Small and Medium Enterprises (SMEs) in Developing Countries The Mauritian Success Case Study

Dr. Rajendra Parsad Gunputh*

Key Words:
1. SMEs
2. Legal and Institutional Framework
3. Funds and Capital

Abstract: This paper deals with small and medium enterprises in developing countries: how to raise funds and capital to promote social entrepreneurship in the country? Through a contextual approach the author tries to demonstrate how some legal aspects and some institutions have improved this emerging sector in Mauritius coupled with financial market regulations and investment laws. This article also reflects to what extent some legal aspects of entrepreneurship are important to promote a better environment for clustering small and medium enterprises in developing countries.

Do your little bit of good where you are; it's those little bits of good put together that overwhelm the world"~Desmond Tutu

Introduction:

There are actually some 2000 registered SMEs in Mauritius and more than 170 in Rodriguez occupying 40% of the share of all employment contributing to 10-23% of the GDP whereas in Thailand, SMEs have contributed to 4% of the GDP in 2004 generating some 6.4 billion dollars annually. The Central Statistical Office (CSO) of Mauritius conducts regular surveys of small establishments employing less than 10 persons which show that the contribution of the SMEs to value added was 20% in 2007 but this figure has decreased to 18% in 2002. According to the 2007 census, the sector comprised of 91,979 small establishments, had a workforce of 208,797, generated a gross output worth Rs 42.1 billion rupees and accounted for 41% of the total employment. Also 21% of the working population is presently working in their own family enterprises whereas the figure was around 18% a decade ago and SMEs cover sectors like food and beverage, furniture, textile, wearing apparel, ceramic, jewellery, potteries, repair of motor vehicles, motocycles, personal and household goods, wholesale and retail trade. The Small Enterprises and Handicraft Development Agency (SEHDA) encourages SMEs and its latest figure reveals that 7,900 small enterprises are registered with 32% are operating in Trade and Commerce, around 16% in Leather and Garments, 13.2% in Food and Beverages and around 13% in Professional and Vocational Occupations.

Actually, SMEs are amongst one of the largest generators of employment and revenue in Mauritius providing the best services and products of international standards to both the local and international community. This paper aims to explain how SMEs have been a success story in Mauritius and how it may inspire other countries to combat unemployment and eradicate poverty in developing countries.

SMEs must have a penetrating power at a time where they have the power to do so. Indeed, SMEs must be clustered and act as a catalyst for Foreign Direct Investment.

In this paper the author tries to demonstrate that small and medium enterprises have been very successful in various regions of the world (literature review) but some legal barriers are still present (legal barriers to social entrepreneurship such as conditions of work, copyrights and passing-off) though some information may be gathered to overcome these barriers (research methodology) followed by facts and figures to prove that entrepreneurs need money to start-up their own business (analysis and findings) with particular attention to questions like how to raise funds and capital (recommendation) in a business world where entrepreneurs have to innovate constantly in order to survive.

Literature Review:

SMEs are a key vehicle for development and growth in any economy, as they constitute the majority of enterprises found even in the most industrialised countries (Masatak 1998 and Storey 1994). SMEs create employment, are a source of innovation, generate export opportunities amongst others (Hall, 1995). Hall added that SMES contribute between 15% and 50% of exports, between 20% and 80% are active exporters and SMEs contribute between 25 % and 35% of world-manufactured exports. Furthermore, Ramsurrun and Dalrymple (infra) argued that such increase in export can only boost the level of sales and employment.

According to Mokshada Devi Jhug (2005), the island of Mauritius,

* The author is Head of Law Department at University of Mauritius and can be reached at rpgunput@uom.ac.mu

because of its past industrial experience, has a large SME sector relative to its size of population. Subsequently, Small and Medium Industries Development Organisation (SMIDO) has contributed greatly to achieve such a success. Established under the SMIDO Act 1993 (now repealed), the SMIDO was a parastatal body, which aimed at fostering growth and development of SMEs in Mauritius and in Rodrigues. Its vision was to create a strong and modern SME sector that is efficient, competitive, integrated and increasingly export-oriented.

According to Ramsurrun and Dalrymple, SMEs in Europe make up 99.8% of all European enterprises, providing 66% of its jobs and accounting for 65% of its business turnover. SMEs have created more than 80% of jobs (Vertica. Oy et al., 1998) whereas Andrew Stone, of the World Bank, said that SMEs have created more employment than large enterprises and with lower investment per job created. Storey (1994) explained that this is so because SMEs tend to be a more labour-intensive sector that requires lesser capital spending on technology when compared to larger organisations.

Jianguo Yu (2002) argued that small and competent enterprises provide a major foundation for modern production. Bhargava (2004) discovered that SMEs have an important role to play in the present circumstances. For Bridges (2003), small businesses are often seen as the backbone of the private sector in the developing world. According to research affected by Poon and Swatman (1999), the size of SMEs' contribution to most national economies exceeds 90 % and they directly impact on the state of national economies.

There are also various barriers to SMEs in Mauritius and in various regions of the world. Chow and al (2002) postulate that bewildering menu of rules and regulations for registration purposes may discourage local entrepreneurs. Liedholm and Mead (1998) suggested that SME financing remains an intractable problem and that capital markets are generally far from adequate for SME debt (bonds) and equity (shares financing). Similarly, Levitsky (2000) argued that SMEs are unprofitable for commercial banks and the main reasons he puts forward are lack of expertise in the evaluation of SMEs and higher transaction costs. For Gerrefi (1999), taxes on exports, policies and regulations often have an unintended, adverse impact on SMEs because of various inconsistencies and trade-offs in their objectives, and hence in their outcomes.

Obstacles and creation of SMEs can be overcome by clusters and clustering. Mokshada (2005) explained that clustering would, among other things, facilitate more regular interactions and consultations among all concerned. This will help to minimize the unintended policy constraints and other inconsistencies as regards SMEs, provided that the sector is well represented in the process.

Steiner and Hartmann (1998) discovered that clusters are sets of complementarily firms (in production and in service sectors) public, private and semi-public and development institutions, which are interconnected by labour market and/or input-output and/or technological links. For Schmitz (1992), a cluster is a group of enterprises belonging to the same sector and operating in close proximity to each other. Porter (1990) defines clusters as a group of firms engaged in similar or related activities within a national economy. Elsner (2000) further defines clusters as groups of firms that are functionally interconnected vertically as well as horizontally.

Dijk (1997) found that the increased popularity of clusters is mainly due to the results in increased performance, their contribution to collective efficiency and ultimately, their facilitation in accessing international markets. Similarly, O'Sullivan (2002) postulated that the need for clusters promises a future towards further growth and development amongst SMEs as collaboration between SMEs in a cluster raises their innovative performance and competitiveness by combining resource and processes of interactive learning. Indeed, through vertical collaboration firms cooperate with suppliers and customers throughout the value chain and through horizontal collaboration firms develop cooperative arrangements with competitors. Pyke and al found that SMEs clustered in industrial districts were mostly responsible for the Italian success story.

Human Resource Development (HRD) in Mauritius: The Institutional Framework

According to Beaver (2002) although there are thousands and thousands of SMEs which are created every year however only a small number remain in operation after ten years of their inception. Why? Beaver and Hutchings (2005) discovered that one of the major contributing factors is a lack of attention and care to the human resource development aspect. In large and powerful economies like the USA or UK, SMEs are contributing to generate employment and neither Mauritius nor India will be an exception to the general rule. In fact, for SMEs to grow substantially and efficiently and to become a pillar of our economy, owners of SMEs must also be sufficiently trained to implement HRD best practices and good governance.

There are legal constraints to social entrepreneurship (fundings and conflicts between employees and employers for example) as well but the author will demonstrate, through a contextual approach, how various pieces of legislations will overcome these barriers to encourage entrepreneurship in the country specially at a time where Small and Medium Enterprises (SMEs) are an effective mechanism for employment, economic growth and, better still, in stimulating development and alleviating poverty. With facts and figures, the author will also demonstrate how entrepreneurs may raise funds in Mauritius (microcredit for example) to create their own enterprises in buying assets (hire purchase, leasing and factoring just to name a few) they need, coupled with various pieces of legislations (The Securities Act 2007) to overcome these legal barriers. These statutes are important: entrepreneurs need money and funds in order to raise capital to do business for both short and long term.

Furthermore, though they have support from the Small Enterprises & Handicraft Development Authority (SEHDA) they have to take loans and sometimes they may not be able to refund the money and in some circumstances they have to dismiss workers when they face financial constraints. Similarly, they have to deal with contracts to buy machines on lease or on hire purchase. In a new world of technology, businesses are also achieved in various different ways such as the Internet (e-commerce contracts, e-business) and digital banking. Entrepreneurs have to adapt to these technologies provided they have the means to acquire them.

Entrepreneurs are risk-takers and they must be risk-takers. The threats they face in Mauritius may also be threats entrepreneurs in other countries will be facing tomorrow: weak marketing skills, inadequate technology, lack of innovation, poor skills at work, inefficient organisation, poor training but above all poor access to credit and lack of finance. Funds and capital are the major obstacles any young African entrepreneur may encounter when engaged in trade, import and export. Nevertheless, there is a glimpse of hope as the World Trade Organisation encourages reduction in tariffs and non-tariffs barriers leading to greater democratisation and trade liberalization. Similarly, the creation of regional blocks and several regional economic partnership agreements will soon encourage entrepreneurs to increase exports in the SADC countries and evading different COMESA markets in the region. Mauritian exports have risen from 2 billion rupees to over 10 billion in 2002.

With a view to democratise the Mauritian economy and to promote HRD, the local government caters for the creation of various institutions in order to promote integration (for example foreign countries are encouraged to have their trade fairs in Mauritius and up to now they have been very successful) and development provided each institution has a purpose to serve. For instance, there is the Small and Medium Industries Development Organisation (SMIDO) and its objectives and missions to the country are to encourage training, counselling and documentation service, the Export Processing Zone Development Authority (EPZDA) encourages productivity and improvement and the National Productivity and Competitiveness Council (NPCC) has settled benchmarks for improvement and clustering, collaboration and networks. However, the most important institution with respect to SMEs is the Development Bank of Mauritius (DBM) which gives loans (around 5%) and various credit schemes and facilities to any entrepreneur in order for him/her to settle business promptly.

Various plans have also been set up (the National Physical Development Plan, the National Human Resource Development Plan) to support these institutions. This year, 2010, the National Human Resource Development Plan has reported that the skill gaps (gaps between employer's needs and skills that their employees possess) are unfortunately particularly acute in small businesses in Mauritius.

To avoid chaos and disorder (such as unfair trade, infringements to copyrights, trademarks and patents just to name a few) and to keep all institutions under control and for all citizens to be able to work properly without any single infringement of the law in addition to an institutional framework there shall be a strong legal framework as well.

Human Resource Development in Mauritius: The Legal Framework

SMEs fall in the category of the informal sector but which is expanded exponentially in the world and therefore they must be treated cautiously so that entrepreneurs may not, inter alia, trade unfairly and that consumers may enjoy the goods they have purchased. In the end there is a win-win situation.

The Mauritian legislature has drafted different Acts of Parliament in order to encourage entrepreneurship with a view of carrying business properly and that all norms such as hygiene and security are respected scrupulously.

It is in that perspective that the Small and Medium Industries Development Organisation (SMIDO) is made statutory but the SMIDO Act 1993 was repealed by Act No.20 of 2005 in order to meet new challenges. As a result, the Small Enterprises and Handicraft Development Authority Act 2005 (SEHDA Act 2005) came into operation and is one of the major pieces of legislation which deal with entrepreneurship in the country.

Actually, there is an arsenal of legislations in order to protect both consumers and the local entrepreneurs and to cope with emerging SMEs around the country such that nobody is below or above the law:

1. The Patents, Industrials, Designs and Trademarks Act 2002
2. The Protection Against Unfair Practices (Industry Property Rights) Act 2002
3. The Copyright Act 1997
4. The Electronic Transactions Act 2000
5. The Information and Communication Technologies Act 2001
6. The Business and Trade Names (Prohibition) Act 1988
7. The Business Registration Act 2002 where a firm includes an unincorporated body consisting of one or more individuals, or of one or more corporations, having constituted a partnership with a view to carrying business
8. The Bills of Exchange Act 1914 facilitates negotiations
9. The Income Tax Act 2005 defines, inter alia, business, relief for double taxation and non-resident who trades in Mauritius;
10. The Borrower Protection Act 2007
11. The Companies Act 2001
12. The Consumer Protection (Price and Supplies Control) Act
13. The Cooperative Societies Act 1976
14. The Investment Promotion Act 2000
15. The Cooperatives Act 2005

According to the National Physical Development Plan, SMEs are contributing to 86% in the employment sector and it takes the lion's share. The Central Statistical Office (CSO) in Mauritius did a census and it revealed that there are 75,000 small establishment and itinerant units in the country and they have created 180,000 jobs compared to 18,000 by large enterprises. It is judicial notice that an entrepreneur cannot work alone. He needs to employ workers but very often they are ill-treated. As a matter of good governance, an entrepreneur must not only be business-minded but also have a duty of care and attention towards his employees. Employees are efficient at work when they enjoy a good social environment and this issue must not be neglected as such. There are implied duties and they include confidentiality, hygiene and security at work. Today, the Employment Rights Act 2008 (Act 33/2008) and the Employment Relations Act 2008 (Act 32/2008) take, inter alia, into consideration the following legal issues in order to promote good governance at work and to avoid unnecessary strikes which may play a very bad trick on the economy of a country:

1. Compensation at work and job contractors
2. Violence at work
3. A Labour Advisory Council
4. Records and administration of employees at work with regard to registration of employers, keeping of records, labour inspection, power to make inquiries and to summon, and the complaint procedure
5. The minimum age for employment
6. Hours of work
7. Remuneration Conditions of employment such as transport, various leaves (annual leave, sick leave, paternity leave) and workers can join any trade union in the country (as stipulated in the Employment Relations Act 2008)
8. Termination of agreement since an agreement may be terminated either by the employer (for example he fails to pay the remuneration due under the agreement to a worker) or by the employee (when he is absent from work for three consecutive working days without good and sufficient cause (Carosin v. Rogers and Co. Ltd), when a worker is ill-treated by his employer or where he is absent from work without good and sufficient cause for three consecutive working days on a second or subsequent occasion, the employer may consider that the worker has broken his agreement)SMEs: some local, regional and international aspects

SMEs and their mushrooming is not only an internal issue. Entrepreneurs may innovate but very often their designs, handicrafts and inventions are not protected and they do not enjoy any trademark or patent rights whatsoever.

In order to minimise the harm that could be done to innovators, Mauritius has ratified a large number of conventions (the Strasbourg Convention, Locarno Convention, Nice Convention 1957, Universal Copyright Convention, Berne Convention) and is a member of the World Trade Organisation and the TRIPS. Today, our total exports are penetrating the European Union (around 67%). With respect to export, though Mauritius is a very influential member of the SADC, only a poor 0.007% goes to COMESA countries, 0.002 % to the SADC members and only 5.89% to the ACP countries. The government and local entrepreneurs are however optimistic because these figures show that there is still room for export. Nonetheless, language barriers and the settlement of a common currency in the SADC are major obstacles for our local entrepreneurs. Similarly, since Mauritius has its own legislations, borrowed and inspired from the UK, it has not been able to adhere to the OHADA Treaty and consequently to harmonize its legislations.

Mauritius has been exporting sugar since independence (1968) but it had to witness a drastic reduction of 36% in the price obtained for its sugar with the expiry of the Sugar Protocol under the LOME Convention. It has compensated the loss with a massive lobbying in the tourist and textile industry. With a financial support from India, Mauritius has created a Cyber City, for the information and technology sector, at Ebene, near the University of Mauritius. The Cyber City will be the stepping stone for the Indian markets towards the African region but China is also a strong challenger in the SADC/COMESA region.

At a time when our local products were not able to penetrate the African markets the African Growth and Opportunity Act (AGOA) came as a divine salvation as it allows African countries to increase their apparel exports to the USA. According to the US International Trade Commission, Mauritius exports have increased by 12.6% from 140 million to 150 million dollars during the period 2002-2003.

Actually, some countries (Brazil, Italy and Mauritius) are clustering SMEs which can challenge larger companies. There is inspiration to take from the Singapore model which is also one of the richest nations in the southern Asia. According to the Singapore SMEs Master Plan, 1987 Singapore's SMEs account for 90% of the total establishment, 44% in the employment sector, 24% of value added and 16% in direct export.

Raising Funds and Capital for SMEs:

There is an abundant literature on clustering of small and medium enterprises but though entrepreneurs may be motivated to innovate and create and with all the good qualities they have (self-determined, the need for independence and achievement and risk taking) they usually face the same obstacle everywhere: how to raise funds and capital to run their business?

According to Priya Basu and Michael Carter of the World Bank :"Bankers are reluctant to lend to SMEs because of the high transactions costs and perceived risks of SME lending, in the face of insufficient credit information, inadequate credit appraisal and risk management skills, poor payment records and low market credibility of SMEs".

In Mauritius, as well as most countries of the world, SMEs are often qualified as undercapitalised and are viewed by banks and other financial institutions as credit risks. To discourage financial constraints, the Development Bank of Mauritius (supra) was created and most local entrepreneurs have been able to finance their SMEs. Through the DBM, the government affords microcredit whereby the DBM will finance the project or innovation of the entrepreneur up to 100% and in return there is an interest of 6% only per annum. The advantage of this emerging Entrepreneur Loan Scheme (Rs 500,000) is that it is repayable over a period of 5 years and there is even a moratorium period of 1 year.

The theory of microcredit has been borrowed from Grameen Type Microcredit (GTM). The Grameen initiative has been very successful in Bangladesh, India (Self-employed Women's Association), South Africa (Self-employed Women's Union), Kosovo and Albania. In Bangladesh there are 40,000 "telephone ladies" selling mobile telephone services in villages of Bangladesh. Such schemes need to be supported and replicated. One way could be to link local initiatives, especially those which offer opportunities for women entrepreneurs, within a global partnership, such as the Micro-credit Summit Campaign, which has mobilized thousands of micro-finance organisations and their actors.

Entrepreneurs in Mauritius may purchase goods and equipments they need from the hirer firm provided there are regular payment with interest and secondly the hirer remains the legal owner of the equipments they have purchased until all payments have been made. Entrepreneurs and consumers in general must not fall in this spiral of credit facilities because every one is tempted to borrow money and goods and consequently overreach their resources.

Three important pieces of legislation have been promulgated so far to encourage entrepreneurship in Mauritius and to protect both entrepreneurs and the consumers: the Consumer Protection Act 1991, the Hire Purchase Act and the Hire Purchase and Credit Sale Act. In addition to microcredit and hire purchase, leasing is popular amongst entrepreneurs who wish to cluster and to grow in larger companies but there is always a risk of being left unpaid but factoring allows entrepreneurs to sell their invoices at a discount. Spring Singapore has conducted a survey and found that half of the applicants for bank loans in the first six months of the year failed in their endeavors.

In order to raise capital easily, local entrepreneurs have created public limited companies and it may offer its shares to the public. Securities such as shares, units, bonds, rights and warrants are also forms of investments of different kind such as shares traded on the stock exchange and bonds issued by the Government and public authorities. The main piece of regulation which provides for security regulations is found in the Securities Act 2005.

Though in Mauritius banks are ready to give loans to SMEs (known as SMEase) and despite government policy to encourage the involvement of small and medium-sized enterprises there is nonetheless an abundant literature which has been able to demonstrate that most SMEs do not have the necessary HRD expertise, infrastructure and general resources which large organisations and companies may enjoy (Moran, 2007) and researchers such as Westhead and Storey (1997) have come to the conclusion that a manager or an employee is less likely to be in receipt of training if he/she works in a small firm rather than a large one. It is therefore time to institutionalize SMEs but how and why?

In Mauritius funds for SMEs have been budgeted. A local institution like SEHDA (supra) has been granted Rs 70 million from the government to encourage and to finance projects in marketing, entrepreneurship development and technology improvement just to name a few. The Mauritius Post and Cooperative Bank has received Rs 200 million to facilitate financing SMEs. The Mauritian government has created the Empowerment Fund Ltd. Financed at Rs 250 million, it aims to give additional support to SMEs and to reengineer firms and marketing.

The Mauritian model is not an isolated one. Indeed, in Thailand the Bangkok Fashion City Project has been initiated from the government and budgeted at 46 million dollars to encourage textile and garments industry development programme and an international fashion school. In Singapore there is the SME 21 Plan which is a ten-year action plan for SMEs. As a result the Local Enterprise Finance Scheme and the Local Enterprise Technical Assistance Scheme have been launched.

Conclusion:

It is difficult to conclude on an emerging, informal sector like SMEs because the road to success is still under construction. It is believed that SMEs and clustering are job creation. Furthermore, Priya Basu and Michael Carter of the World Bank stated that: "Small and medium enterprises are potentially key engine of the economic growth, job creation and greater prosperity in India". For a nation to be wealthy, first it has to combat illiteracy and poverty (Muhammad Yunus, Nobel Prize winner for his research on Microcredit). Education is compulsory to one and all. As from 12th March 1968, the Mauritian legislator is fighting for human rights, against discrimination and is promoting gender equality just to name a few so that the country is a wealthy one and that each individual without exception enjoys prosperity and freedom. The Mauritian know-how is universally recognised and the economic contribution of each community (PIO, French, Creole, Muslims, Chinese, and Tamils) and citizen of Mauritius concur perfectly with Desmond Tutu's quotation.

References:

Mokshada D. Jhug (2005): Investigating the effectiveness of clustering of small and medium enterprises in Mauritius.

Ramsurrun and Dalrymple (2002): Global competitiveness with small and medium manufacturing enterprises in Mauritius.

Jianguo, Y. (2002): WTO and the development strategies of Chinese SMEs.

Bhargava, S. (2004): Developing competitive advantage through SMEs to face WTO regime

Poon S. and Swatman P. (1999): An exploratory study of small business internet commerce issue.

Liedholm and Mead (1998): The dynamics of macro and small enterprises in developing countries, World Development, 26, 1, January

Levitsky (2000): Guarantee schemes and other innovative financial instruments enhancing SME access to credit.

Gereffi (1999): International trade and industrial upgrading in the apparel commodity chain, Journal of International Economics.

Djik (1995): Bridging the gap- Philippine SMEs and globalization. Manila: Small Enterprises Research and Development Foundation

O'Sullivan (2002): Dot Com Clusters and Local Economic Development: A Case Study of New Media Development in London's City Fringe.

Beaver G. (2002): Small Business, Entrepreneurship and Enterprise Development, Prentice Hall, Harlow.

Beaver G. and Hutchings K (2005): Training and developing an age diverse workforce in SMEs. The need for a strategic approach, Education + Training, vol. 47 No.8/9, pp.592-604.

Section 2 of the Income Tax Act 2005 enacts that business: "includes any trade, profession, vocation or occupation, manufacture or undertaking, or any other income earning activity, carried out with a view to profit".

Part X of the Employment Rights Act 2008

Part XII of the Employment Rights Act 2008

Part X and Part XI of the Employment Rights Act 2008

Part XIV of the Employment Rights Act 2008

Part III of the Employment Rights Act 2008

Part IV of the Employment Rights Act 2008

Part V of the Employment Rights Act 2008

Part VII of the Employment Rights Act 2008

Carosin v. Rogers and Co. Ltd 1985 MR 74/SCJ 100

The OHADA Treaty was created by the Traité de Port-Louis on the 17th October 1993. Up to now 14 African States have ratified it.

www.grameen.com,

www.sewa.org,

www.changemakers.net

www.microcreditsummit.org.

Moran, P. (2007): Training Needs and Human Resource Development Analysis of SMEs in Mauritius, Human Resource Development Council. Newbury Park, CA