



The McLeod Group



SMALL AND MEDIUM ENTERPRISE DEVELOPMENT

The Private Sector in Developing Countries: Theirs, not Ours

Small and medium-sized enterprises – usually defined in the global South as registered businesses with fewer than 250 employees (see box, this page) – drive local economic growth everywhere on the planet. From Afghanistan to Zimbabwe, small businesses can provide good livelihoods and, often enough, pathways out of poverty for their owners and employees, as well as their families, sometimes even the communities they live in.

Where development cooperation is concerned, being pro-business doesn't mean using aid to underwrite the costs of Canadian companies operating abroad. We already have Export Development Canada (EDC) and other trade promotion programs for that. Instead, it should mean strengthening small and medium enterprises (SMEs) in developing countries in ways that advance the interests of people on the margins of their societies.

Canada's aid program already promotes SMEs in a variety of ways. In one initiative, for example, Canada has been working with the International Finance Corporation to mobilize capital and other services to support small and medium-sized business in developing economies. But we could do a lot more.

As Canadians who own or work for SMEs in their own country know very well, growing a small business is neither simple nor easy. Many don't reach their potential, or they fail outright. Lack of management or technical skills, inappropriate technology, corruption and crime, inadequate access to inputs, market research and

Definition of SME

The definition of SME varies. The European Commission describes a *microenterprise* as having fewer than ten employees, *small* having fewer than 50, and *medium* having fewer than 500. In many developing countries the cut-off for *medium* is set at 250, and in others it is fewer than 100. The Brookings Institute argues for country-specific estimates of a company's turnover. In Ghana, an SME would have an annual gross income between \$23,700 and \$2,370,000, while in Thailand the range would be between \$84,400 and \$8,440,000.

See Brookings:

www.brookings.edu/~media/research/files/papers/2008/9/development%20gibson/09_development_gibson.pdf; European Commission: http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index_en.htm.

The McLeod Group works to strengthen Canada's contribution to a better world.

The McLeod Group is made up of professionals with many years of experience in government, civil society and academia, working across the fields of international development, diplomacy and foreign policy. We work with others who value human rights, inclusion, equality and sustainable development to advance Canadian policy and action on international cooperation and foreign affairs.

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sustained financing, domination of sectors by large companies, fluctuations in commodity prices – there are many obstacles to success. The constraints are much greater for small and medium enterprises than for large firms.

Canadian Support to SME

- CIDA operated an SME support program in Egypt (1989-2011) with an investment of nearly \$80 million.
- Global Affairs Canada (formerly CIDA/DFATD) currently runs an active SME program in Vietnam (2010-17) with a budget of \$10 million.
- GAC (DFATD) has created a 15-year fund in support of the Mennonite Economic Development Associates of Canada (MEDA) aimed at leveraging up to \$400 million to help up to 250 SMEs. This project (2013-2028) has a GAC contribution of about \$20 million.
- INFRONT (Impact Investing in Frontier Markets), led by MEDA in partnership with Sarona Asset Management and the MaRS Centre for Impact Investing, is supporting 18 local funds for onward SME investing. This fund, with up to \$250 million to invest, has received important support from DFATD of \$15 million.

To remove or reduce these barriers, aid dollars can fund programs to provide the right kind of business advice and training, market intelligence and tailored loans and equity investments. Aid can also support improved tax policy and regulatory regimes aimed at enabling SME growth.

Interestingly, much of Canada's expertise and experience in designing such programs resides in the non-profit sector. The Mennonite Economic Development Associates (MEDA), the Société de Développement International Desjardins, and Digital Opportunity Trust are three examples of Canada-based NGOs that work effectively with SMEs in poor countries (*see box, this page*).¹

More than that, there is a social consideration in which Canada could play a leadership role. Canadian aid could go beyond basic small business support and give priority to SMEs that are owned by, or employ women, youth, the disabled, and ethnic and sexual-identity minorities. Doing so would not only advance economic development, it would also promote human rights.

Of course, it is crucial to target sectors within which small businesses can flourish – sectors that offer robust and accessible value chains and procurement possibilities and, sometimes, the edge of new technology. Communications, health care, agriculture and agri-food, construction and even digital outsourcing all seem to hold promise in Africa, in particular.²

And there's more. As the International Labour Organization argues, to really contribute to poverty reduction, small businesses in the developing world must provide decent wages and better, safer working conditions.³ Networks of SMEs, large employers, non-profits, universities, governments and unions can work together towards these imperatives.

What Canada Should Do

1. Stop using Canadian aid dollars to boost Canadian companies operating abroad. Building the private sector in developing countries is important, but this is not the way to do it.
2. Expand and speed up support to SMEs in developing countries, especially at the margins, through programs with local banks, governments and NGOs that provide access to inputs and markets, business advice, market intelligence, training and finance, especially to small business owners who are women, youth, members of minority groups, or disabled.
3. At the same time, support programs that provide incentives to big and medium-sized local companies to source some of their goods and services from SMEs operating at the margins.
4. Boost grants to national government programs that assert the rule of law and uncover and prosecute corruption and crime in relation to SME development.
5. Continue to catalyze capital pools that blend private, public and third-sector funds that target equity and debt investments in SMEs at the margins, in order to achieve high social impact and good financial returns at the same time.
6. To improve the scattered and partial knowledge base on small business, Canada should fund, compile, analyze and publicize findings from diverse SME models across different contexts, becoming a go-to source of information for governments, support organizations and SMEs themselves.

The Importance of SMEs in Development

As the UN Industrial Development Organization has argued: “For developing countries, integration into the global economy through economic liberalization, deregulation, and democratization is seen as the best way to overcome poverty and inequality. Crucial to this process is the development of a vibrant private sector, in which SMEs play a central part.

SMEs make up over 90 per cent of businesses worldwide and account for between 50 and 60 per cent of employment. However, their importance in the development process goes beyond their strength in numbers:

- SMEs tend to employ more labour-intensive production processes than large enterprises. Accordingly, they contribute significantly to the provision of productive employment opportunities, the generation of income and ultimately, the reduction of poverty...
- There is ample empirical evidence that countries with a high share of small industrial enterprises have succeeded in making income distribution more equitable. This in turn is a key contribution to ensuring long-term social stability...
- SMEs are key to the transition from agriculture-led to industrial economies as they provide simple opportunities for processing activities which can generate sustainable livelihoods. The predominant role of women is of particular importance.
- SMEs are a seedbed of entrepreneurship development, innovation and risk-taking behavior and provide the foundation for long-term growth dynamics and the transition towards larger enterprises...
- SMEs, as amply demonstrated in information and communication technologies, are a significant source of innovation, often producing goods in niche markets in a highly flexible and customized manner.”

Source: UNIDO, “CSR Implications for Small and Medium Enterprises in Developing Countries,” 2002, pp. 2-3

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NOTES

Photo: Indi Samarajiva, Flickr. Kandy Businesses. <https://www.flickr.com/photos/indi/3947441785/in/photostream/>.

¹ For more details, see MEDA (<http://www.meda.org/>); Developpement International Desjardins (<http://www.did.qc.ca/en/>) and Digital Opportunity Trust (<http://www.dotrust.org/>).

² Canada can utilize innovative research and development in this area. Several US-based foundations are very active in testing the potential of these sectors to deliver jobs to young people in poor countries, notably construction (MasterCard Foundation), agriculture and agri-food (the MasterCard and Gates foundations), and mobile technology (Omidyar Network). For its part, Canada’s own International Development Research Centre recently completed a major program on information and communication technologies for development (ICT4D) in Africa, which offers insights into technology applications for livelihoods, social inclusion, e-health and other areas (see http://www.idrc.ca/EN/Themes/Information_and_Communication/Pages/IDRCBookDetails.aspx?PublicationID=1263).

³ See International Labour Organization, Geneva (<http://www.ilo.org/global/lang-en/index.htm>).