Human capital and other important factors as elements of entrepreneurship and SMEs in developing economies

Klaas Havenga

1 Introduction

In recent years entrepreneurship and the nurturing of SMEs have become the dominant themes of development economics. This re-discovery of the importance of the spirit of free enterprise was undoubtedly prompted by the failure of centrally planned socialist economies. It was also enhanced by the achievement of impressive prosperity by certain East Asian and Western countries as a result of mobilising the creative energies of entrepreneurs and by reaping the benefits of relatively unconstrained competition.

2 The re-discovery of the entrepreneur and the SME-sector

Entrepreneurship was, and is still often treated in theory as the vague and unquantifiable force which brings together labour, and capital assumes the risks of production and distribution and on which the whole success of the capitalist system depends (Naudé 1999, p.2).

Schumpeter made the entrepreneur the focal point and key to the dynamic of economic development and growth. It is entrepreneurs who put together new combinations, and whose actions have consequences on the basis of their organizational skills, their creativity as decision makers, and the distinctive opportunity structures (the settings, circumstances or situations within which the decisions and choices are made). Schumpeter (1934) stated that entrepreneur is the decision maker in a particular cultural context who commands a range of behaviours that exploits the opportunities. His idea that the entrepreneur functions primarily as a creator of innovations in the production process has influenced much of the literature on entrepreneurship in developed economies. Alternative explanations of the entrepreneurial role have focused more on the entrepreneur's ability to organize rather than to create (Spring, MacDade 1998, p.2).

The natural home of the business entrepreneur is the small and medium size enterprise sector which in recent times assumed a position of almost universal orthodoxy. In all the successful economies of the world, they figure as a dominant force. The impressive economic performance of certain South East Asian such as Taiwan, Korea and Western countries has focused the attention of business leaders, policy makers and academic analysts on the prominent role played by SMEs.

Drawing on the experience of these countries and seeing what tremendous influence SMEs can have on the economic growth and development of a country, some developing countries also resorted to it as the engine for economic growth and development.

Leaders in developing countries also realize that the SME sector can make a significant contribution to economic growth, employment generation and social progress. They are the most effective job creators, because they are generally more labour intensive than larger enterprises and generate more direct and indirect jobs per unit of capital invested. They provide a seedbed for entrepreneurial talent and contribute to competition within an economy. They aid the promotion of free enterprise and self-sufficiency by creating and spreading wealth to the grassroots level and as a result enhance economic and political stability.

In many developing economies it has been found that the large-scale enterprises have had limited success in generating job-creating economic growth. The concentration of economic power and the capital-intensive nature of large business and manufacturing organizations were in many instances in direct conflict with more generally held goals of social and economic development. SMEs in contrast were found to employ a large proportion of the human capital. They also provide a productive outlet for expressing the entrepreneurial spirit of individuals and to assist in dispersing economic activity throughout a country.

3 Human capital, entrepreneurship and SMEs

The term "human capital" coined in the 1960s by Schultz, refers to the fact that labour is not just a homogenous factor of production, but is a differentiated and mouldable input into production (Cypher, Dietz 1997, p. 384). Human capital also refers to skilled labour which is labour that functions on a higher level and has the ability to create new ideas and new methods in economic activity (Ray 1998). It is this type of human capital that contains the seed of entrepreneurship within itself, but needs improvement especially in developing countries, through education, work training, on-the-job training, health care, nutrition and sanitation in order to germanate and grow.

Naudé (1999, p. 11) says that apart from the direct evidence from cross-country regressions that point to the significant effect of human capital accumulation on economic growth, case studies of developing economies provide dramatic illustrations of the potential significance of human capital.

When considering the role of human capital (and eventually entrepreneurship) in economic growth, it is particularly instructive to review the East Asian growth experience. In four of the NICs (newly industrialising countries) of East Asia namely Hong Kong, Singapore, South Korea and Taiwan, rapid and sustained growth in per capital GDP between 1960 and 1990 averaged 6%–7% per annum. Accompanying this rapid output growth was rapid growth in human capital accumulation and the growth in secondary and tertiary education.

According to the World Bank (1993) approximately 66% of the observed growth in NICs can be attributed to the accumulation of physical and human capital, and education is the single largest contributor among these factors.

The question that can be raised is how does "human capital" contribute to economic growth?

Referring to Benhabib and Spiegels endogenous growth model, Naudé (1999, p. 13) states that human capital affects growth through its effect on total factor productivity. This takes place through two channels. First, as Romer (1990) sees it, human capital influences productivity directly by determining the capacity of nations to innovate new technologies, thus creativity through entrepreneurial actions in countries becomes the dominant factor.

Secondly, human capital levels affect the speed of technological catch-up and diffusion – i.e. the ability of a country to adopt and implement new technologies from abroad as a function of its domestic human capital stock. It should be noted that the World Bank (1993) concluded with regard to the East Asian growth experience that higher levels of labour force cognitive skills permit better firm-level adoption, adaptation and mastery of technology. The question that can be asked is whether most African countries with its lower levels of labour force can really accomplish this?

A question that can also be asked is, why does capital not flow readily from rich to poor developing countries? Apart from the political instability and other related factors the role of human capital in the endogenous growth theory can also be used to explain the fact that capital does not flow from rich to poor countries. Physical capital in particular fails to flow to poor developing countries because of their relative poor endowments of human capital which acts as a complement to improve the efficiency of physical capital.

The human capital accumulation can broadly be seen as to include formal education, on-the-job training, basic scientific research, learning-by-doing, process innovations, product innovations and industrial innovations. Iyigun and Owen (1998) consider human capital as consisting of both "professional" or skilled labourers and entrepreneurs.

In their definition the entrepreneurs provide the economy with new ideas, products and ways of doing things.

Thus one can quite safely deduce that the higher the level of human capital the greater the portion of the labour component that are entrepreneurs and consequently the greater the provision of the economy with ideas, products and ways of doing things.

Consideration of the low level of human capital on the African continent therefore limits the entrepreneurial component and consequently retards economic growth and development.

The deficiency characteristics of entrepreneurship that makes it an important force for economic growth, and that differentiates it from more skilled labour are (Naudé 1999, p. 15):

- Entrepreneurial activity is risky. There is a positive probability that entrepreneurial activity will result in failure, or an outcome with very low payoff.
- Entrepreneurs learn by doing; entrepreneurial skills are honed by investing time working in an entrepreneurial venture.
- Entrepreneurial human capital may be more productive in the development of technology. Entrepreneurship thus determines the level of technology. This idea can be traced back to Schumpeter.

Recently it has been shown that the differences between entrepreneurs and professional/skilled labour is important for the composition and effect of human capital on economic growth (Iyigun, Owen 1998, p.454). More specifically stated:

- Entrepreneurial human capital plays a relatively more important role in intermediate income countries. This result is due to the riskiness of entrepreneurship. For instance, in more developed economies individuals may be expected to allocate fewer resources towards entrepreneurship because good, safe alternatives to the risky activity exist. The level of economic development and growth rate of a country is in itself a determinant, not only a consequence, of entrepreneurship. Thus;
- Professional labour is relatively more important in higher-income economies;
- Because there are more than one way of accumulating human capital, an inefficient allocation of an individuals time between schooling and gaining entrepreneurial experience may occur.

Economies that have a lack of either entrepreneurial or professional human capital may end up in a development trap. An example of the latter may be the countries of the former East Bloc, where professional human capital was accumulated to the detriment of entrepreneurial human capital. Even worse is the situation in Africa where a large number of countries have to little of either entrepreneurial or professional human capital. More than 90% of the human capital are unskilled labour, resulting in a situation where no or even negative economic growth and economic development situation occurs. Although it may seem, due to the vast number of small and micro enterprises, if adequate entrepreneurial human capital does exist, this is far from reality. These small businesses are merely forms of livelihood, ways to be part of subsistance economies with no real value being added to economic growth and development. In fact they are actually sharing poverty.

4 Government, financial systems and entrepreneurship

According to Naudé (1999, p. 8) two institutions have been identified as vital for reducing the uncertainty that may be inhibiting entrepreneurship, namely the government and financial system.

With regard to governments and constitutions it is shown that low security of property rights over physical capital, profits and patents may reduce incentives and opportunities for entrepreneurs to invest, innovate and obtain foreign technology. Furthermore, cumbersome and dishonest government bureaucracies, which are numerous on the African continent, may delay the distribution of permits and licences or other forms of assistance, thereby showing down the process of creative destruction.

It is especially in Africa where the institutional requirements on government for growth and economic development is lacking. This disfunctionality of African governments according to the Bates-Morrison Thesis (Collier 1977) is a result of a number of African Governments having permitted only a low level of civil liberties whereby ordinary people are denied the channel of popular protests. Secondly, the argument that African governments' credibility have been severely eroded by its reneging on past reform promises.

As far as the role of financial institutions on entrepreneurship is concerned another one of Schumpeter's ideas, namely, that the services provided by financial intermediaries are important for technological innovation by entrepreneurs to take place, has recently been taken up (King, Levine, 1993a; 1993b).

Firstly it is especially commercial banks that are important, in that they provide financial risk management and investment information services to entrepreneurs. Effective financial risk management stimulates economic growth by increasing the rate of human and physical capital accumulation and by improving the efficiency with which economies use that capital.

In the second instance the financial system fulfills the role of a selection mechanism. They evaluate prospective entrepreneurs, mobilize savings to finance the most productive activities, and diversify the risks associated with annovations brought forward by entrepreneurs.

The importance of the financial system and appropriate institutional framework should be clear, and as Naudé (1994) puts it: "Government policies towards financial institutions therefore have an important causal effect on the long run growth".

5 Some realities of African entrepreneurship and SMEs' entry into entrepreneurship

If we now take a closer and more practical view of entrepreneurship and SMEs on the African continent it may prompt the reconsideration of previous dictums or assert the applicability of new theories. However, this is not the objective of this talk, but rather to highlight the discussion with some facts.

In Zaire, MacGaffey (1998) shows that the lack of state support for business activities forces survival strategies to new heights as entrepreneurs provide missing infrastructure, use substitute currencies, and pursue unusual trade networks to maintain "the second economy" in the absence of the first. The scope of these entrepreneurial enterprises encompasses large and small firms, mostly in the informal sector, because there is previous little left of the formal sector.

MacGaffey borrows from Schumpeter's definition that if entrepreneurs "have not accumulated any kind of goods, they have created no original means of production, but have employed existing means of production differently, more appropriately, more advantageously".

Entrepreneurs function outside the defunct official economy using creativity and ingenuity, in the force of "insurmountable obstacles". These include the collapse of the banking and transportation systems, the unavailability of foreign exchange, the decline of public services and administration, the collapse of supply systems, and the harassment, extortion, and arrest of entrepreneurs.

In short entrepreneurs fill in the functions of a government that has failed to supply the infrastructure that is conducive to business in general and small and medium size enterprises specifically.

Daniels (1998) questions whether the supply of labour (human capital) hypothesis (surplus labour with limited skills and access to capital) or the market demand hypothesis (entry influenced by consumer demands for micro and small enterprises) holds.

In this case both influence entry into commerce, but the labour supply hypothesis is supported by evidence from low-profit SMEs in which people turn to these informal sector enterprises as alternative income sources in a declining economy. In contrasts the high-profit entry model is not driven by excess supply of human capital, nor is it affected by changes in the GDP; these entrepreneurs have some access to capital as well as greater business experience. Still, there are entry barriers to high-profit entrepreneurial activities, and these include capital, experience, and government regulations.

6 Public policy and private initiatives in entrepreneurial development

Entrepreneurial activities are highly affected by public policies and their level of enforcement. As mentioned previously the business sector in Africa especially SMEs frequently suffer from harassment by government officials. Even within the formal sector private enterprises often do not find a conclusive environment within the financial system, reducing tariff restrictions, providing adequate infrastructure (Himbara 1998), producing educated skilled human capital (Naudé 1998), ensuring access to technology, and creating markets (Blewett, Farley 1998).

Specifically focusing on policy, Himbara (1998, p. 219–232) departs from conventional interpretations that hold that colonial governments used restrictive policies to impede the development of indigenous African Enterprises and to restrict them to a few types of industries. He maintains that such interpretations are myths and argues that instead of impeding or obstructing African entrepreneurs, British colonial policy in Kenya fostered an indigenous entrepreneurial class by promoting SMEs in the informal sector as a base from which an indigenous capitalism could develop.

Government policy in Kenya encourages their people to establish medium-, and large-scale businesses in commerce and industry, but, Himbara argues, most Kenyan Africans are not yet ready for the step. He attributes the stagnation in the private enterprise sector to policies that impose "capitalism from above". These policies benefit reigning politicians and high-level civil servants rather than indigenous private sector business persons. The misunderstood colonial approach was vindicated in the 1980s when the government began to integrate the small-scale and informal sectors into its overall policy regime.

In 1994 the new South African Government inherited an apartheid economy with specific problems, which required the urgent implementation of an appropriate economic development strategy. Since this time the new government produced a number of important policy documents to assist in the formation of entrepreneurs and the development of SMEs.

7 Structural adjustment programmes

This address in the present period would not be complete without touching on the global allocation of resources. Here we focus on the impact of externally induced policies, such as the SAPs (Structural Adjustment Programmes) and foreign assistance and control.

How entrepreneurs react to these external pressures, and how these programs affect the ability of developing economies entrepreneurs to compete in their own domestic markets and succeed in the international marketplace should also be considered.

How do SAPs affect entrepreneurs? SAPs particularly affect those entrepreneurs that form part of the informal sector, in part because of their already disadvantaged status in obtaining capital, credit, and training, and in part because of the increased competition from those who have lost formal sector jobs and enter the informal sector. (Osirim 1998).

As an example one can refer to the Zimbabwean case (Osirim 1998, p. 277–297). Recent changes in the Zimbabwean state and its economy, presented micro-entrepreneurs (micro-businesses) with new challenges. Declining prices for primary product exports, destabilization in the region caused by the situation in South African and war in countries bordering Zimbabwe in the 1980s meant that the government could not sustain the growth in unemployment and the expansion of social services it embarked on in the immediate post-independence period. In order to rectify the economic crisis, the government enacted a SAP in 1990 at the behest of the World Bank and the IMF.

The result of this SAP was that many males lost their jobs in the formal sector under adjustment and this had a twofold affect on self-employed females. The state encouraged retrenched male workers to start their own small and micro-enterprises as a means of earning a livelihood. The advantaged position that these males were in as far as access to loans and other resources were, even compounded the problem and resulted in unfair competition with the existing female small and micro-enterprises.

The most adverse effect of the SAPs on Zimbabwe can be seen in the growing ranks of the poor in that country. In 1991, one year after adjustment, of the 10.3 million residents of Zimbabwe, 6.6 million were estimated to be living in absolute poverty and more than 40000 state employees lost their job under this plan (Osirim 1998, p. 282).

The funds made available by the World Bank for these SAPs are however, subject to certain requirements. One of these includes the liberalization of international trade, which means the decrease or abolishment of protection regulatory requirements like tariffs and quotas.

Many of the recent policy measures taken to remedy the problems of African economies have prescribed market liberalization, which requires resources such as human and physical capital to be allocated by private sector entrepreneurs for tradable goods. Naudé (1998, p. 298–311) discussing policy credibility in South Africa argues that the positive impact of liberalization can be obstructed when investors and entrepreneurs begin to doubt that it can correct economic ills, especially if they do not understand the importance of their own roles in making it work.

Liberalization programs may initially cause increases in unemployment and resource security, as the economy tightens into a more efficient system. Entrepreneurs may interpret this as the failures of liberalization rather than transitory effects that will be corrected and there may be private sector demands to discontinue such programs. These programs may, of course, have the negative effect of creating an over supply of unskilled and to a lesser extent skilled human capital that revert as "forced-entrepreneurs" economic to non-value-adding subsistence small and micro-enterprises.

The ability of developing economies' entrepreneurs to maximise their returns from reforms due to SAPs can be enhanced, according to Naudé (1998) if they develop their technical managerial, accounting, marketing and sales skills in order to respond more effectively to the new incentives and opportunities.

8 Conclusion

While the social organization and economic systems resulting from Africa's past contribute to its present dilemma, the future will be constructed from the efforts of its entrepreneurs as they work within the evolving systems. The past policies of most African countries have left it with an inadequate stock of human capital. Moreover, as in the East Block countries, the allocation between entrepreneurial human-capital and professional human-capital was skewed in favour of the latter.

If one recognises, as does Naudé (1999, p. 20) that the stock of human capital is growing on average by 9% per annum in Asian countries then one might conclude that the South African economy will fail to converge to the same per capita income currently enjoyed by Asian economies. This statement can also be applied to the rest of the African continent if we acknowledge the fact that South Africa has one of the highest developed economies on this continent.

Furthermore to think that the encouragement of small businesses may stimulate entrepreneurship and that entrepreneurs can maximise their efforts in isolation, may be flawed. A supportive economic milieu, as well as appropriate government policies will play critical roles in their success or failure. Small and micro-businesses on this continent are often "residual" businesses with a lack of access to credit and financial means whereby risks can be absorbed and managed.

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