Creating a Productive SME Environment and the OECD Policy Framework for Investment

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Small – Exception or Norm?

• Big captures prestige, gov’t & media attention
  – Forces of political economy, urban domination of rural, large of small, hi prestige of low, tax base, party funding

• But SMEs more indicative of economy
  – Range from survivalist to high-tech manufacture
  – In EU SMEs are 95% of all firms, 60-70% of jobs, 40-80% of manufacturing employment
  – In South Africa 90% of jobs outside of big business
  – SMEs in all industries, in all towns and villages
  – Both services and manufacturing
  – Key role in spread of new technology

• SMEs dominant in internet, engineering, medical, dental, accounting, law, tourism, agriculture, construction trades
Structural Biases Against SMEs

- **Investment thinking often favours big business**
  - Better access to decision makers, can fund lobby groups, lawyers and researchers to study proposed laws
  - Politics dominated by elites; Large firms far more influential politically
  - In Africa, foreign investors secure better terms than local

- **Small size limits ability to interact with gov’t**
  - Too few staff to research, lobby, comply
  - Too sectorally diverse, geographically spread
  - Passive vs active outreach: Open door does not mean SMEs can enter

- **Regulation follows bureaucratic logic, not ease of use**
  - Regulation accumulates, involves many bodies: 29 different permits needed to build warehouse in Georgia
  - Harare all buildings inspected personally by the chief or deputy chief building inspector. Result is 952 days; US$38,347 to secure all permits needed
  - The more an area regulated, the less supply and more distortions

- **Regulation consumes time and money – hurt SMEs more**
  - Poorer the country, the more survivalist and informal the SMEs
  - SMEs need free, flexible, DIY environment
Who deals with SMEs?

• Tendency to appoint SME agency or few SME programmes
  – Low visibility, transparency can make SME agencies prone to abuse
  – Weaknesses in uptake: SA example only 28% heard of, 8% used, at survivalist level almost none used government
  – SMEs can't use gov't pgms for same reasons can’t influence policy

• But comprehensive investment assessment is vital
  – SMEs affected by policy in agriculture, commerce, local/provincial gov, land use, tax, customs, labour law and regulations of professions

• Investment authorities as champion of business within gov’t
  – Need explicit outreach mechanisms
  – Good SME climate needs both focus on horizontal vs vertical
  – General efficiency vs Sector specific plans
  – Evaluate individual regulations but also overall regulatory burden
Horizontal and Vertical

• Key horizontal issues: land, tax, permits, labour law, dispute settlement, property regulation to eliminate disputes, trade, competition policy, macro-econ
  – 6 traits of good regulation: proportional, accountable, consistent, transparent, targeted, evidence-based
  – Simplification, one-stop shop approaches effective but cut across bureaucracies -- requires top-level attention
  – Political pressures favour vertical over systemic horizontal changes

• Vertical or sector approach – should consider SMEs in all sector plans through dedicated studies, surveys, outreach
  – Balance SME and big business interests
  – Balance segments of value chain
  – Balance domestic production and retail cost
  – Facilitate large-small business linkages
Promotion or General Environment

- Temptation to focus on high profile deals to neglect of ordinary business
- Subsidies to few deals imply higher taxes for all – can be tax on SMEs
- Opting out – Frequent risk particularly in poorer countries
- Challenges of direct SME promotion
  - very diverse geographically, sectorally
  - awareness of programmes
  - need for many access points, labour intensive
  - limited by few SME advisory staff with real world experience
  - very low uptake levels
  - importance of linkage, fair public tendering rules
  - prone to abuse, elite capture, political conflict of interest
Infrastructure & Financial Sector

Electricity, Telecoms, Water, Transport – Roads, Rail, Ports, Airports – Specialised handling services: cold storage, food storage and loading, phytosanitary testing

- High cost, low reliability infrastructure has higher impact on SMEs
  - Chamber of commerce survey, Uganda electricity, Ghana/SA telecoms

Financial sector development

- Desire to promote SMEs leads to direct micro-finance pgms
  - No substitute for removing horizontal and vertical obstacles
  - Effective micro-credit is labour intensive, requires many more loan officers, competes with formal sector lending for loan staff
  - Micro-credit schemes frequently fail to work out collection strategies,
    - Continuous recapitalisation, public perception as grant rather than loan.

- Effective micro-credit can’t be developed quickly, needs capacity development, slow geographic spread, social and group lending

- Requires regulation, enforcement, transparency, land titling, effective courts, credit registries, creditor protection laws, cost of bank accounts (Mzansi in SA), slow pace of spread of micro-credit
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