

## Ewart S Williams: Supporting the growth of small and medium enterprises

Address by Mr Ewart S Williams, Governor of the Central Bank of Trinidad and Tobago, to the Nova Committee of the Trinidad and Tobago Chamber of Industry and Commerce, Port of Spain, 16 March 2006.

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Let me first of all congratulate the NOVA Committee of the Trinidad and Tobago Chamber of Commerce for its initiative in organizing this conference. I consider it a particularly encouraging sign that, at a time when the energy sector is leading one of the strongest expansions in our post-Independence history, we have seen the need to convene a forum on “**Supporting the Growth of Small and Medium-Sized Enterprises in Developing Countries**”. It is a discussion which, in many ways, brings us face to face with the crux of our development challenge.

In virtually all economies in the world – developed and developing alike – small- and medium-sized enterprises (SMEs) are critical to the generation of economic activity and to long-term sustainability.

It is sometimes assumed that in industrialized countries large firms constitute the main drivers of economic activity. However, in a sample of developed countries drawn from the World Bank database, SMEs accounted for about three-quarters of GDP and just over 60 per cent of employment. The figures are generally much higher in the case of the developing countries, confirming the critical role of SMEs in the development process.

In addition to the contribution of SMEs to economic growth and to the creation of jobs, SMEs broaden the base of participation in society, decentralize economic power and give people a stake in the society's future. Small-business ownership encourages personal freedom and individual empowerment and contributes to social and political stability. In many developed countries, the SME sector has been the catalyst for product innovation and for productivity enhancement.

For these reasons, in virtually all successful economies, the development of small- and medium-sized enterprises is given special priority.

An analysis of countries that have had the most success in the development of the SME sector suggests that there is no single blueprint that is effective for all times and in all places. The analysis, however, points to certain pre-conditions and best practices which are paramount. The main preconditions have been:

- (1) a macro-economic environment in which entrepreneurial activity is able to thrive and prosper;
- (2) an education, or more broadly, a **value system**, that encourages an entrepreneurial culture;
- (3) a comprehensive support regime, including financial assistance in various forms, as well as technical support and training. **This is the area in which governments usually have a critical role to play.**

I would like to expand a bit on these critical requirements.

The experience in many Latin American countries has shown that macroeconomic stability **creates the essential cradle for the expansion of the SME sector**. Macro stability is conducive to SME development because it implies low inflation, low interest rates, a stable exchange rate and ample external reserves. The macro-economic pre-conditions (which incidentally come under the Central Bank's mandate) provide the kind of environment in which particularly small and medium-sized businesses are able to plan and prepare to take risks.

The importance of an entrepreneurial culture for SME development is more subtle but no less a real pre-condition. In Trinidad and Tobago, for example, my generation grew up in a culture in which you studied hard to get a job, to work for a large firm or the Government. At that time, business acumen was considered hereditary and involvement in small business was not generally encouraged. **It is now acknowledged that the culture most conducive to SME development** is one in which business studies are an integral part of the school curriculum; one in which a high school or a university student sees starting a business as one of a number of viable career options ; one in which students have a passion, not solely to get a job, but also to create a job.

Many countries in Latin America make special efforts to lift the status of small-business activity and of entrepreneurship. The idea in that region seems to be that a country that wants to promote small business must work to have its population look up to entrepreneurs, as they do to doctors and lawyers.

**Improving access to finance is deemed to be the major challenge to the development of small- and medium-sized enterprises** all over the world. Because of imperfections in financial markets, small enterprises almost never have the same access to finance as do their larger more powerful counterparts. For commercial banks, for example, small enterprises are considered to be of lower profitability and are assumed to carry greater risks than large enterprises. Thus the availability of bank finance for SMEs is usually limited and, even when credit is available, it is usually at a higher cost and on unfavorable terms – for example, through high cost overdraft facilities rather than through term loans.

For these reasons, **Governments which are committed to SME development focus on making funding available on reasonable terms.** One challenge they and central banks face is to encourage the traditional financial institutions, particularly the commercial banks, to lend to SMEs. Invariably they try to do this through loan guarantee schemes. The logic is that banks are more likely to make loans to perceived “risky” small businesses when they know that the Government (or some government agency) will guarantee repayment even if the borrower defaults.

Credit guarantee schemes have become the most popular of government support schemes worldwide **since they combine a subsidy element with market-based characteristics.** The arrangements are also intended to make use of the banks’ infrastructure for loan administration. But guaranteed schemes are not perfect and lead to moral hazard since the banks’ funds are not at risk, and since the small businesses can default with little cost. Variations of the scheme have been devised to deal with these issues.

To supplement credit available through the traditional institutions, several governments see the need to establish institutions that provide direct credit to small and medium enterprises. Such institutions (development banks in most countries) face unique challenges in avoiding political interference and operating along strictly commercial lines.

At times, rapidly **growing small businesses require equity as well as debt financing.** Several countries have sought to address this deficiency through the development of a venture capital industry. The United Kingdom has a very interesting concept called “**the business angel**” where small amounts of venture capital come with considerable technical expertise and general management advice.

It has been demonstrated that the successful promotion of SMEs development requires the integration and linkage of technical training and business support services with financial assistance programmes. **Governments are best placed to take the lead in adapting the education system to the needs of business, and in particular, small business.** Governments are also well placed to provide arrangements for entrepreneurial training and support perhaps in collaboration with private sector or non-governmental organizations (NGOs). In many countries, the state has sought to nurture an enterprise culture through an alliance of business education and training programmes with initiatives like “business incubators”, which in effect are facilities where aspiring entrepreneurs can learn business skills.

Some people think that the effect is exaggerated and that the **best thing that the Government can do for SME development is to reduce regulatory impediments and bureaucratic red tape** and implement tax policies that promote small-business growth.

A bit about our local situation.....

Notwithstanding our abundant energy resources and our robust energy based industrial platform, the imperatives of economic diversification and the need to provide productive and sustainable **employment have led to increased attention to the development of the small- and medium-sized enterprise sector.** Our strategy recognizes the importance of an enabling business environment of macro-economic and financial stability and provides for a critical role for the state. The Government’s involvement centres on two state-owned institutions viz: the National Entrepreneurial Development Company (NEDCO) and the Business Development Company (BDC).

- (i) NEDCO’s primary mandate is the management of a credit programme for small businesses. NEDCO also offers a suite of business support services including

entrepreneurial education and development, business advisory and coaching services, training and business mentorship.

In an effort to strengthen the entrepreneurial culture, NEDCO recently expanded its training programmes to secondary schools and tertiary institutions. **The Government's vision is to integrate entrepreneurship into the school curriculum at all levels, starting at the primary school level.**

- (ii) The mandate of the BDC is to facilitate the growth and expansion of small- and medium-sized enterprises. BDC pursues its mandate by providing loan guarantees for commercial bank lending to these enterprises. BDC also provides direct support for capital investment by way of lease financing.
- (iii) The Government has sought to provide venture capital financing by offering tax credits for contributions to a venture capital fund. The supply of venture capital to prospective entrepreneurs has however been very limited.

While comprehensive data are not available to allow a precise estimate of the impact of the new SME expansion thrust, the evidence is that there has clearly been strong growth in the SME sector over the last few years. The NEDCO programme has built a client base of 5,600 businesses and has advanced close to TT\$100 million in loans to various sectors including light manufacturing, services, and food and agro-processing. Since 2002, close to 5,000, persons have also benefited from the training and mentorship programmes.

Let me end by raising what I think is a very important challenge for SME development in the Caribbean today.

Globalization and trade liberalization are presenting new opportunities and challenges for small business development. In the case of the Caribbean, SMEs have, to date, largely confined their activities to catering for the domestic market place. If SMEs are to contribute more meaningfully to Caribbean development, they need to adopt a more outward oriented strategy, seeking export opportunities or finding ways to participate in production chains with large producers abroad. **There is no reason why the Caribbean SMEs cannot capture a share of the outsourcing market that is now dominated by countries such as India.**

To take this leap forward, the focus must be on innovation and increasing productivity and competitiveness. The strategy may need strengthened financial support and perhaps more trade and export market facilitation. In Singapore, for instance, a new SME Loan Programme has been introduced to help Singaporean firms penetrate global markets. As a start, a similar scheme could be devised under the recently launched Caribbean single market programme to enable Caribbean SMEs to develop the potential and capacity to export.

While most SMEs will remain focused on the local market, those that are likely to thrive and expand are the ones that embrace the export challenge and are prepared to adopt new technology, develop new information systems and devise innovative products that are globally competitive.

Here at home, as part of its diversification effort, the Government is investing in the development of a cluster of technology industries linked to the University of Trinidad and Tobago. This cluster is expected to develop a range of innovative products that can compete at the global level.

There is no reason why this should not be fertile ground for the expansion of the SME sector.

Let me end by again congratulating the NOVA Committee of the Trinidad and Tobago Chamber of Industry and Commerce for arranging this most important forum. I am sure that the dialogue and the exchange of ideas and experiences that will take place over the next two days will help the SME sectors throughout the Caribbean come closer to realizing their potential and expanding their contribution to the transformation of the region.

The future of the region is in their hands.