

X. Small and Medium Enterprise Development

Providing Special Consideration and Assistance for Small-Scale Rural Enterprises

The private sector assessment of the Pacific reveals a strong dependence by the majority of the population on rural-based activities for their livelihoods. Further, the income level of rural people is well below those in urban areas, and in fact, majority of the poor are rural residents or rural migrants to the fringes of major cities. This situation makes it necessary for a private sector strategy to address this often neglected group and provide more direct poverty reduction efforts. While there continues to be a need to assist the poor—especially the poor in rural areas—through social assistance, there is also an argument for assisting the development of commercial opportunities for small and emerging rural businesses.

The argument for rural businesses is based on the need to explore all possibilities for creating viable income-generating opportunities for communities, families, and individuals that would thereby reduce the numbers dependent on social assistance. This approach is especially relevant in the case of “failing states” where the potential for more general business environment reform is low. In such circumstances, operating at the local level, particularly in rural areas, may be the only opportunity to assist businesses. However, this is not an argument for more general direct intervention to *promote* business, but rather a suggestion that pilot projects along the lines of those suggested for SMEs in the section below, could be tried in rural areas, especially in cases where the central administration is in disarray.

Of the many variants of assistance directed to communities and small businesses by the multilaterals, ADB is presently piloting an innovative approach in Papua

New Guinea. The Nucleus Enterprise Project (ADB 2001b) promises to build communities while providing the type of assistance to small and emerging businesses that are likely to succeed. Since it is operating in what is almost an enclave environment, it ameliorates some negative effects of the generally highly unfavorable private sector environment in the country. This project should be monitored carefully as an approach to private sector development, which may be applied to other PDMCs, especially those where the state is dysfunctional.

Is There a Need for Generic SME Policies?

If small-scale rural enterprises are to be a focus of targeted assistance, a further relevant question is whether there should be specific SME interventions. Any answer to this question should emerge more generally from the justification for SME policies. Much of the rationalization of many SME interventions does not, in most cases, stand up to a careful examination of the evidence.⁷⁰ However, it is undeniable that SMEs suffer from particular handicaps because they face higher transaction costs, both on a per unit of output and on a per employee basis than large firms do.

By international standards, there are few large businesses in the Pacific, with the exception of a small number of natural resource companies that operate in Papua New Guinea and other island economies. A specific SME policy would therefore be targeting almost all businesses in the region. Such a policy would be redundant in the sense that the resulting strategy would apply to all SMEs, which constitute nearly all Pacific businesses. Consequently, there is no need for a separate policy for SMEs.

Since nearly all businesses in the Pacific are small or microenterprises, should “traditional” SME policies such as business development services, loan guarantees, incubators, and small business investment funds be an important part of policy in the Pacific? We suggest that it should not be. A major theme of this analysis of the private sector in Pacific

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⁷⁰ Arguments include (i) small businesses create more jobs (they do, but they also fail at a much higher rate than larger companies, so they also lose more jobs—SMEs on a net basis do not create a disproportionate number of new jobs); (ii) SMEs are more innovative (research indicates the opposite); (iii) SMEs are more flexible (there is no convincing evidence to support this contention); and (iv) SMEs are more entrepreneurial than large companies (there is no convincing evidence to support this statement).

countries is that previous interventionist “bottom up” approaches to private sector development have produced disappointing results over an extended period. This paper recommends that private sector development policies focus primarily on the enabling environment for business rather than sector-specific interventions. A similar theme is beginning to appear in more recent work on policies toward SMEs. While the strategy should not necessarily rule out all specific interventions, they should be strictly on a pilot basis with very carefully designed success criteria that are directed at output variables such as sustainability, cost per intervention, and contribution to business value added, rather than input variables such as businesses that have been “helped.” Only in this way can the viability of such approaches be tested.