
Basic Structures and Focus Points of Different Strategies: MSE Development or Poverty Alleviation?

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The Meaning of 'MSE'

Micro and small enterprises (MSEs) share many features and are substantially different from medium and large enterprises (MLEs). MSEs are the:-

- Smallest and most modest enterprises or businesses in terms of technology, labour, know how, information, investment and working capital;
- least endowed in terms of access to land, capital, infrastructure, training, counselling, qualified labour, markets, legal and social security and other important resources and assets;
- least promoted and most prosecuted;
- enterprises that ignore, neglect or consciously avoid most of the conditions and regulations imposed by state authorities.

MSEs work in manufacturing, repair and maintenance services, construction, transport, trade, lodging and catering, food processing, and peri-urban horticulture, meat, milk, egg and fish production. MSEs are located in the open air, in workshop premises, homes and at clients' premises.

If MSEs are motivated to form groups with other MSEs of their own choice not much attention is usually paid to their poverty status. Ensuing groups are composed of MSEs from the same trade and from the same vicinity, irrespective of income differences. Corrective action may be taken later if considered necessary.

Objectives of MSE Promotion

What are our ultimate intentions? Do we aim primarily at:-

- MSE sector development through improved promotion strategies and instruments, with some positive side effects on poverty alleviation (Objective A)?
- Broad scale poverty reduction through employment and income generation in the MSE sector (Objective B)?

Main Features of the two Basic Strategies

- Strategies aimed at Objective A are based on the assumption that MSE sector growth will create employment for the poor. Proponents like to differentiate be-

tween MSEs with growth potential and survivalists and prefer to promote the first ones. This strategy is guided by highly aggregated and/or abstract constructs such as GDP growth, export earnings and international competitiveness, and interested in human beings and their welfare only in a long-term perspective. Its credo: Produce first and distribute later (Strategy A).

- Strategies aimed at Objective B focus on persons and endeavour to alleviate their poverty. Its credo: Distribute opportunities for production to the poor as a condition for them to work and earn an income. The poor are differentiated according to the constraints they face when they want to access income earning opportunities (e.g. employed/unemployed men/women, trained/untrained youth/drop-outs, poorest of the poor). This differentiation is needed for the selection of appropriate methods and instruments. Strategy B wants to provide all categories of poor people equally with chances to overcome poverty. It is left to the market to decide who is competent enough to become a “real” entrepreneur and who will stay a survivalist (Strategy B).

Status of Strategies

- Presently, Strategy A is prevailing. The methodological discussion focuses on the BDS paradigm and its implementation, on the promotion of the local and regional economy, and on systemic (international) competitiveness. Many projects and programmes are assigned the task to implement Strategy A. The complexity of reality rarely allows a methodologically pure transfer of the concepts into practice.
- Verbally and in their concept papers, almost all donors place high priority on poverty alleviation (Strategy B), but most of them do not have an all-encompassing strategy. Poverty reduction programmes often target the social rather than the productive sectors. If they do, projects and programmes often have a limited scope.

Assessment of Strategies

Strategy A

Strategy A tends to repeat the mistakes made in the 70s when modernisation strategy led development practitioners to handpick and pamper a few enterprises believed to be promising. By focusing legislation and promotion tools at small enterprises with a growth potential, Strategy A accentuates market distortions, helps to push weaker, unsupported businesses out of the market and may thus increase poverty.

Strategy A takes globalisation very seriously, on the one hand, and recommends developing and transition countries to strive for international competitiveness. On the other hand, however, it ignores globalisation's first commandment that says: Substitute capital for labour. We remember: In Europe and North America the first sector to be penetrated by capital was manufacturing (the secondary sector), the

next was agriculture (primary sector), and since about a decade or two the services (the third sector) are being transformed from a labour intensive to a capital intensive sector. Thanks to globalisation, this trend invades also the countries of the South.

This means, Strategy A faces a dilemma. By developing the MSE sector so that it contributes to international competitiveness, Strategy A enhances the sector's capital intensity and, hence, reduces its employment potential. Therefore, Strategy A is not suited to alleviate mass poverty.

Strategy B

If the alleviation of mass poverty is considered a major objective of Development Co-operation (DC) another strategy is needed. Strategy B is based on experiences and observations shared by the economist Amartya Sen and brought to world-wide attention by the award of the Nobel prize to him in 1998. Sen explains poverty with the lack of the poor of entitlements, i.e. resources allowing people to make commodities their own. Poverty is the result of entitlement failures of particular population groups. The entitlement set of a person is determined by her/his original bundle of ownership (her/his endowment) and the various alternative bundles s/he can acquire starting from each initial endowment, through the use of trade or production. A person has to starve if her/his entitlement set does not include any commodity bundle with adequate amounts of food. Most persons have no other endowment (original bundle of ownership necessary to acquire commodity bundles) but their labour.

If this explanation is correct, mass poverty cannot be alleviated merely by increasing the production of goods and services at the national scale. It can be alleviated only if the poor are able to earn an income so that they can afford to buy the additional goods and services. Such income may take the form of transfers paid by relatives working abroad or by social organisations. Sustainable incomes will be earned, however, by the involvement of the poor in the production of goods and services as employees or self-employed. MSEs provide both kind of work places at low cost.

Strategy B has hardly been implemented on a broad scale. Pilot projects exist, but models have not been developed for regional or even national outreach. Such pilot projects are so busy to cope with constraints, obstacles and problems that they often miss to reflect about their medium-term and long-term effects on MSEs not supported by them, and on ecology.

The Need for a Strategic Choice

When projects or programmes are planned, DC organisations must choose between the two strategies. Since many methods and instruments serve both strategies, DC organisations must – at least – decide which objective they want to attain. Assuming that the audience is interested in poverty alleviation as overall objective, I suggest to concentrate now on the question in which way the micro and

small enterprise sector can contribute to poverty alleviation and how it can be supported to do so.

First we look at the MSE sector and those business people that work already as producers or service providers. Then we regard the poor outside the sector and the ways and means to provide them with opportunities in the sector to earn an income.

Causes of Poverty in the MSE Sector

MSE owners have no access at all, or at unaffordable high cost, to production factors such as land, capital and qualified labour, to raw materials and markets, marketing information, managerial know-how and technical skills, government commissions, etc. Tax assessment is often done arbitrarily. Markets are distorted, since only medium and large enterprises obtain subsidies and privileges. MSEs are not organised, do no advocacy and are not considered important partners by government and private sector organisations. That's why reforms are hardly initiated.

The situation in towns and cities is aggravated by the never ending flow of rural – urban migrants many of whom – in need of employment and income – join the MSE sector and increase the competition for clients. The demand for production and marketing space and premises in urban areas exceeds the supply and pushes prices up. Many new entrants are forced to squatter on public or private land and work under the permanent threat of violent expulsion. Registration and licensing procedures are cumbersome, time consuming and costly. New entrants cannot therefore afford to comply with all the regulations. Squatters and MSEs that do not comply with regulations are considered illegal by authorities at all levels and henceforth prosecuted.

This situation triggers off vicious circles that prevent MSEs to earn incomes high enough to finance investment and a decent living. Subsequently, MSEs do not grow and do not create additional work places, and owners and employees subsist on low and stagnant incomes. MSEs that are no legal entities lack legal security. This implies three permanent threats: (i) Prosecution by the state authorities for non-compliance with rules and regulations, (ii) eviction from the work sites and confiscation of the tools and materials by police, and (iii) the inability to sue business partners or employees in court for violation of contracts. As a protection against the first two threats MSE owners bribe officials and keep their businesses small and invisible (no investment in valuable machines and tools, no advertisement). To protect themselves against the third threat MSE owners rely on social bonds by rather employing unqualified relatives than qualified foreigners and establishing trade relations with people of the same origin even if this is less profitable. Social pressure is a substitute for legal security. All these actions make MSE owners either waste income for unproductive uses or lose opportunities to raise incomes. Subsequently, poverty cannot be alleviated and additional income cannot be earned to finance the cost of legalisation.

Three factors are responsible for the causes of poverty:

- Government and private sector organisations (incl. of MLEs) do not know and understand the strengths and weaknesses, problems and constraints, potential and needs of MSEs, and they are not really interested in understanding and assisting them.
- The regulatory framework of most developing countries is an imitation of the model used and applied in industrialised countries of the North and therefore not suited for MSEs in the South. The framework and its application by 'rent seekers' forces MSEs to stay informal and illegal.
- It is true, MSE owners and self-employed are usually self-confident, independent and mature personalities that take risks and work hard. Many of them have, however, no expertise and experience in managing enterprises, honouring commitments and handling loans, many are ignorant of their deficiencies and quite a number have earned themselves a bad reputation by acting on the brink of crime.

Action Needed to Overcome Poverty in the MSE Sector

The Four Levels of Action

The above mentioned factors are located at four levels; so action is needed at all levels:

Meta level: The public's values, customs, attitudes.

Macro level: Government's national policies and overall macro and regulatory framework.

Meso level: Sector policies and strategies, public and private agencies' private sector and MSE promotion measures, membership organisations' services and advocacy.

Micro level: Owners and employees of MSEs, self-employed, MLEs, commercial service providers.

Experiences so far are, however, not very encouraging at all levels:

The time needed for changes at the meta level are usually measured in generations.

Macro level: Government advisors and policy dialogue have had little effects so far; no levelling of the playing ground for MSEs has been effected, yet. The regulatory framework is still inimical for MSEs.

Meso level: Instead of creating and implementing friendly sector policies, at best, MSE development strategies have been drafted. Most meso level organisations are not interested in MSEs as members or clients and therefore do not offer services suited to and demanded by them.

Micro level: Individual MSEs and groups of MSEs respond quite well to counseling and support offers. Successes have been reached as to organisation, training, bulk purchases, marketing, even sub-contracting of MSEs by MLEs, but on a very limited scale only.

Empowerment at the Micro Level

About two decades ago a number of donors shifted the focus of MSE development to the micro level. Since macro and meso level organisations did not respond to external advice they started empowering micro level MSEs in a way that they were able to solve some of their problems themselves and to exert some pressure on macro and meso level organisations. Unfortunately, often the donors were impatient and advised MSEs to form trade associations at too early a stage and at too large a scale, i. e. before MSEs had learned to operate associations in small groups at the local level. On the other hand, outreach of projects was too limited as to build up social or political pressure that counted.

The idea is still correct. MSE owners must take the initiative to bridge the gap between themselves on the one hand and government and private sector actors on the other. Firstly, they need to join hands amongst themselves and analyse the genuine causes of their problems. On the basis of the findings they must enter into contact with those organisations and companies that are responsible for the inimical environment and start discussions and negotiations with them. MSE owners must urge their partners to change attitudes and to take action. They stand to gain from project support, in terms of empowerment and assistance.

This approach aims at development from below. Projects and programmes facilitate the processes by addressing MSE owners and inviting them to meet in groups, identify their most pressing problems, analyse the root causes, devise a strategy to solve the problem and implement the strategy. Eventually, they encourage and counsel the groups to address actors at the meso and macro levels needed to solve the problem and to take up negotiations with them. Experience shows that while solving one problem groups face the next problem that needs to be tackled. This automatically leads to integrated, organic multi-sector development.

To be effective, such an approach must be run at least in one whole province. It is better to spread it over all densely populated provinces. Only then the momentum can be created necessary to impress macro and meso level organisations. Donors working in the same countries need to co-ordinate their projects and programmes for this purpose or rather divide developing countries among themselves.

Action at Other Levels

If organisations at the macro and meso levels react positively to the demands put forward by MSE groups and associations in the negotiations and need assistance or support in the implementation of the reforms required, projects should help them.

Whereas projects dealt with MSEs directly in the past, nowadays donors prefer their projects to work with meso level organisations. The capacity of organisations such as chambers of commerce and industry or existing trade associations is to be strengthened so that such organisations are capable to serve as facilitators and service providers. From a systemic point of view this approach is welcome. It is not easier, however, than the other (direct) approach because the mentioned meso level organisations lack the will, the expertise, the staff and the funds to do the job required. All this must be fostered, supplied and financed by the donors, at least during the first couple of years.

Creating Employment in the MSE Sector for the Poor

Conditions

The above mentioned promotional measures assist existing MSE to address the causes of their poverty. Now we look at people that are not working in the MSE sector, yet, deriving a small, insufficient income from work in another sector or having no income of their own. Before we answer the question: How can they be helped to enter the MSE sector in search of remunerative employment? we need to ask ourselves whether it makes sense to help such people in view of the high competition.

From a social point of view it is imperative to give as many people as possible an opportunity to earn an income. Economically, however, it makes no sense to invite an increasing number of people to work in the MSE sector if this one is hardly able to nourish the persons working in it. If more and more people enter a stagnant sector, as a consequence, an ever increasing number of people must 'share the cake' that cannot grow. In other words, the income of each worker decreases and, eventually, falls under the poverty line. The MSE sector will be able to absorb more people only if the regulatory framework is reformed to be conducive, if market distortions and other forms of discrimination by public and private organisations is abolished, and if MSEs have access to production factors, resources and information at reasonable cost. Measures to qualify more people to work in the MSE sector must therefore be accompanied by measures to reduce poverty in the sector (see the previous section).

Measures for Men, Women and Youths

Many micro-finance institutions have shown that poor men and women have ideas how to improve their income situation. To implement these ideas and to start a business, they principally need capital (usually small amounts only). When the businesses outgrow the facilities at the homes of the entrepreneurs they need a piece of land or workshop premises. Growing businesses usually make the business people aware of their managerial and technical deficiencies and create demand for training, counselling and linking (to other businesses e.g. for sub-contracting arrangements).

New business creation courses, such as CEFE or SYB, are useful for emerging entrepreneurs, but costs in terms of fees, subsistence, transportation and lost income are much too high for poor people. Women often cannot stay from home for such a long time. So even subsidisation will not always allow potential entrepreneurs to take part in such courses. As a rule, emerging entrepreneurs should be assisted with the service they need and demand first. The demand for other services follows organically and should be satisfied when it arises. This demand-led procedure guarantees that the service is absorbed and 'digested' by the clients. Supply-led services usually overtax the clients and are therefore not internalised and used.

To prevent youth unemployment two kinds of activities are recommended. Curricula of secondary and high schools and of vocational training centres need to be completed with achievement motivation, entrepreneurship and management modules so that students know an alternative to salaried employment and are somehow equipped for self-employment.

Unemployed drop-outs and school graduates are young and lack experience. So it is advisable to invite them to courses where they are introduced to entrepreneurial thinking and basic management and where their technical skills are consolidated and enlarged. Incubators should be obligatory in the neighbourhood of vocational training institutions where the trainees have a chance either to establish their own businesses individually or jointly, or to gain experiences in existing businesses as interns or apprentices.

Pro-Poor MSE Promotion Needs a Participatory and Holistic Approach

To reverse the prevailing situation, initiative must be taken by the business people themselves who, after acquiring political power through joining forces, address service providers and decision makers and involve them in negotiations about the improvement of their situation. Initiation and maintenance of a process of change can be guided, coached and facilitated by external organisations (donors), but they should never assume the 'ownership' of such processes and never control them. Donor assistance will be most welcome and utilised most effectively if it follows the steps taken by the local partners in the change process and supports the implementation of those reforms that have just been agreed upon. This also implies that the donors should be prepared to support any action in any area (micro-finance, commercial land, incubator, information, counselling, liaising, vocational training reform, etc.).

This demand puts donors in a difficult situation: Why should they refrain from the creation of a service if they know from experience that the service is necessary and will be needed by local business people? If they want the service to be utilised by the mass of MSE owners they better wait for the time when the mass of MSE owners feels the need for the service and demands it. Otherwise services will be utilised by a minority of privileged and well-to-do people only (such as many CEFE courses and BDS).

Pro-Poor MSE Promotion Needs a Realistic Approach

The Poorest of the Poor

Even micro-finance institutions, such as the Grameen Bank in Bangladesh, that target the very poor (women without land) do not reach the poorest of the poor, even not those that are economically active. There are two main reasons for this failure. Firstly, extremely poor people are so pre-occupied with securing their subsistence that they cannot spare the time to meet with other poor or to work for the improvement of their situation. Secondly, solidarity groups that guarantee the loans of their members are reluctant to accept the poorest since they believe that the poorest will not be able to repay their loans. So, with conventional tools we will not succeed in integrating the poorest of the poor in the MSE sector.

BDS and the Poor

The 'New BDS Paradigm' has two positive aspects. Firstly, donors assist facilitators to create or strengthen BDS providers. Most of them are MSEs themselves. So the paradigm helps directly to create employment and income in the MSE sector. Secondly, the supported BDS providers offer services – hitherto unavailable – to MSEs that help them survive and grow and thus create and secure employment and income.

The paradigm stipulates payment of clients for BDS. The reasons given are reasonable. Experience in countries all over the world – in industrialised countries of the North as well – show that only large enterprises hire BDS providers on their own initiative and pay fully for the services. MSEs have no tradition in asking unknown persons for advice. They are suspicious of foreigners and fear the direct and indirect costs unknown to them in the beginning. Only if they are members of a chamber or association and have established a trustful relationship to their organisation they may approach an advisor and ask for a piece of advice. Usually, such counselling is either free of charge or subsidised by the organisation.

As earlier mentioned, it is advisable not to create or strengthen commercial BDS providers unless the mass of MSEs demand such services. Meanwhile, in order to make MSEs used to BDS, these services should be provided by chambers and associations with high – varying – subsidy elements.

Pro-Poor MSE Promotion: Subsidisation and Sustainability

Subsidies are said to erode sustainability. True, but what kind of sustainability is at stake?

Five steps are essential for the development of the MSE sector. What is their sequence, who bears the cost and what should be sustainable in the end?

1st step: Poor MSEs lack nearly everything a business needs for profitable and sustainable production. To get access to the urgently needed assets, poor MSEs need power as a pre-requisite for being taken seriously by other actors. They have not succeeded to empower themselves, yet, because they have not recog-

nised the importance of empowerment. So somebody is needed to conscientise MSE owners about the advantages of being organised and acting collectively. Since they are not aware of the necessity of being conscientised they are not prepared to pay for the service. Local NGOs or DC therefore initiate and finance the processes aimed at empowerment (full subsidisation).

2nd step: MSE groups and organisations negotiate with authorities about the improvement of the regulatory framework and with private and public service providers about the adaptation of services to their needs. The negotiations are initiated and implemented by the groups and organisations on their own but NGOs and DC projects and programmes may be needed for counselling, coaching and facilitation (some subsidisation).

3rd step: Subsequently to the negotiations, authorities embark on reforming the rules and regulations inimical for MSEs, and service providers start customising their services to the needs of MSEs. If required local NGOs and DC projects and programmes assist the authorities and service providers by providing advice, expertise, facilitation and – at a limited scale – funds. They might also help for-profit and not-for-profit service providers to tap funds subsidising the services aimed at MSEs (some subsidisation).

4th step: MSEs avail of the reformed rules and regulations. This does usually not involve much cost. MSEs utilise the customised services as well. Some services may be fully subsidised, some partly and some not at all. So, in many instances MSEs are obliged to pay fees or to contribute to cost coverage in other ways. For many reasons, payment for services obtained is considered positively. As stated elsewhere, MSEs cannot, however, be expected to cover the full cost of services. Subsidy models (e. g. voucher systems) exist (some subsidisation).

5th step: MSEs – inclusive of BDS providers – must work profitably, i. e. must be competitive at least on the domestic market. If they are, they are sustainable, especially after the mentioned reforms have been performed. Production itself should never be subsidised. Counselling, coaching and facilitation may be subsidised at a regressive rate until such time when MSEs have recognised the benefits of such services and are willing to pay adequately (some subsidisation for 'soft' services).

DC projects and programmes have a limited life time. Before they end, they must – even by the use of subsidies – help attain two kind of sustainability. Firstly, MSEs and their organisations must have acquired the expertise to advocate their interests and negotiate reforms repeatedly, and secondly, MSEs must be able to benefit from reforms and to work profitably. In the MSE sector the use of subsidies is necessary to reach sustainability at the levels of organisations and enterprises.

Urban Bias

MSE promotion is guided by an urban bias. In view of the location of MSEs and the empowerment approach this can hardly be avoided. Empowerment of MSEs is dependent on large numbers. MSEs are concentrated in urban agglomerations.

So, it is easier and more economical to work with urban MSEs. Efforts should be undertaken, however, to include rural MSEs in groups and organisations formed nearby.

Conclusions & Recommendations

If DC focuses on poverty alleviation, MSE promotion can contribute to this objective by assisting existing MSEs on a broad scale to improve their environment and by helping un- or underemployed men, women and youths to enter the MSE sector as self-employed.

Both categories need a variety of services, all of which are equally important but needed in different turns by different enterprises: micro credit, imparting of entrepreneurial competencies to starters and business people, managerial and skills training, market and marketing information, clustering, incubators, linking MSEs to MLEs, adaptation of vocational training to the needs of MSEs, etc.

The adaptation of the enabling environment and of the services to the needs of MSEs should primarily be done in negotiations of MSEs on the one hand and authorities and service providers on the other. DC should assist all actors to play their roles. Subsidies may be often necessary. This is no problem as long as they contribute to sustainability at the levels of MSE organisations (effective advocacy) and enterprises (profitability of un-subsidised production).

Pro-poor MSE promotion will have a significant impact only if the recommendations are implemented in most of the densely populated provinces of a country at the same time. Since the initiation of group formation and the coaching of groups will be done by local animators / facilitators using local means of transport, costs of such promotion activities are low compared to conventional projects. An animator can handle 10 to 12 emerging groups with a maximum of 25 members at a time. When the groups graduate s/he can handle more groups.

Concentration of donor funds to a few countries and sectors may be necessary.

Munich, January 2002

Note to Page 3:

° Amartya Sen, Hunger and Entitlements, World Institute for Development Economics Research (WIDER), United Nations University (ed.), Research for Action, Helsinki (1988)