1 Introduction

1.1 Mauritian SMEs, Policies and the Asian Currency Crisis

Mauritius, because of its past industrial experience, has a large small and medium enterprise (SME) sector relative to its population size. Our estimates suggest that there are about 25,761 SMEs and micro-enterprises (1997) in non-primary sector activities (see Chapter 2). 5,731 of these are in the manufacturing sector. SMEs and micro-enterprises account for 32.1% of total manufacturing employment. This figure is comparable to employment shares in advanced industrial countries (such as the UK, France and Korea) and well ahead of industrialising economies in Africa. While the size of the SME/micro-enterprise sector is documented in Mauritian publications, little is known about its record of competitiveness on international markets and its future prospects.

This study of the competitiveness of SMEs in the Mauritian manufacturing sector has been conducted at a time of crisis and uncertainty in the international economy. Since the second half of 1997, the East and South-East Asia has been engulfed in a financial crisis which has lasted more than a year. The sharp reversals for some of the world's fastest growing economies and the greater caution of international investors have chilled world economic growth.[1] Economic theory suggests that most of initial impact of the crisis will be felt inside Asia itself and it will take some time to spread elsewhere. Two kinds of transmission mechanism are associated with the contagion from Asia:

- Whether an economy outside Asia will be affected by primary effects of the crisis will depend on the degree to which it has developed trade and investment (as well as tourism, aid and capital market) linkages with the East and South-East Asian economies.
- A given economy may suffer secondary effects arising from the impact of the crisis on the US and EU economies.

To what extent is Mauritius likely to be affected by the contagion?

Take the primary effects of the crisis. There are no aid linkages with Asia and little inflow of tourism from Asia. Mauritius is also relatively insulated from an external shock in its direct trading linkages with East and South-East Asia – for instance, East Asian economies (largely Singapore and Hong Kong) accounted for less than 1% of EPZ exports

[1] For the best and most up to date work on the Asian crisis see the IMF World Economic Outlook., published twice a year.

in 1996 while the EU (71.3%) and the US (18%) accounted for the bulk of these exports.[2] However, Mauritius is less insulated from a shock from its direct investment linkages with Asia. Hong Kong and China alone made-up about one third of Actual FDI inflows in 1990-1997 while the EU economies account for the most of the remainder.[3]

Secondary effects are likely to be even more significant than direct shocks because the EU and the US economies are Mauritius's major trading partners and the EU is its major source of inward investment. Consequently, manufactured exports from Mauritius may decline as the Asian crisis causes slower growth in the EU and US economies and as competition increases from Asian economies that have devalued their currencies. The latest OECD forecasts for world GDP growth are quite pessimistic -the 1999 GDP forecast for the 29 leading economies was recently cut from 2.5% to 1.9%[4]. Similarly, between July 1997 and February 1998, alone the currencies of the South and South-East Asian economies have depreciated between 50% and 231% against the US$.[5] At the time of writing, world growth still appears unstable in the short-term and tit-for-tat devaluations have intensified.

The full impact of the Asian crisis upon Mauritian industry and its manufactured exports is not yet known. Before the onset of the crisis, it seemed that Mauritian industry would confront several related economic threats in the early 21st Century: a severe deterioration in the international economic environment, falling world demand, volatile private capital flows, reduced foreign aid, rapid technological progress, and intense competition from low labour cost economies. The Asian crisis will greatly add to these pressures as Asian firms' restructure, become more efficient and globalise their production.

The intense competition underlying this scenario suggests one thing: to survive, more of Mauritian business has to match the productivity and technological capabilities of the best in the world. The Government of Mauritius also needs to support enterprise competitiveness with a coherent strategy for industrial adjustment. Mauritius can be viewed as a pioneer in the Commonwealth for its new export strategy, which was announced in the 1998 Budget of the Minister of Finance.[6] This strategy emphasises the growth of products that already have a competitiveness advantage in world markets and the development of new competitive advantages in manufacturing and services. The government has also institutionalised the process of strategic export thinking in a newly created Mauritius Productivity and Competitiveness Council. These initiatives will give Mauritian business a "first mover advantage" over neighbouring African economies and some South Asian economies.

A hitherto somewhat neglected aspect of industrial policy adjustment in Mauritius is the potential contribution that can be made by SMEs. Policy attention was

[2] Bank of Mauritius (1997), p. 106.
[3] Estimated from FDI data provided by the Bank of Mauritius.
[4] The OECD forecast was reported in The Guardian 16 November 1998, p. 26.
[5] UN World Investment Report 1998, p. 210. The currency deprecations are: Indonesia (231%), Korea (83%), Malaysia (55.4%), Philippines (51.4%) and Thailand (87.1%).
[6] The Commonwealth Secretariat provided technical assistance in developing the new export strategy and advised the Government in the 1998 pre-budget consultations with the private sector. The assistance was based on Lall and Wignaraja (1998).

traditionally geared to encouraging the entry of foreign direct investment and the growth of large firms. It was implicitly assumed that SME growth and exporting automatically follow suit. In this regard too, the 1998 National Budget saw the beginning of a more active approach to SME promotion. For the first time in the country's history, a specific package of measures was announced for SME development:

1. A National Entrepreneurs Bank promoted by the Development Bank of Mauritius (DBM) and the State Investment Corporation of Mauritius.
2. Five new industrial estates for SMEs run by the Mauritius Export Development and Investment Authority (MEDIA).
3. Feasibility study grants from the Small and Medium Industry Development Organisation (SMIDO) on a cost-sharing basis to potential SMEs.
4. Product and process development grants from SMIDO which covers up to 50% of direct project cost of new products and processes.
5. Training grants for technical and managerial education of employees of SMEs.
6. Some land in the Freeport Zone to assist SMEs in the marketing of their products.

Recent budgetary policy is influenced by a more pro-SME emphasis in industrial policy by the Ministry of Industry and Commerce (MOIC). A fundamental element of MOIC's approach is to enhance the competitiveness of small firms in Mauritius. The MOIC has attempted to foster a collective approach to small firm service delivery by SMIDO and MEDIA and to source technical assistance. In this vein, in 1999, the MOIC received a European Union grant of about 6 million ECUs to provide 50:50 cost-sharing grants for consultancy services to upgrade products and processes; to establish a Mutual Guarantee Fund and Equity Participation Fund for easier access to finance; and to provide training for management and export development.[7] It also obtained assistance from the Commonwealth Fund for Technical Co-operation (CFTC) to undertake this diagnostic study of small firm exports, policies and support institutions.

The move towards a small firm focus in budgetary/industrial policy is a welcome development for the country. Moreover, some of the actions mentioned above are useful interventions for small firms. However, a coherent approach to foster competitiveness in SMEs of the type witnessed in successful SME-driven economies (such as the UK, Ireland, Singapore and Taiwan) still appears to be absent in Mauritius. These economies are able to sequence economic liberalisation with a comprehensive package of support services to SMEs involving finance, technology, training and marketing. The two together provide a "push and pull" effect for small firms to upgrade and become competitive. There is also a general dearth of policy analysis and data on

[7] Further details of this project are contained in MOIC (1997).

SME issues in Mauritius, which confirms our impression that historically the subject was not in the forefront of economic policy.[8] The Government of Mauritius is aware of these gaps and is searching for solutions to remedy them.

Changes in the nature of business world-wide are tending to favour the resurgence of the SME sector as a global player.[9] Consumer preferences are moving towards specialised and customised products, creating niche markets that are more easily met by small-scale flexible and adaptable enterprise structures. Paradoxically the globalisation of business creates the need for localised supply chains, comprising numerous small businesses subcontracting to larger ones, in order to deliver faster and more efficiently. Developments in communications technologies are minimising the requirements for physical presence, facilitating the "downsizing" of the large, monolithic company and the emergence of the virtual organisation, and thus revitalising the role that SMEs can play in the world economy. A dynamic internationally competitive SME sector would also contribute to economic growth, generate exports, alleviate foreign exchange constraints, increase employment opportunities and reduce poverty. These trends reinforce the need to add another leg to the new export strategy in Mauritius by fully integrating the role of SMEs in the bid for greater enterprise and hence national competitiveness.

1.2 Aim and Method

The objective of this study is to assess the export competitiveness record of SMEs in Mauritius and to suggest policy improvements for future SME performance. To this end, the study aimed to:

1. Examine the magnitude of the SME population in the manufacturing sector and its export performance, in overall terms and at an industry-level.
2. Use an enterprise survey, to highlight the marketing, technological, human capital and strategic strengths and weaknesses of SMEs in selected industrial and service sectors.
3. Analyse the influence of the outward-oriented, market-friendly policy regime on incentives for SME growth and competitiveness.
4. Examine the role and adequacy of the support provided by public institutions for SME competitiveness.
5. Make suggestions for future SME competitiveness drawing on best practices in Commonwealth and non-Commonwealth economies.

It is a first attempt to synthesise what is known about the state of SME development in the country, the nature of manufacturing capabilities of small firms, the policy and

[8] The few available papers and studies on SMEs include: SMIDO (1996), Jeetun (1997), and De Chazel du Mee (1998).
[9] See Humprey and Schmitz (1996), DTI (1996) and UN, World Investment Report 1998.

institutional obstacles facing small firms, the quality of business services provided to small firms by public sector institutions, and what might be done to help small firms grow and compete overseas. The study does not claim to be comprehensive in its coverage of firms, sectors, policies and institutions. The two-person Commonwealth team did what it could in about two weeks of fieldwork and some months of data processing and report writing. More work needs to be done by Mauritian institutions to refine and implement the findings of this study.

1.3 Concepts of Enterprise and National Competitiveness

The framework for this study is based on an enterprise-level theory of comparative advantage. Studies by economic historians from Joseph Schumpeter onwards suggest that technological change is the principal source of industrial growth and rising living standards in both developed and developing economies. In general, developing countries lag well behind developed countries in their technological and other industrial capabilities because of differences in scientific and engineering manpower, R&D infrastructure, industrial experience and expenditure on R&D. Within developing countries too, there are large technology and productivity gaps between best practice and other firms. Building on this work, new theoretical approaches in economics suggest that competitiveness arises at the level of the manufacturing enterprise with national competitiveness being the sum of the efficiency and dynamism of component firms within a given developing economy.[10] The creation of enterprise (and hence national competitiveness) occurs through a risky and uncertain process of acquiring technological and other industrial capabilities in a system of imperfect factor markets (like finance, skills, information and technology).

Many external factors – such as initial economic conditions, the international economic environment, luck and policy support (to remedy market imperfections) – influence the learning process at enterprise-level. Of these, policy support is probably the most important determinant of success (and is the only one that can be readily influenced). Commonwealth experience suggests that most developing countries can reap the rewards of liberalisation and structural adjustment programmes compared with inward-oriented, state dominated development strategies. In order to capitalise on these gains, markets and governments need to work together to evolve coherent national competitiveness strategies, which promote policies to reduce domestic distortions in markets and those to accelerate technological change in enterprises. Successful national competitiveness strategies feature the following elements:

- A stable, predictable macroeconomic environment for enterprise development characterised by low budget deficits, tight inflation control and competitive real exchange rates.

[10] See Lall and Wignaraja (1998), Wignaraja (1998 and 1999) for elaboration of this approach to comparative advantage.

- An outward-oriented, market-friendly trade and industrial regime emphasising dismantling of import controls and tariffs. This signals industry to restructure and develop a strong export push (duty-free access to raw materials and assistance for export marketing).

- A pro-active foreign investment strategy which emphasises targeting of a few realistic sectors and host countries, overseas promotion offices as public-private partnerships, competitive investment incentives and radically streaming investment approval processes.

- Sustained investments in human capital at all levels (particularly tertiary-level scientific, information technology and engineering education) and increased enterprise training (with assistance for industry associations to launch training schemes, accompanied by an information campaign to educate firms about the benefits of training and tax breaks for training).

- Comprehensive technology support for quality management, productivity improvement, metrology and technical services for small and medium enterprises (including grants for SMEs to obtain ISO9000 certification, creating productivity centres and commercialisation of public technology institutions).

- Access to sufficient industrial finance at competitive interest rates through prudent monetary policy management, competition in the banking sector, training for bank staff in assessing SME lending risks and specialist soft loans for SMEs.

- An efficient and cost-competitive infrastructure with respect to air and sea cargo, telecommunications, Internet access and electricity. This might include liberalisation of air and sea cargo entry and commercialisation/privatisation of infrastructure parastatals with effective regulation.

Some of these elements, for instance macroeconomic management and outward-orientation, are a part of standard structural adjustment programmes. Others (such as human development, technology support and targeted foreign investment promotion) go furhter but are still consistent with a market-friendly approach to industrial export development.

In a market economy, the main role for the private sector is to become productive and generate national wealth. Business associates assist industry by advocating the case for business and deregulation. With a rising share of private sector activity in GDP, however, the private sector needs to move beyond its traditional function of wealth creation and advocating the case for business. The private sector itself can make an important contribution in designing and implementing national competitiveness strategies in developing countries. This pro-active role can include: helping government to plug information gaps through participation in national policy making bodies and international trade negotiations; augmenting government capabilities via short-term secondment programmes of private sector managers and technicians; participating in infrastructure projects through joint finance and management skills; and helping weaker firms to help themselves via creating industry-specific training centres and other actions.

In formulating coherent competitiveness strategies, governments and markets should bear in mind that a number of negative factors could hinder successful outcomes. These impediments include: weak government capabilities to design and implement competitiveness strategies; a lack of government commitment to reform; poor relations between the government and the private sector; deteriorating macroeconomic conditions; and political instability. Experience indicates that countries that take steps to mitigate or reduce the impact of these impediments are more likely to succeed than others.

1.4 Outline of the Study

The study is set out as follows.

Chapter 2 examines the magnitude of the SME and micro-enterprise population in the manufacturing sector and its recent manufactured export performance. It looks at the export propensities of EPZ and non-EPZ SMEs, the export performance of EPZ SMEs compared to large EPZ firms at an industry-level (export growth, productivity and export shares by skill intensity) and the pattern of exports from non-EPZ SMEs. The lack of data on these issues confines this analysis to either the post-1992 period or post-1995 period. Longer time series analysis would be valuable to investigate whether the short/medium-run trends in SME exporting behaviour hold over the long-term.

Chapter 3 examines the capabilities of a sample of Mauritian SMEs in three critical industries (textiles, printing and publishing, and information technology). It looks at marketing, design, technology, human capital competences as well as strategic capabilities.

Chapter 4 analyses the nature of key macroeconomic, trade and industrial policies in Mauritius particularly as they affect the fostering of competitiveness of SMEs. The coverage includes import liberalisation, export promotion, exchange rates, industrial finance, bureaucratic procedures, policies for clusters and linkages, and infrastructure.

Chapter 5 analyses the nature, coverage, adequacy and service delivery of the key public sector SME institutions. The focus is on those institutions dealing with marketing, human capital and technological needs of small firms. Private sector SME institutions were excluded from the analysis.

Chapter 6 draws on the findings of the previous chapters to present policy suggestions for enhancing the competitiveness of small firms in international markets.

The four appendices present the SME survey, the framework used for evaluating SME capabilities, a list of the permits and clearances required for the setting up of an enterprise in Mauritius (including an SME), and suggestions for new institutions and policies. There is also a detailed bibliography.

At the request of SMIDO, the empirical part of this study defines SMEs as enterprises with 10-49 employees and micro-enterprises as those with less than 10 employees. When SMEs and micro-enterprises are mentioned together, this means all firms with less than 50 employees. Future work on small firms could usefully consider the use of alternative definitions of firm size (see Box 1.1).

Box 1.1: What is an SME?

Several different criteria can be used to distinguish between SMEs and large firms in an economy. The three most popular benchmarks are: the value of production equipment, the value of sales and the number of employees. Each of these has its relative merits. However, setting the cut-off point between an SME and a large firm is more difficult and can vary depending on the level of development, the structure of an economy, and the characteristics of particular production technologies. Under its 1993 Industrial Expansion Act, Mauritius defines an SME as one whose production equipment does not exceed 10 million Mauritian Rupees. Unfortunately, this definition cannot be used in our empirical work as national data collection agencies (such as the Central Statistical Office of Mauritius) rely on employment rather than production equipment to capture firm size. Apart from this practical issue, an employment-based definition is more appropriate to distinguish between manufacturing and services activities. As skills (rather than equipment) drive services, production equipment would be a misleading indicator of firm size in this regard. These considerations suggest the need for a new definition for SMEs in Mauritius. For simplicity, an SME in manufacturing could be a firm with less than 50 employees and in services one with less than 20 employees. In both cases, they should be firms that are independent and not a subsidiary of a larger organisation.