

Impact of smes on economic growth



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The small and medium enterprises' (SME) sector has been and is known to be the growth driver of economies in many countries and is the most flourishing business sector particularly in the developing countries.

SMEs have benefited the macro – economy of several developing countries through creating employment, motivate people in entrepreneurship, generating income, and provide encouragement to social and political stability.

The contributions made by SMEs in the economic development are measured by observing the rise or fall in the gross domestic product (GDP) and employment rate. This ultimately shows the economic performance of any nation.

The aim of the research is, first to recognize the contributions made by SMEs in economic growth of countries in the Sub-Saharan Africa that is; Nigeria, Zimbabwe and Tanzania. Second, is to appraise their performance. Third, is to identify the challenges affecting the performance of SMEs.

1. INTRODUCTION

In today's world, small and medium enterprises (SME) have contributed immensely towards the social and economic well being of the countries. Africa is by no means left behind and therefore the SMEs are becoming a major force of driving the economy of developing countries.

SMEs have been recognized as an important means in the economic growth of any nation by contributing towards gross domestic product (GDP), creating

jobs, reduction in poverty, generate income and facilitate nation's wealth thus resulting in national development.

Generally, a nation's economic development can be measured in terms of gross domestic product (GDP), gross national income (GNI), inflation rate, employment rate and other necessary indicators. (Begg et al, p. 423)

In spite of the fact that, majority of the firms in developing countries are small and medium enterprises (SME) and have been acknowledged as major players in the economic development; it is difficult to obtain specific evidence of contributions made by SMEs. This is because, SMEs operate in almost all sectors, embody different firm size; vary in terms of formality level and technological know how.

2. SME CONTRIBUTION TO THE ECONOMY

Small and medium enterprises have significantly contributed to the economic growth of many countries such as developed, developing or least developed countries (LDC). There are about 90% of small and medium enterprises that contribute over 50% of employment worldwide (IFC, 2010). For OECD economies, that is countries under Organization for Economic Co-operation and Development (OECD); have more than 95% of the entities as SMEs generating about 60% -70% of the employment. (OECD Report) (EuroJournals Publishing, 2010)

In Africa, 90% of the businesses operate as SMEs and contribute towards more than 50% of employment as well as GDP. For example; the SME sector in South Africa comprises of 55% employment along with 22% of GDP, in Kenya SMEs contribute 18% of national GDP, while in Morocco the SME

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sector accounts for 93% of the industrial firms and 46% employment. Some of the less developed SMEs can mainly be found in Zimbabwe, Tanzania, Kenya, South Africa and Nigeria. (Saravanan A. et al, 2008)

According to many researches and surveys, there is lack of written evidence with regard to measureable contributions provided by SMEs. This is due to their involvement in almost all the sectors, different firm size and their level of formality. For this reason, the research will determine the contributions made by SME activities based on the nation's GDP and employment rate.

Conversely, according to Fjose et al, in the ' MENON – Publication' (June 2010), contributions by SME sector to both GDP and employment have a strong relationship with the GDP per capita. Thus, the more affluent a country; the greater SME importance is to the overall economy.

For an organization or business to succeed, or fail; depends on the environment in which it operates. There are external and internal factors that determine the poor performance of SMEs, consequently affecting the economic growth, leading to fewer outcomes.

External factors are those that belong to the macro-environment that is; the political, economic, social, technological, environmental, and legal and can not be controlled. Some of the factors are competition, economic crisis, consumer behavior, governmental policies, access to finance, geographical location and corruption.

Internal factors are those which can be controlled and are considered to be decided within the organization. Some of these factors consist of:

management competencies, lack of skilled labor, marketing, technology, research and development (R&D) (in support of innovation) and corporate social responsibility (CSR).

Therefore, the above factors are important in determining the performance of the SMEs. These need to be addressed by the necessary government and financial institutions which would in turn give an impetus towards the economic growth of the respective countries.

3. THE NIGERIAN SITUATION:

Nigeria is known to be one of the powerhouses in Africa due to the economic growth that it pursues.[8]The country has been facing political instability, corruption and poor financial policies, for many years. Despite that, the economy of Nigeria is one of the fastest growing economies in Africa. This has been possible because of the immense contribution provided by the SME sector for many years.

Although a big chunk of Nigeria's revenue comes from the oil sector, it has highly depended on non-oil SMEs. These enterprises have contributed extensively over the years showing a positive growth in the economy of the country. According to the recent statistics, it has shown that the overall economy has increased gradually with an average of 7.4% from 2003 to 2009. The economy in non-oil sector grew by 9% from 2003 to 2009 along with good performance in agricultural, manufacturing, solid minerals and telecommunication sectors. (World Bank, 2010)

As affirmed, currently about 87% of the businesses in Nigeria operate as small and medium enterprises. According to the survey, 95% of the formal

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manufacturing activity is held by SMEs and 70% of industrial jobs. This sector employs approximately 50% of the working force contributing up to 50% to its industrial output. (SME e-access and usage, 2006) (Imoyo, 2010)

In relation to GDP contribution; it is estimated that SMEs create approximately 50% of the GDP and represent many business sectors that is; 50% as distributive trade, 10% in manufacturing, 10% in the service and 30% in agriculture (Lemuel, 2009).

SMEs have not only contributed towards the employment and nation's GDP, but also in economic development and industrialization resulting to diversity of industrial structures, input requirements, technologies and product quality.

Despite of the significant role played by the SMEs, their performance recently has been below the expectations. This is because of the workers' attitude and habits towards environment-related factors.

This has turned out to be a concern for Nigeria since most of the industrial work and other development is based on SMEs. Some of the other factors leading to reduction in the SME performance are explained below.

Inadequate access to finances has been one of the major constraints. This is because banks and other microfinance institutions refer SMEs to be high at risk. At many times these enterprises fail just because they have insufficient collateral, unprepared business proposals.

Another factor that has affected the SMEs in Nigeria is the managerial problems. This is in relation to shortage of entrepreneurial and managerial

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skills. The reason behind is the lack of appropriate education and limited financial resources leading to the employment of semi-skilled or inexperienced workers.

According to the survey conducted, 84% of the people have primary and secondary education while about 16% of the people have tertiary education.

In relation to work experience, nearly 5% have experience of 15 years whereby majority of the people do not have experience in business.

(Ekpenyong D. and Nyong M, 1992) (Ogunsiji A. and Kayode W., 2010)
(Central Bank of Nigeria, 2003)

Despite of the availability of business schools and institutions in Nigeria, there is a need in the training specifically on the areas such as accounting, marketing, information technology and technical processes as well as standardization.

It can not be denied that infrastructure is another vital constraint that has an effect over the performance of SMEs. This includes roads, telecommunication, electricity and water supply. These services have high impact on the production and contribution made by SMEs.

For instance, in the beginning six months of 2010, the GDP contributed by manufacturing sector in the non-oil segment had been lower than 5% because of poor power supply.

The small and medium enterprises in Nigeria have a great influence over the country's economy and the government has realized their potential.

However due to the above factors SMEs have been underperforming. This

will have a dire effect on the economy of the country knowing that it will always have to depend on the strength of SMEs. Therefore it is important that the necessary steps be taken.

4. THE ZIMBABWEAN SITUATION:

SMEs in Zimbabwe have become bedrock for the economy, since it is on this informal sector that the nation's economy depends. It is believed that SMEs have significantly supported Zimbabwe especially during the financial crisis from 2000 to 2005, when many sectors were declining.

The nation suffered liquidity crisis as a result of deprived export performance and lack of international capital inflows which led to inadequate credit and donor support. Consequently, many banks failed due to economic meltdown, hyperinflation and mismanagement.

During the declining economy from 1999 to 2008; the output had dropped to over 40%. For the agricultural sector, production decreased to over 60% while mining and manufacturing sectors decreased more than 50%. The recent statistics show that the economy has improved during the first half of 2010 with a growth from 4.8% to 5.4% and that it is expected in the years to come, the economy might progress. (World Bank, 2010)

According to the Finance Minister, Tendai Biti, the country is already recovering from the economic crisis in 2008 and that, it is anticipated that the economy will grow to 9.3% in 2011. With the increase in mineral earnings, the country's GDP growth was predicted to be 8.1% in 2010 as compared to 5.7% in 2009. Together with that, it was expected that inflation

rate would reduce from billions of percentage (during the crisis) to 4.8%, in 2010. (M & C – News, 2010)

This steady growth has come about due to the introduction of multicurrency which has reduced the hyperinflation. In addition, the recent coalition government resulted in political stability which is enabling stable price environment resulting to the economic growth.

When the financial catastrophe occurred, it led to under-performing of many large firms resulting to output going to almost zero. This made many businesses to retrench, downsize and cut down employment in order to reduce cost.

According to the findings, done by The APEC, World Bank and Inter-American Development in 2002, the rate of unemployment had gone up to 80% due to decline in the formal sector, retrenchments and rise in the number of unemployed graduates together with employment seekers. (SME e-access and usage, 2006)

Alternately, through the introduction of SMEs, there has been a progress in the national economy. It was these SMEs which have always played a crucial role in building up the economy especially taking the country through the financial crisis. This contribution has been greatly recognized by the government leading to better support in uplifting these enterprises.

SMEs have not only supported the nation during crisis but have also created employment opportunities for the society. This was done through the entrepreneurial activities especially at the time when unemployment was a

major problem. As a result, it has become an alternative way of earning and this has uplifted the standards of living for many people resulting to reduction in the poverty.[22]Some of the SME types consist of activities such as “ handicraft, shops, restaurants, computer software, and other small activities” (SME e-access and usage, 2006)

The recent statistics as per the Ministry of Small and Medium Enterprises of Zimbabwe show that SMEs presently contribute about 12% of the GDP as well as 27% of employment. This is a much better economic scenario than the past, promising better economic stability. Although, Zimbabwe’s economy has started recovering; the economy is still facing adversity. It is anticipated that in order for Zimbabwe’s economy to stabilize, SMEs need to contribute at least 30% to GDP and 40% to employment by 2015.

Hence, during the crisis, SMEs played a major role in supporting the nation by generating income through which Zimbabwe would not have survived. Thus, SMEs in Zimbabwe are the key sectors to the economic growth.

Even though, SMEs in Zimbabwe have created employment and income opportunities; they are still categorized to having low contribution towards the economy. According to the findings, done by The APEC, World Bank and Inter-American Development in 2002, factors that hinder SME performance comprises of uncertainty in business environment such as high inflation, political instability, high interest rates and lack of foreign exchange. (SME e-access and usage, 2006)

One of the major factors that have affected the SMEs is the macro-economy and lack in liquidity of the country. Zimbabwe had been experiencing

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recession, high interest and inflation rates which made it difficult for the microfinance institutions to lend credits. Due to hyperinflation, many banks were failing which was again an issue through which it was difficult to provide credit to the SMEs.

Other economic factors that affect the performance of SMEs are exchange rates, market size; customer's spending power, competition intensity within the market and accessibility of business premises.

Another factor is the acquiring of financial resources and capital. SMEs are not able to obtain the funds, mainly due to volatility of the economy as well as their high risk in nature along with lack of necessary collateral which is important in order to obtain funds from the financial institutions.

The other factor is the lack of knowledge and skills such as entrepreneurial, marketing and management. It is through these skills that SMEs are able to know what the customers want, their tastes and preferences and how to retain them.

Together with the economy instability, Zimbabwe has also experienced political instability which has equally affected the performance of the SME sector. This has caused many businesses to lose their confidence.

In addition, Zimbabwe has inadequate facilities that can lead to poor performance of the SMEs. Due to the fact that the sector has very little access to finance, denying them to infrastructures, such as land, roads, machinery, power, water supply and telecommunication.

SMEs contribution towards the economy of Zimbabwe, however small in percentage, has supported in the growth of the country. Despite facing a lot of challenges, it has indeed changed the lives of many people as well as of the nation at large. It is these SMEs which have a potential for growth which can assist the country during its efforts to turn around its economy.

Regardless of its economic and political despair, Zimbabwe has been able to achieve great strides in its economic growth which has not only boosted the country but also motivated its people. SMEs in Zimbabwe are dedicated to grow so as to enable this sector help realize the potential in all the entrepreneurs. However there is still a lot to be done in order to sustain the economy.

5. THE TANZANIAN SITUATION:

Tanzania has been enjoying political stability since its independence and this has helped in creating favorable environment for many small and medium enterprises to emerge. SMEs in Tanzania are recognized to play a vital role in terms of creating employment and generating income.

Tanzania's economy mainly depends on agriculture along with other sectors such as mining, manufacturing and tourism. Tanzania's economy is steadily growing and has achieved to maintain the macro-economy.

Statistics show that there has been economic growth between 5 to 7% per annum ever since 2000. The inflation rate has been stable averaging 5. 7% from 2003 to 2007, however it had increased up to 10. 7% in 2009 because of high oil and food prices, but it is projected that it will decrease due to the

drop in drought and food crisis. This illustrates a growth in the economic performance of Tanzania. (World Bank, 2010)

During the past years between 1980s and 1990s, there were very few SMEs existing due to lack of capital, skilled employees and modern technology. Currently, due to better credit facilities, training and other opportunities the number of SMEs has increased and they are considered to be the growth drivers in Tanzania.

SMEs, in Tanzania, contribute nearly one third of the GDP. The Survey made in 1991, estimated that, micro enterprises in the informal sector consisted about 20% of the Tanzanian work force. According to the International Finance Company (IFC) of World Bank, 98% of 2. 7 million enterprises are micro enterprises.

The Minister for Industry, Trade and Marketing, Dr. Mary Nagu, in 2009, emphasized on the importance of SMEs by saying that the informal sector which is about 2. 7 million MSME operate without formal registrations, and account for approximately 50% of the GDP and 70% of Industrial employment. Together with that; SMEs currently contribute around one-third of the GDP along with 20% of the working personnel. This contribution of around 50% towards GDP and 70% of employment in a nation, especially in a low income country shows an increase in the development of the economy.

However the employment rate shows an increase because of the high number of school leavers who join the SME sector. According to the study, 94. 7% of the school leavers are employed in the SME sector while the remaining 5. 7% are work in the public sector.

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The SME contribution towards the manufacturing sector is high.

Approximately 90% of industrial activities in the manufacturing sector are operated by small and medium enterprises. These SMEs are specialized in activities like food processing including dairy products, meat packing, presentation of fruits, leather production and leather tanning and plastics. The rest 10% belongs to the large firms.

With the new outlook in the policies, the government has been actively engaged in encouraging the growth of SMEs thus enabling better performance. Despite of the environment provided to the SMEs, their contribution is seen to be low. This is due to of some bottlenecks that hinder the performance of these enterprises as identified below.

One of the factors is limited access to finance. Just as with the above two countries, regardless of the financial support, SMEs in Tanzania still face a challenge in obtaining funds. This is because of the weak or no collaterals, the size along with the high risk nature.

In an interview conducted by the Vodaworld Tanzania with Evan Mulokozi, the Managing Director of Serengeti Coffee, a start up SME in Tanzania, it was expressed that, “ most small businesses in Tanzania fall because they simply do not have the funds to get their business on its feet. Along with that, banks are usually not willing to lend start up firms due to the risks”. (Vodaworld Tanzania, 2010, p. 90-91)

Another factor is lack of market accessibility. Even though the government spends largely on procurement, it has not been able to support in terms of

access to market. Thus, lack of market penetration leads to SMEs to become idle.

More over, infrastructure has been a major problem in Tanzania. Since most of the SMEs are in the manufacturing sector, with disruption of power and shortage of water supply, and high energy costs it is difficult for SMEs to operate thus affecting the quality of the products.

Transportation costs and increase in price due to the incremental costs in fuel and poor roads leads to higher costs of goods ultimately leading lower profit margin.

There is lack of advancement in technology which results to less or no research and development (R&D) in the nation.

In addition, market for skilled workers is lacking due to poor managerial and entrepreneurial skills along with lack of experience in the business field. Thus, employing expertise can raise the costs making it expensive to hire them. As a result, SME growth is slow and do not have appropriate skills to understand the market.

Further more, Tanzania has unfavorable legal formations and regulations that affect the SMEs. For instance, the taxation rates in Tanzania are high resulting to SMEs not registering themselves into formal sectors. This may result to less income to the nation.

From the above, it can be seen that SMEs in Tanzania contribute considerably and that the government has already recognized their capabilities towards the economic growth. However in order to empower

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these enterprises to develop, it is necessary that the challenges faced are reduced to a bear minimum.

6. SMEs IN THREE COUNTRIES

The contribution of SMEs in Zimbabwe is much low as compared to SMEs in Nigeria and Tanzania. One of the reasons is that; the economy of Zimbabwe had been declining for many years and has recently started to recover whereas in Nigeria and Tanzania, the economy has been stable and striving to increase.

The SME contribution in Nigeria has been higher than that of Zimbabwe and Tanzania; due to the fact that most of the SMEs operating belong to the formal manufacturing sector. These SMEs are registered and pay taxes through which the country gains its revenue whereas in Zimbabwe and Tanzania SMEs belong to the informal sector.

Looking at the GDP per capita (in US \$), perspective; Nigeria's GDP per capita in 2009 was 1092, while in Tanzania it was 509 and in Zimbabwe it was 274. This illustrates that SMEs in Nigeria contribute a larger share towards the GDP as compared to the other two countries. This shows that the Nigeria has a robust economy and that its overall economy highly depends on the SMEs. (World Bank, 2010)

Taking the SME life cycle into consideration, SMEs in Nigeria have been in existence for many years hence they have reached a maturity level in terms of development. This allows them to be a part of the formal sector leading to more contribution towards the economy of the nation. Whereas SMEs in Tanzania are still in the growth stage and have now been looked upon as a

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means of creating employment and income thus most of the SMEs belong to the informal sector leaving very few or no SMEs in the formal sector. For Zimbabwe, SMEs are at the introduction level as a result they are very small businesses which support the living standards of the people.

In terms of employment basis, SMEs no doubt support all the three countries, however even with such contributions; labor productivity in these countries is still low. Some of the reasons are due to not having appropriate education, entrepreneur and managerial skills, lack of information, employment opportunities in the formal sector. As seen in Zimbabwe, the employment rate is as low as 27% of the working force in contrast to Tanzania whose employment contribution is nearly 70% of industrial workforce in the informal sector whereas the employment contribution in Nigeria is 70% of industrial workforce in the formal sector.

From the comparison, it can be seen that the annual growth in Nigeria is higher than Tanzania which is again higher than Zimbabwe. However there are chances for improvement in the economic growth in all three countries within the next few years.

Even though the growth for these countries is slow; the governments are trying to improve the economic status through implementing various programs and plans. Some of these are; helping in finance by giving out loans and credits, providing trainings and other development programs through which SMEs can grow.

7. CHALLENGES FACED BY SMEs

Despite of having policies, programs and support from the government and Micro finance institutions in various ways, SMEs in the Sub – Saharan Africa still remain to underperform due to many challenges that hamper the performance. Some of the challenges are: Improper facilities such as infrastructure, water and power supply, the mortality rate for enterprises are high, shortage of favorable environment for operating business, having restricted access to market, inadequate entrepreneurial skills and too many regulations and policies.

From the above challenges, the most difficult is having access to finance. The SMEs especially in the developing countries suffer due to shortage in financial resources such as credits, loans and funds. One of the reasons is because SMEs are considered highly risky along with high mortality rate. Besides that SMEs also lack the collateral as a result the financial institutions are hesitant to invest these enterprises.

Narrowing down to the Sub-Saharan Countries; SMEs face a lot of challenges which limits the contribution of these enterprises. The obstacles that influence the SME performance can be explained using the ‘ Enterprise Survey’ done by the World Bank.

The “ Enterprise Survey” conducted by the World Bank, whereby 100, 000 enterprises in 123 countries were surveyed shows the challenges faced by SMEs in Sub-Saharan Africa. Below is a figure showing ten business environment constraints for companies in Sub-Saharan Africa against the percentage of companies.

Figure 1

[Source: SMEs and growth in Sub-Saharan Africa, 2010]

According to the survey, the figure shows that, core obstacles that were considered to hinder the performance of SMEs are; lack of key infrastructures for instance power supply whereby 25% of the companies were effected and the second biggest hindrance is access to finance whereby 20% of the companies were effected. There are other main constraints such as tax rates, corruption, political instability, transportation and many others affecting their performance.

The above snapshots show that these obstacles can be addressed and with proper initiatives and support from both the government and the people, the economies of these countries can gradually develop to an expected level.

8. RECOMMENDATIONS AND WAY FORWARD

It can be seen undoubtedly that, SMEs are the keystone for the growth in many countries regardless of the challenges they face. They contribute to the economic development by generating income, employment and poverty alleviation. Due to the many challenges faced by the SMEs, their performance level tends to decrease.

To rectify this situation, it is mandatory that the government supports and encourages SMEs to grow from micro, small and medium enterprises to large enterprises so as to increase their contribution to the economic growth of the nation. This can be possible by implementing measurable actions through developing strategies. Some of the actions are as follows.

One of them is offering education. This includes, promoting trainings on managerial, technical and entrepreneur skills, and facilitate SME such as start ups. In relation to infrastructure, the government is required to improve the amenities such as water and power supplies, provide good communication and transportation structure. Without these services, SMEs become handicapped. Another strategy is the aspect of regulations whereby the government should develop soft policies that favors and encourages SMEs. The taxation should be resonant to the strength of the SMEs whereby it encourages them to register and become formal enterprises.

Although the SMEs are undergoing an uphill task to establish themselves as economic contributors to the countries, there are many promises by civic, investment institutions and business leaders who not only recognize the role of SMEs but are ready to support.

9. CONCLUSION

Currently many countries in Africa are experiencing development and this has been possible due to the contributions made by small and medium enterprises. Given that SMEs have the potential to create the economic as well as social growth, they are considered to be an important segment by the government together with microfinance institutions. It is therefore essential to minimize the constraints and to provide a suitable environment for the small and medium enterprises to operate.

With the current trend of globalization and the presence of global businesses in the country the SMEs have a greater chance of growth since it will involve local suppliers and distributors thus encouraging and boosting new ventures.

SMEs have a long way to go but with the right environment they are surely here to stay.