymakers in both developed and developing countries. Poverty is observed to be closely related to malnutrition, lack of education, low life expectancy, high mortality rate and substandard housing. Both the urban and rural poor lack access to basic services such as water and sanitation, electricity and telecommunications.

Accordingly, governments have devised two broad policy interventions to ameliorate the conditions of the poor. The first such strategy is indirect. It is designed to accelerate growth and to direct the flow of growth benefits to the poor. It involves encouraging countries to adopt market based resource allocation techniques which emphasizes competition as a basis for sustained economic growth, ensuring greater availability of land to the poor through land reforms, creating productive employment opportunities through better land utilization and ensuring greater accessibility of the poor to social services. The second set of policies is intended to reduce poverty by providing consumption entitlements to the poor in the short term and redistributing incomes in favour of the poor. Public provision of education, health, nutrition and housing form the core of this strategy.

A prominent component of this second approach is the design and implementation of self-employment and wage employment programmes targeted at the poor to improve their conditions of living to explicitly defined levels. This strategy recognizes the fact that wage employment policies are the most desired instrument to provide basic consumption needs of the poor mainly because of its self-targeting nature. A very prominent example of such interventions is the use of Small and Medium size Enterprises (SMMEs) to reduce poverty. The World Bank and other multilateral development agencies have long recognized the importance of targeted assistance to SMMEs in accelerating growth, promoting economic development and reducing poverty in their interventions in developing countries.

The mainstay of this pro-SMME policy is threefold. First, SMMEs enhance competition and entrepreneurship and hence have spillover effects on innovation, efficiency and productivity growth. Second, SMMEs are generally held to be more productive than large firms although financial markets and other institutional failures could impede their development. Thirdly, expansion of SMMEs could boost employment more effectively than large firms because they tend to be more labour intensive. From this perspective government intervention to subsidize SMMEs could help to alleviate poverty.

Although some of these arguments in support of SMMEs have not been substantially proven, available empirical evidence especially from developed countries tends to support these basic tenets. A recent survey of OECD countries[1] showed that SMMEs account for a large share of the private sector

[1] See OECD Small and Medium Enterprise Outlook (2002).

economy representing between 96 and 99 per cent of the total number of enterprises in these economies. Microenterprises (0-9 employees) account for between 70 per cent and 90 per cent while small firms (0 to 49 employees) constitute at least 95 per cent of the total. Only 0.5 per cent of enterprises in the manufacturing sector employ more than 500 in OECD countries. It should not be a surprise therefore that SMMEs are responsible for the vast majority of new businesses.

The report further revealed that SMMEs account for a significant share of output in OECD countries. In the United States for instance, they account for about 40 per cent of total economic activity. About 17 per cent of manufacturing output comes from SMMEs in OECD countries. In Korea and Japan, policy makers look up to the SMME sector to reinvigorate the national economy. SMMEs also make an important contribution to overall employment, accounting for 60-70 per cent of the manufacturing total in most OECD economies. In the services sector, small firms provide the vast majority of jobs. During the 1990s, small firms were responsible for up to three quarters of employment growth in the United States, and businesses with fewer than 20 employees are now generating up to one-half of the jobs in the country. In Korea, national statistics indicate that SMMEs increased their share of manufacturing employment from 63.5 per cent in 1991 to 74 per cent in 2000. In Australia, statistics show that the share of small business in total employment has been growing at about 3.1 per cent since the early 1980s. SMMEs have tagged on to the globalization trail. Although initially most SMMEs focused on local markets, the trend has changed in the past couple of years. SMMEs now account for between a quarter and two-fifths of the worldwide manufactured exports. In Korea, SMMEs account for roughly 40 per cent of manufacturing exports. In Europe, 20 per cent of SMMEs are engaged in exports.

It is generally accepted that SMMEs even have a greater role to play in developing economies especially when it comes to employment generation and output growth. Preliminary estimates for developing economies in South-East Asia show that SMMEs provide employment to over 80 per cent of the labour force. They also contribute more than 50 per cent to GDP, meeting the demands of local and regional markets. SMMEs also make a substantial contribution towards export earnings through direct and indirect exports.

Also significant is the fact that the SMME sector provides both rural and urban women an opportunity to utilize their vocational skills while staying within their residential premises. In urban areas, most female entrepreneurs have introduced product lines whose uniqueness has created a strong demand in the market place. Today, most big industrial establishments depend on SMMEs for their value addition. It is on record in most emerging markets that the fastest growing export industries (cotton weaving, textiles, surgical instruments, carpets and footwear etc) have been dominated by SMMEs. Thus, SMMEs have played very significant roles in reducing the poverty levels in many developing countries. It is no surprise therefore that as countries prepare their Poverty Reduction Strategy Papers (PRSP), emphasis has been placed on pro-poor growth led by the private sector especially through SMMEs. Sectors such as agriculture, services, manufacturing with heavy content of labour-intensive activities have received much support by programme implementers because of their potential for reducing poverty.

Given this increasingly important role of SMMEs in both developing and developed economies, the need for policy intervention to stimulate the growth of this sector remains an active debate in the literature. This is particularly so given the failure of most intervention policies in the past. Governments, cognizant of the need to provide a favourable business environment for their business communities and becoming increasingly aware of the role SMMEs play in achieving economic and social goals, have stepped up efforts in this regard over the years. Such efforts have focused mostly on the need to provide appropriate competition policies, appropriate taxation regimes, flexible labour markets, an educational system which promotes entrepreneurship, open capital markets and more liberal access to financing.

In deference to the organizers of this conference, allow me to make a few remarks on the last two issues. Globalization and liberalization of financial markets have had some far-reaching effects on SMMEs. On the positive side, industrial restructuring through various types of business linkages, especially cross-border alliances and mergers and acquisitions have opened up international business opportunities for SMMEs. Globalization may also have opened up access to international sources of financing thus removing a major constraint to SME development. However, SMMEs especially in developing countries may have to contend with more competitive products from the developed countries where the availability of adequate technology and well-funded research and development strategies may have resulted in lower costs of production. Moreover, in many developing countries, financial liberalization may have resulted in higher real rates of interest and the suspension of subsidized lending to SMMEs thus further reducing SMME access to finance. Restrictive monetary policies which often accompany structural adjustment programmes may heighten interest rates and thus discriminate strongly against SMMEs. Moreover, the strict requirement for collateral lending which is more predominant with financial liberalization policies could bring about a conflict between banking prudence and the policy of government to target borrowers who in the first instance cannot afford such securities. The overall impact of globalisation and liberalisation on SMMEs needs to be properly researched and appropriate policies designed to ameliorate any adverse consequences.

By far the most publicized of all the barriers to SMME development is the issue of access to finance. This is not to denigrate other SMME problems such as skills shortages, sometimes unfriendly regulatory and supervisory environment, scarcity of capital goods, poor management, lack of data on the sector, resistance to change and marketing difficulties especially for export-oriented SMMEs. Despite all efforts by financial institutions and governments to close the financing gaps in the market, SMMEs continue to experience considerable difficulty in obtaining risk capital. Access to finance therefore remains a policy priority by most governments.

Finance for SMMEs remains problematic because their borrowing requirements are usually small and frequently does not appeal to financial institutions. Where they are available, more collateral may be required than SMMEs can pledge. Moreover, flexibility on terms and conditions that many SMMEs require may not be available. Governments must therefore come in to complement the efforts of private financial institutions with such policies that are aimed at easing access to existing and newer sources of financing.

In particular, SMMEs face considerable difficulty with sourcing start-up finance. Given the risk involved at this stage, most commercial banks are very reluctant to go into such ventures. This has led in recent times to an increasing role for, credit guarantee schemes and venture capital in the SMME sector.

Many countries have also developed seed capital funds to provide capital and competence for projects involving high risk at an early stage. Furthermore, many governments have now embarked deliberately on enterprise promotion schemes to build an entrepreneurial culture through the inculcation of entrepreneurial behaviour so as to foster competition and innovation in the SMME sector. In spite of recent attempts to bridge the gap in SMME finance, much still needs to be done and a lot of understanding needs to be created. This is why a forum such as this could go a long way in improving our understanding of this very important sector of our economies.

Let me at this juncture briefly highlight developments in the SMME sector in my country, Namibia. The government of Namibia recognises the vital role which SMMEs can play in the country's socio-economic development. Both the First and Second National Development Plans (NDP) have as their main focus the eradication of poverty and inequality, two main problems that the country inherited at independence. This problem was exacerbated by the fact that a large proportion of the population did not have direct access to the means of production especially land and capital before independence. This previously disadvantaged people therefore constitute the bulk of the unemployed.

Realising the role that SMMEs could play in bridging this gap, government produced a policy paper on SMME in 1997 entitled *"Namibia: Policy and Programme on Small Business Development"*. This policy document, amongst others stipulates government programmes in place to ensure that conditions are favourable for SMMEs in Namibia to flourish. The government initiatives mainly concentrated on the following three areas: De-regulation in terms of policy and legislative measures so as to create favourable regulatory environment to serve as an incentive to SMME, programmes designed to overcome constraints towards the development of the sector in the areas of finance, marketing, technology transfer, purchasing of inputs by SMME and sites and premises for SMME to operate from, and institutional support, whereby the Ministry of Trade and Industry serves as the lead ministry for the small business sector. The government has successfully launched and implemented the above mentioned programmes. This is clearly manifested in the increase in SMME contribution to the economy in terms of growth promotion and jobs creation.

According to a recent survey conducted by the Namibian Economic Policy Research Unit (NEPRU, 2003) on SMMEs, it is evident that this sector is a key sector in poverty alleviation and economic growth generation in Namibia. The study showed that the sector has exceeded the targets set in NDP2. In terms of the sector's contribution to GDP, it increased from 8.0 per cent as recorded in 2002 to 11.0 per cent in 2003, exceeding the target of 5 to 10 per cent by 2006. In terms of the sector's share in the labour force working full-time, its contribution increased by 4.8 per cent to 19.8 per cent in 2003. As it is in the case of the sector's contribution to GDP, SMMEs share in total labour force exceeded the set target of 2.8 per cent annual growth rate in NDP2. The sector's contribution in terms of employment and economic growth is expected to grow further as its contribution to investment increased from 5.1 per cent in 2002 to 8.5 per cent in 2003. Generally, an increase in investment is followed by more employment creation and growth.

One of the challenges that Namibia is facing, is the challenge of lessening gender inequality and ensuring that the previously disadvantaged gets into the mainstream of the economy. It is therefore encouraging to note in this regard that about 37 per cent of the businesses surveyed in Namibia are owned by women and 93.4 per cent of the business owners can be classified as previously disadvantaged Namibians. SMME in Namibia are therefore not only playing a significant role in terms of their contribution to GDP but equally in terms of addressing social evils such as poverty and inequality.

From the foregoing, one can conclude that the SMME sector in Namibia has flourished and met most expectations. However, the issue of access to capital, entrepreneurial development, and enabling regulatory environment still pose serious challenges that require active government and private sector involvement if the huge potential in this sector is to be harnessed.

For us at the Bank of Namibia, our efforts have been geared towards providing policy advice to relevant stakeholders in this regard. In a recent research paper by the Bank, the issue of private equity and the contributions they could make to the growth of SMMEs received our attention. Among others the paper concluded that private equity as a source of alternative finance for SMMEs in Namibia could go a long way in removing the constraints posed especially by start up capital for SMMEs. The paper accordingly recommended, among others, that Venture capital should be encouraged as one of the sources to finance SMMEs in Namibia. In addition to providing finance, Venture capital also assists with the provision of expertise necessary for the success of these businesses at the initial stages. Specifically, the paper recommended that private-public partnership be encouraged particularly for investments in start-up businesses. This initiative will stimulate the growth of the SMME sector, reduce the backlog of unemployment and thus promote the attainment of the goals of poverty and income inequality reduction in the economy.

Ladies and Gentlemen, let me conclude by restating the fact that SMMEs will continue to play a very important role in the economy especially in developing countries where the twin problems of unemployment and poverty constitute major development challenges. Well targeted government intervention in this sector remains indispensable provided such interventions do not displace the private sector. These are serious challenges. However, given the quality of papers that will be discussed in the course of this conference, I am convinced that useful policy recommendations will emerge at the end of the different sessions.

I thank your for listening.