SMEs – Champions of sustainable business development

Lessons for a regulatory framework

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Jost de Jager is a German strategy consultant working at the interface of politics and business. He advises private companies and public institutions in strategy processes and political communication. By linking political, economical and social dimensions, the analysis of regulatory frameworks and their influence on business models are main activities of his advisory work. As an integral part, it covers relationship management in networks and the creation of synergies.

In order to find an economic model that creates sustainable wealth and growth in emerging and developing countries, experts and policymakers readily call for strengthening small- and medium-sized enterprises (SMEs). There are so many answers SMEs seem to give: they avoid economic dependencies on large corporations and foreign investment, they foster innovation and self-reliance, they give ecological business cases a chance and they even meet gender objectives. Often women are the more successful entrepreneurs in developing markets.

Many look at the German Mittelstand as a role model for commercial policies in different parts of the world. And writing as someone with a background as an economic policymaker and management consultant in Germany, I agree. The Mittelstand was one of the reasons why the German economy recovered faster than many other countries from the financial crisis of ten years ago. SMEs are still the backbone of the German industrial sector and have been for more than seven decades. Furthermore, family-owned companies tend to react differently in times of crisis. They think in longer cycles and have a closer relationship to their employees.

And yes, small and innovative firms have been the early drivers of the German Energiewende and still account for a large share of renewable energy production. So, why not take the Mittelstand as a role model?

Because there is more to the prospect of small- and medium-sized enterprises than just cherry-picking best practice examples. Medium-sized companies, managed by their owners, need a strong regulatory framework and an active and efficient state. GIZ, Germany's central development aid agency, recently commissioned a study to outline the characteristics of the German social-ecological market economy and asked which features might be transferrable into developing countries.[1] Of course there is a whole mindset attached to the model of a social-ecological market model. But in a nutshell, it melts down to

- access to markets,
- access to funding,
- access to education and infrastructure and
- equal living conditions.

If you look at SMEs as enterprises in industry and production with a sustainable business case, they depend on a fair and indiscriminate access to markets. So in the first place there needs to be a market that is not dominated by state-owned companies and huge international corporations. That means, secondly, that a fair system of licensing, procurement laws and exports is essential if SMEs are not meant to operate on the fringes of the commercial activities of a country.

In order to invest, to drive innovation and to survive in volatile markets, these enterprises need access to funding. Often commercial banks on their own cannot provide this due to their respective restrictions and policies. Here, the necessity of strong public structures comes into play. One striking characteristic of the German economic model is the existence of a decentralized structure of state-owned banks, business development agencies and guarantee funds, which ensure access to financing and the availability of commercial space. These are strictly not subsidies. To ensure market conformity of this way of financing small companies, these public support structures are obliged to cooperate with private partners in the financial sector in consortiums, financing the "last mile" in restructuring processes and investments.

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Of course there are small businesses in developing countries and in emerging markets. But very often they rather fill a service gap in the retail, trade, food supply or in the labor market without a distinctive business model. In some African countries, such as Ghana, this informal sector accounts for almost half of GDP, according to estimates. Skills – personal skills and the collective competence of the workforce of a company regardless of size – are a distinctive competitive factor for any enterprise in any economy. General education obviously is the foundation for that. But when it comes to business development, (basic) education needs to be supplemented by vocational training. Qualification of employees is an integral strategic objective for the management of companies. But in order to maintain a high level of technical competence of the workforce at large, the provision of vocational training ought to be a public task combining theoretical skills with practical knowledge. This pillar of the educational system should be ranked equal to schooling and higher education. It also needs some self-organization and qualification standards on the business side. But it guarantees the qualification of young professionals and high professional performance standards.

Economic performance fundamentally depends on another state provision – reliable and efficient physical infrastructure for transport, communication, energy and water supply. Whether this infrastructure should be financed and maintained by private investors or not, is an ongoing argument in advanced economies as well. But beyond doubt it is crucial that such infrastructure does not only exist but that it is also commonly available to everyone.[2] In the context of SMEs it means that infrastructure needs to be available outside of the big cities. When, as it is the case in Myanmar, forty percent of the country's territory is not covered by an electricity grid, it is impossible to foster sustainable economic development in rural areas.

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The aforementioned GIZ study of Germany examines wealth distribution and social cohesion in the vertical way as a characteristic feature. But there is also a horizontal wealth distribution which is at the same time cause and effect of the German economic model. In Art. 72 of the Grundgesetz (Basic Law) equivalent living conditions are laid down as an objective of legislative action of the Laender (states) and the central government.

This has two effects: One is that, authorized by the constitution, the state provides its services in the same quality even in peripheral areas and guarantees schooling, vocational training, transport, housing and energy supply in all parts of the country. This is the basis for comparable and compatible local conditions and specifically for the availability of a qualified workforce in almost every corner of Germany, a very important reason why highly specialized enterprises can prosper in remote and rural areas as well.

Another effect of the legislature was and is the lack of big cities in Germany compared with international standards. In the late eighties, before German unification, equivalent living conditions had almost been achieved. Ever since, various social trends have changed this and we have seen a rapid growth of the seven largest urban regions in Germany and the contrary development in some rural areas. But still, most people in Germany live in small- and medium-sized cities and towns with a substantially high standard of living.

[1] The Social-Ecological Market Economy in Germany by Alexander Kritikos et. al, commented by Jost de Jager; published by Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH, 2018.

[2] Ibid.