

Emerging Opportunities for Micro, Small and Medium scale Enterprises in the Wider Economy

Introduction

Micro, Small and Medium scale Enterprises (MSMEs) do not operate in a vacuum, they are already part of the wider economy. There have always been smallholder farmers, livestock keepers, petty traders, artisans and craftspeople working with raw materials to process crops, produce tools, garments, building materials, furniture, etc.

These MSMEs have played a major role in ensuring food security for large populations; have supplied a range of goods and services needed by communities, as well as providing income and employment to large numbers of people. They have therefore been an important element of the wider economy.

But those involved in MSMEs (particularly the smaller ones) have tended to be marginalised players – with limited resources, skills, knowledge, access to technology, or capacity to influence the environment in which they operate their businesses. With the rapid pace of technological developments elsewhere, some of the more traditionally businesses have been left further behind. Consequently, they and the success of their various enterprises have been vulnerable to the commercial activities of other more powerful players, nationally and internationally.

These include larger firms located in areas with more developed infrastructure, which enjoy a number of distinct advantages. These include: economies of scale, access to skilled manpower, capacity to take advantage of technological developments, ability to meet the needs of larger, more discerning, and more affluent market segments, and power to exert influence upon the policies and practices of governmental bodies and private sector service providers.

As the pace of technological development, urbanisation, industrialisation, and international trade increases, the competitive pressure upon MSMEs will increase, but does this mean that they, like subsistence agriculture, will decline as an economic opportunity? Maybe so, in their present form. But most industrialised economies depend upon a dynamic and thriving MSME sector. This paper looks at the changing landscape and emerging opportunities for MSMEs that are arising in developing countries and argues that they can be seized by men and women willing and able to adapt and change with the changing circumstances. These changing circumstances and opportunities point to the need for SED practitioners to adapt / change their practices to better enable those men and women to take advantage of the emerging opportunities

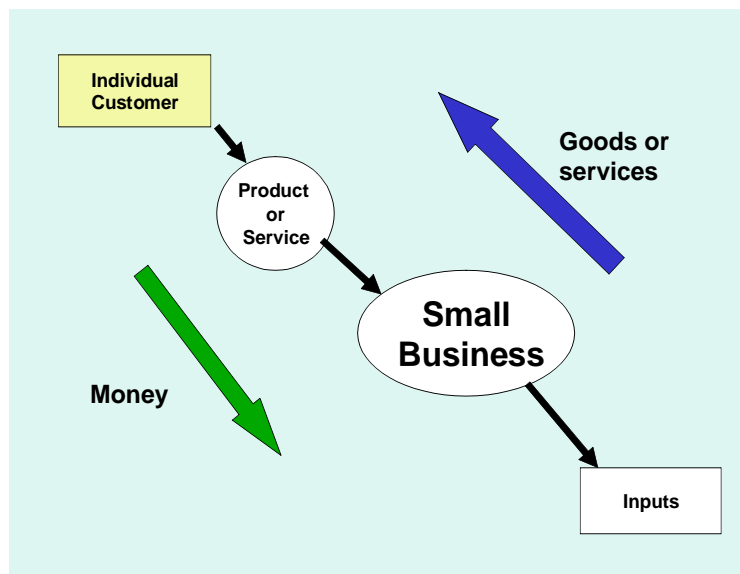
1. Traditional characteristics and roles of MSEs

- Isolated, independent enterprises, in an environment with poor infrastructure (poor roads, communication systems, training facilities, public health services)
- Low value goods or services – predominantly primary production (crops, animal or forest products, with little value addition), services (transport, repair) and petty trading.
- Selling locally to individual customers - saturated markets, competing on price

- Some sales to middlemen for on-selling to distant markets
- Limited access to appropriate / affordable financial and business services

The simplest market chain for a traditional micro enterprise would show the flow of goods from producer to consumer. In Fig 1, below, the arrows have been reversed to highlight the flow of income in the opposite direction. This is deliberate to introduce a demand-led perspective and to provoke users to consider for example how a greater share of consumer's purchasing might reach targeted small businesses¹.

Fig 1 Simplest market chain for a traditional small enterprise



2. Recent changes in operating environment for MSEs:

This section examines the changes happening around the MSEs which have a direct impact upon the operation and survival of the business. These changes may be broadly divided into three areas; firstly input or 'supply-side' changes; secondly customer, market or 'demand-side' changes; and thirdly changes in the policy environment.

2.1 Supply-side changes

There are a range of changes which are taking place, that on the face of it should make small business owners better able to run their businesses. Examples include:

- Improved access to basic education
- Access to a wider range of material inputs (including imports)
- Some improvements in transport (eg roads / vehicles) and communication (eg mobile phone, internet)
- Improved access to financial and business services (savings, credit, skills, information, technology)

¹ "Albu & Griffith (2005) Mapping the Market". Forthcoming, will be available on the www.bdsknowledge.org website in May/June

- Enhanced capacity for collective action (eg through group formation)

These changes have - and continue - to come about through various ongoing processes - technology advances, international trade, as well as development interventions. Such changes are by no means widespread, but most small businesses have already experienced at least some of these changes.

The effect of these supply side changes is that where they have occurred, the MSEs have an increased capacity to produce:

- existing goods and services more efficiently
- new, more diverse products
- add value to existing products
- quantities and qualities needed by corporate buyers, and to
- take their goods and services to more distant markets

However, having the capacity to produce does not mean that they can sell at a reasonable profit for their efforts. This will depend upon the preferences of the customers, which will in turn depend upon the alternatives open to them (the competition). The next section will look at the customers of MSME goods and services and recent changes affecting them:

2.2 Demand-side changes

Who is buying what the MSEs can supply, and what changes are occurring in their buying habits and preferences? This section will look at the different end users or consumers of the kind of goods and services that MSEs can provide. We will look not only at the traditional customers (poor individuals), but also other potential customers, other businesses large and small and government, in turn.

2.2.1 Rural individuals: These tend to have limited purchasing power, and require a small range of goods and services. The actual demand is also reducing for a number of reasons. First, the proportion living in rural areas is reducing as more migrate to urban areas. Second, families in rural areas often have family members in a town, who purchase and send/bring products from the town. Third, more products from large, distant companies are available in rural areas (eg farm implements, soft drinks).

2.2.2 Urban individuals: These include people with a wide range of purchasing power and looking for a broader range of goods and services. But although the proportion (and total number) of urban individuals is increasing, the amount they buy directly from MSEs is reducing as they increasingly spend more of their available incomes in larger retail outlets (including supermarket chains)

2.2.3 Government departments: These usually require large quantities and often operate a tendering system which MSEs find it difficult to satisfy. There is an increasing trend of governments to decentralise some of their functions and to privatise some of their services. This may provide increasing opportunities for supply or service contracts, by smaller elements within the private sector, to decentralised government departments.

2.2.4 Buyers for large firms: Large private commercial firms (such as supermarket chains, clothing and furniture stores, manufacturing companies and exporters need to regularly purchase a wide range of goods and services. These include goods: raw materials, semi-processed goods, finished products, components, tools, etc and services: sub-contracts for processing or packing, cleaning, repair and maintenance, transport, storage, printing etc. Such buyers usually set demanding standards including large quantities, consistent high quality, competitive prices, reliable deliveries and convenient transaction arrangements (order / delivery / payments). Buyers for these large firms find that they can achieve these standards by trading with other large firms in their own country or by importing from other countries. In contrast, they often find that the purchase of such inputs from many small diverse and disparate MSMEs in their own country is fraught with difficulties. Even if the price is right there may be problems with the quality or consistency. If the quality is right there may be problems with the timeliness of delivery, or the supplier may not be willing to agree to present an invoice for payment within 30 days. However, there are many examples where these problems have been overcome – often with the help of an intermediary - and MSMEs have won orders from large firms. This is an area where the demand for goods and services is increasing as the following two trends have been observed:

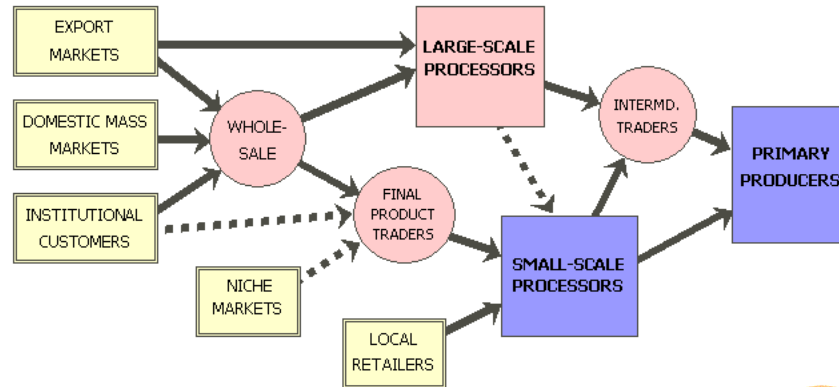
- A rapid increase in the number of supermarkets, hypermarkets, and chain stores in urban centres. With a corresponding shift of customers away from more traditional markets and small shops. Such stores tend to sell products with greater added value such as more processing and packaging.
- Large firms, to remain competitive and responsive to the rapidly changing (global) market situation, try to keep their running costs and overheads low, by “outsourcing” as many of their non-core functions as possible.

2.2.5 Other MSMEs: There are numerous examples of mutually beneficial transactions between different small enterprises – from farmers co-operating to weed their crops, and village blacksmiths selling farm implements, to printers making labels for jam-makers, and traders transporting milk to the city. There is clearly scope for an increase in the number and variety of such transactions, as a way to meet the changing market needs – of all types of consumers as described above.

In dynamic and thriving MSME sectors, we find enterprises of all sizes linked in various ways, interacting or trading with each other and with larger firms. For example a large hotel chain obtains furniture, furnishings, food and drinks, printing, and maintenance services from a number of suppliers. Each of those suppliers will depend upon other small enterprises – such as a farmers’ co-operative, transport companies, food processing businesses, and packaging firms - to supply them. In this way the chains that link the final customer to those businesses that have contributed to its arrival at the point of sale, can often be both long and with many strands (see Fig 2). The term “missing middle” has been used to describe the gap that exists in some developing economies – notably in Southern Africa – between the large, formal and relatively modern, private sector and small, traditional subsistence level enterprises.

Fig 2

Channels of Market Demand for Output from Small-scale Producers



Source: Albu & Griffith (2005) *Mapping the Market*



2.3 Policy Environment

For MSMEs, their capacity to flourish is not only affected by the resources available to them (supply side, above), and their customers' willingness and ability to buy (demand side, above) but also the extent to which the government's policies and practices are enabling or disabling for the initiation, operation, and development of profitable MSMEs.

Formal or official policies

In many countries there are laws and regulations which governments have introduced that directly affect the small enterprises. Examples are licenses (to trade, to build premises, health and safety), import regulations, and taxation. Procedures are sometimes very time-consuming and costly, and in some cases the regulations are of a general nature such as applying to all industry (whether large or small) and are inappropriate for very small enterprises. In some countries, although the regulations exist, the policing of them is ineffective – many of the small enterprises being informal and not monitored. This is particularly true for home-based or mobile enterprises.

Often people who are operating very small enterprises are unaware of the regulations and laws which they are expected to follow or which give them certain rights.

Informal

In addition to official regulations and controls, there are often other less formal or legal pressures facing small enterprises. These may be from competitors (eg larger firms or groups of small enterprises) who harass the owners to move, corrupt government officials who harass for bribes, suppliers who deny access to certain materials etc.

For some enterprises, the “informal” controls can be a more significant constraint to the development of their enterprise, than the formal ones.

The extent to which national or local authorities create an operational environment that is conducive to MSMEs flourishing is sometimes - but not always - a factor of the resources available to them. Other factors are limited awareness of the needs of, and constraints facing, MSMEs, little awareness of the impact of existing policies and practices, and more effective lobbying pressure from other more influential groups.

Are there trends / changes in this area? Is the policy environment becoming more enabling or disabling? It is difficult to generalise, the policies tend to fluctuate according to whims, experience of policy makers, resources available and competing pressures.

3. Most promising opportunities for MSME growth

There is likely to always be a niche role for some small enterprises to sell directly to consumers, but the majority of emerging opportunities for micro, small and medium scale enterprises are likely to be as part of the wider economy – linked to each other and to larger firms through a network of mutually dependent transactional arrangements.

With advances in technology, communications and the trends within the large firms described above, there is potential for growth and diversification of MSMEs of all sizes to fill the *missing middle* – to bridge the gap between the growing markets of large private sectors nationally and small scale producers of primary products. If this can be achieved then the result would be a greater integration of MSMEs in the wider economy through a) import substitution (greater proportion of supplies of large firms sourced locally) and b) export (more internationally competitive products available to exporters). Such greater integration would provide opportunities not only for incomes and employment in the MSME sector, but importantly, through their mutual dependence with the formal, mainstream or global markets, their prospects of sustainability and growth are increased.

This mutual dependence of a network of enterprises has another consequence or effect of interest to SED practitioners and donors. Within the interlinked network of numerous and varied enterprises there is a combined wealth of a wide range of resources including capital, specialised expertise, knowledge and influence. This offers the potential for the network to of enterprises to be more than the sum of its parts. It also permits the provision of mutually beneficial business services between different market players. These are sometimes called embedded services and can include input supply, skills training, credit facilities, quality assurance etc.

From the foregoing, the main growth opportunities for employment and income in MSMEs may be broadly categorised in two areas:

1. Primary production and secondary processing for onward sale to other businesses.

2. Service businesses providing a range of services to MSMEs and large firms. This includes a wide range of conventional service businesses such as trading, maintenance, repair, packaging, transport, sub-contracting, tool-making, component fabrication, printing, accountancy and communications. (They may also include MSMEs offering those business services that have traditionally been the role of government or NGOs – skills training, information, quality assurance, preparation of business plans, management consultancy)

4. How can SED practitioners help MSMEs to seize these opportunities?

Most interventions have addressed supply-side constraints: offering credit, skills training (technical and business), advice, information and infrastructure development (working premises, roads ...)

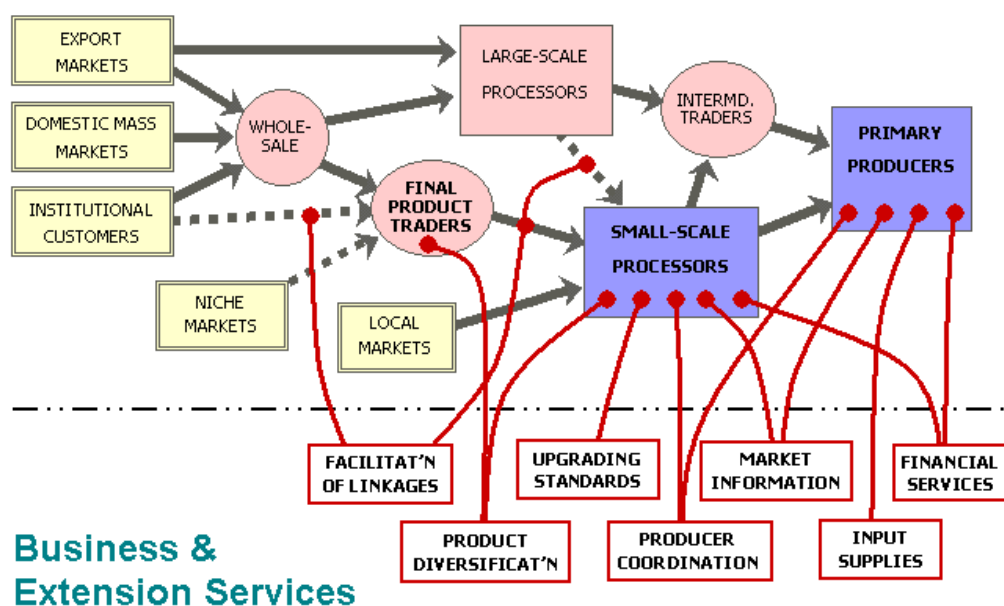
Such interventions have led to improved access to technology, tools, working premises, increased capacity to produce better quality and diversity of products and to produce more efficiently.

However, another range of interventions have been found to be more effective in addressing the demand-side constraints – promoting and forging linkages through which goods and services can be sold. These include forming and capacity-building of producer groups and business associations, facilitating sub-contracting and forward contracts arrangements between businesses of all sizes, assisting enterprise clusters and intermediaries, promoting capacity of SMEs to commercial buyers through trade fairs, catalogues and internet.

Such interventions have enabled SMEs to enjoy some of the advantages previously only available to larger firms, such as access to large orders, economies of scale (eg reduced unit costs of inputs), and ability to share in the production and profit from the sales of high value products for mainstream or export markets.

Figure 3 shows a range of services that may be provided to promote a thriving network of micro, small, medium and large businesses. These include both supply-side and demand-side inputs, and illustrate that interventions are not only direct services to individual small businesses but targeted interventions at various points in the network.

Fig 3 Business Services (a generic schematic)



Business & Extension Services

Source: Albu & Griffith (2005) *Mapping the Market*



The effective targeting and delivery of such services require an appreciation by SED practitioners of not only the characteristics of, and constraints felt by, people in small businesses, but also the existing channels of market demand (Fig 2), and the characteristics of other market actors.

A third set of interventions relate to the policy environment. A more traditional intervention by SED practitioners or donors has been to educate and inform policy makers (eg of “best practice” elsewhere). More recent approaches include efforts to stimulate greater dialogue between policy-makers and the owners of small businesses eg through business association representatives.

Well organised groups (eg farmers groups and small business associations) can be a useful vehicle for identifying common needs and constraints, articulating these to policy-makers and lobbying for changes where appropriate. Some of these may be addressed at local levels – such as land-use planning, licensing procedures, etc., and changes do not necessarily require additional state resources.

Such groups, or their representatives, can also negotiate with other private sector firms for services that better meet their needs.

5. Conclusion

The situation for small enterprises continues to change. They will need to adapt to survive, but for those willing and able to adapt there are emerging opportunities – opportunities to become less marginalised and better integrated into the mainstream

economy. This will depend upon building a strong network of linked enterprises who are mutually dependent and who together perform better than the sum of the individual parts.

For SED practitioners to help MSEs to respond to these changes and opportunities, then they will need to adapt their programmes in a number of ways:

- Interventions to be based on a better understanding of the market demand and channels
- Increased emphasis on interventions to address demand-side (market) constraints
- Strengthen the capacity of MSEs to forge and sustain links with other stakeholders , including other MSEs, large firms, service providers