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Developing countries need a boost

By Alan Patricof and Julie Sunderland

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In the past decade, wealthy nations and international organisations have been captivated by the idea that microfinance initiatives, which provide small loans to the poor to invest in their own businesses, could be the panacea for two of the most tenacious problems of development: alleviating poverty and creating a seedbed for industrialisation. Heartening stories of poor people pulling themselves up by their bootstraps by building viable economic enterprises with loans of \$50 to \$1,000 appeal to our belief that companies are all started in a garage with nothing but entrepreneurial spirit and angel capital.

Microfinance has been a valuable tool of poverty alleviation and deserves continued support for helping the poor build income-generating micro-enterprises. But microfinance can only accomplish limited objectives since these businesses can rarely graduate beyond subsistence level to become competitive, employment-generating enterprises. Even if they could, the amount of capital microfinance provides is too small, the terms too short and the costs too high to support significant growth in such businesses.


On the other hand, small and medium-sized enterprises (SMEs) in developing countries - the agribusiness processors, the components manufacturers for multinationals, the software outsourcers - are the real potential engines of growth and employment and have a much greater possibility of becoming competitive businesses.

Though SMEs may not be as prevalent in developing countries as they are in wealthy nations, a significant number of entrepreneurs are similarly oriented towards adding value to commodities, creating and applying innovations in their markets, achieving economies of scale, re-investing profits and personal capital in their businesses, with a multiplier effect on employment. Yet their companies, requiring investments in the range of \$100,000 to several million dollars, have little access to long-term capital or the support programmes they need to grow.

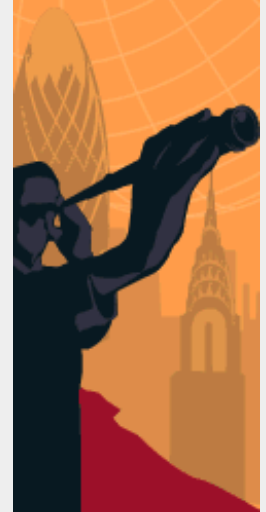
Developing countries need much more help from wealthy nations and international organisations to address this large capital and resource gap at the SME level. Unlike microfinance, which can be deployed through stand-alone institutions independent of the local business environment, support for the SME sector requires resources devoted to three broad initiatives. First, governments of developing countries must reform their business environments, concentrating on ineffective legal and regulatory regimes for small businesses and on the corruption that plagues them. If these old problems are not resolved first, other efforts to support small businesses will fail. Second, SMEs'

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access to capital must be expanded through accelerated development of financial markets, with government or donor-supported capital augmenting investment by private investors. Third, entrepreneurs and managers of small businesses need access to skills and knowledge gleaned from practical experience and international best practice. These types of initiatives have all been analysed and attempted separately in myriad forms by international bodies and governments. But all these components are critical and must be pursued simultaneously; otherwise competitive businesses will not form. Furthermore, instead of the traditional conflict between government and the private sector, effective deployment of these initiatives requires a long-term commitment from disparate stakeholders including local and foreign governments, international organisations, local and international investors, successful businessmen, multinationals and entrepreneurs themselves.

The Group of Eight and other wealthy nations should follow up on several recent initiatives - including the United Nations Commission on Private Sector Development, the proposed activities of the US's Millennium Challenge Corporation and the G8's recent Sea Island Action Plan on applying the power of entrepreneurship - and develop an action plan to support the development of SMEs. Capital from G8 countries must be made available through new forms of hybrid instruments and it must flow to the companies with real potential for growth. Government- or donor-supported capital should leverage capital from private investors, especially the few local investors who have capital, knowledge of local companies and a long-term interest in building the local business sector.

These nations could mobilise a new "Peace Corps" of business ambassadors - successful entrepreneurs, finance professionals and industry experts - to help their counterparts in developing countries learn the international language of business. G8 nations could also provide incentives to channel a portion of the \$100bn in remittance flows to developing countries from the diaspora towards productive investment in SMEs.


By supporting these indigenous companies, wealthy nations will begin to create an environment of opportunity and potential in developing countries and to alleviate the sources of discontent and frustration.

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