Realistic SME Policy Requires Attention to Large Enterprise Links and Emphasis on the Key Role of Local-level Governments

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Policies to stimulate SME growth are clearly warranted and it is obvious that policy development should spring from analysis of real conditions and the effects of policy in such real conditions. Yet the reform failures of the past decade give good reasons to pause and reflect on what will work, taking care to distinguish viable policies from what simply sounds good (and appears to be easy to do by centrally controlled program initiatives). Earlier reform efforts were always dressed in the cloth of “modern economy”, “markets” and “normal society”. SME development is prone to ideological imaginings and policy dead-ends because it forms the core of the most simple-minded conceptions of market functioning.

This paper reports comparative research at UNU/WIDER on "SMEs in Transition Economies" that shows that the small enterprise sector will not by itself create successful economic growth. This is especially evident as soon as attention shifts from retail and neighbourhood-level services to directly productive small enterprises. SME sector success requires both active support services at the local level and the survival, revival or development of a healthy large enterprise sector as supplier of inputs, output market, provider of various social and technical externalities, and also (unexpectedly) as source of individual entrepreneurial leadership. Unless surrounding large enterprises have been successfully commercialized (meaning that privatization has either been delayed or done in a way that does not sever existing working relationships) and overall demand conditions are not severely restrictive, no significant and sustained SME growth can be expected.

This points to the need to create a synergistic relationship between the SME and the large enterprise sectors, not thinking of a zero-sum environment where success of the small can only be secured by destroying or further disassembling the large. Equally misguided were assumptions that individual private ownership was the only viable form and that banking services are best provided by large, usually foreign-owned, national units. Hopes that internationalization and the local effects of globalization will make it unnecessary to formulate local level development polices are also likely to be forlorn, as shown by the recent UNCTAD study on the effects of structural adjustment programs on SME (2002), suggesting that the process of opening up even well established market economies has strong negative effects on the SME sector. This reflects a mixture of the effects of domestic demand repression and the arrival of more mature foreign competitors in all economic sectors. The results could be even more negative for many transition countries, where an era of normal growth is yet to occur, making vulnerability of outsiders even greater.
Various form of “incomplete” privatization often leave local government with de facto ownership rights, raising the possibility of development of something like "core-TVEs". Pressures to reorganize municipal service provision units into quasi-corporate "ESCOs" (Energy Service Companies), "TSCOs", etc. offer similar opportunities. Local and regional governments have a central role in stimulating growth of various types of business activity. At the enterprise level various forms of full and partial employee ownership are appropriate, as illustrated by some promising recent developments in various transition economies. Local government roles in this area can include creation of a local finance system based on credit co-operatives to overcome the SME credit famine and stimulate local saving-investment cycles, as well as directly para-entrepreneurial functions (including equity ownership), all generally consistent with the "local developmental state" growth model. The natural synergy between co-operative savings/credit co-operatives and production units with co-operative or partial employee ownership is evident in Nordic experience and is relevant here as well. There is a delayed but still potentially important role for cooperatives and other employee-owned enterprise forms in filling the still gaping (directly-productive) small enterprise "black hole".