

## **Commonwealth Business Forum.**

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### **Finance, Technology and Entrepreneurship: Drivers of SME Growth**

**Session to be held on 25th November**

#### **Presentation by Louis Farrugia**

Good morning to you all and thank you Chairman for that introduction.  
(Slide 1)

Well as you have just been informed I come from the island of Malta. Malta is a small island state in the Mediterranean Sea, an ex British colony which obtained independence in 1964. It has a history which is inevitably linked with that of the Mediterranean Sea Basin. Over the last 2000 years it has been ruled by the Phoenicians, Romans, Arabs, Normans, the Knights of St Johns, the French and the British. We have a rich history which has determined the character, and nature of its people.

Since independence a little over four decades ago, our economy has developed into a diversified and well structured one resting on 4 key pillars (Slide 2) – export manufacturing, tourism, financial and transshipment services. However, it is worth mentioning that prior to independence Malta had virtually no industry or tourism to speak of due to the fact that the entire economy was geared towards servicing the British navy and army forces. Following independence in 1964, and the departure of all British forces in 1979, Malta had little choice but to develop, practically from scratch, its industrial and tourism base.

The initial industrialisation model (Slide 3) used to promote industrial development in Malta during the 70s and 80s was a two pronged approach resting on a policy of protectionism and import substitution combined with the attraction of foreign direct investment into Malta via the provision of a multitude of fiscal and non-fiscal incentives.

During this period our economy has developed from that of a fortress economy dependent on British military expenditure to that of an open economy within the largest free trade bloc in the world. (Slide 4) From

an economy that was heavily protected from imports, through tariff and non tariff barriers and where the state had a substantial stake in economic sectors, such as the banks, media, utilities, to an open economy and where the state had divested itself of most of its holdings in such economic activities.

In 2004 Malta became a full member of the European Union and the last vestiges of protection for local industry were gone and many of the incentives were now considered by the E.U. as constituting 'State Aid' and therefore no longer permissible. In 2008, Malta joined the Eurozone and the country's integration within the E.U.'s economy was complete.

This 'historical' narrative begs the question. How could a small, peripheral and protectionist country transform itself into a diversified and fully liberalized member of the E.U. within the space of just two decades? The answer is through SMEs.

Let me first introduce you to a few facts on the Maltese economy, then explain how (Slide 5), SMEs constitute its backbone, and how we as a country have tried to support the growth of our SME base.

Malta in Numbers – Main Facts About the Maltese Economy

(Slides 6 to 9) *Speaker to comment briefly on each slide as it appears – unscripted commentary*

SMEs are the mainstay of the Maltese economy (Slide 10) and constitute 99% of all registered companies on the island, with the largest number of these falling under the micro enterprise category. At present there are around 30,000 enterprises in Malta, the vast majority of which are SMEs. Indeed only 41 enterprises (out of 30,000) are considered to be large and who employ more than 250 people. This pattern in Malta is also reflective of the general pattern within the E.U. where around 91.8% of all enterprises are micro-enterprises, 6.9% are small enterprises, 1.1% are medium sized enterprises, and only 0.2% are considered to be large companies. (Slide 11)

So how did Malta achieve this transformation from a protected type of economy some 2 decades ago to one where SMEs are the mainstay of a fully liberalized economy?

Well first of all, (Slide 12) I have to say from 30 years of personal experience as an entrepreneur in the food and beverage business that it has not been an easy ride. My company is one of those enterprises that is

(statistically) considered to be a large enterprise. However, although the Farsons Group of Companies employs close to 900 people, its operating units typically employ less than 250 people, and are therefore by definition and character, SMEs. In other words, we've experienced at first hand what it means to be an SME emerging from a protected business environment and what it takes to compete in a liberalized economy in Malta and abroad.

The companies and business units in the Farsons Group managed to overcome the transition from a highly protected to fully liberalized economy in the space of two decades by doing what many other SMEs in Malta (and other countries) had to do to survive – we adapted! (Slide 13)

More specifically, we planned ahead and changed the way we operate. We invested in new plant and machinery and warehousing facilities thereby reducing headcount and labour costs via technological improvements in these areas. Concurrently with this, we invested in new product development and diversified our portfolio of locally produced products. We also entered into new businesses such as fast food franchising, retailing and food importation. We also pursued an aggressive internationalization and export led strategy in order to lessen our dependence on our domestic market. (Slides 14 and 15)

Throughout all this, we were fortunate that the Government of Malta, directly and indirectly via its various business support agencies like Malta Enterprise, recognized the needs of SMEs early on – particularly those relating to access to finance, the need to cultivate an entrepreneurial culture, the need for SMEs to adopt newer and improved technologies in key areas of operation from production to research and development, and last but not least, the need for SMEs to internationalize their operations through exports and even investment abroad.

While 'Finance', 'Technology' and 'Entrepreneurship' are undisputed drivers of SME growth, one has to look a little deeper in order to understand what drives SMEs. I would venture to say that there are 2 main types of 'drivers' of SMEs growth (Slide 16). The first set of 'drivers' refers to the provision of suitable infrastructural support in terms of transportation, telecommunication and above all education, while the second set of 'drivers' refers to the provision of targeted, user-friendly support programmes aimed at SMEs in their endeavours to modernize and internationalize. These two sets of drivers are interdependent, and one cannot succeed really without the other.

Put simply, support programmes for SMEs will work only if entrepreneurs have a flexible regulatory environment within which to work where administrative burdens are manageable as opposed to insurmountable. Likewise, SME programmes such as those facilitating access to finance are likely to be much more effective and better utilized if an entrepreneurial culture is encouraged and instilled in the population from an early age. Education is key.

In recent years there has been a drive to teach entrepreneurship in our schools. A recent article in the Times of Malta by a leading Maltese educationalist has called for entrepreneurship to be taught in all disciplines, namely science, mathematics, languages, social studies and the arts. Certainly entrepreneurship is about an individuals' ability to turn ideas into action. It includes creativity, innovation, and risk taking as well as the ability to plan and manage projects. The more citizens understand and work with the culture of entrepreneurship the more one's economy can benefit from such economic activity and so the creation of wealth will in turn help the nation's ability to pay for needy social services.

(Slide 17)

A quick glance at the sort of support programmes that are being offered to SMEs in Malta today provides some interesting examples of practical and proven measures to stimulate SME growth. The Farsons Group of Companies is a regular user of a number of these programmes, and I have to say from personal experience that if used properly, they can produce some impressive results.

Our main development agency responsible for many SME programmes is an organisation known as Malta Enterprise. They have formulated a number of financial and non-financial support packages specifically targeted at SMEs. It is possible to classify these incentive programmes for SMEs into 6 main categories:-

- Investment Aid (such as investment tax credits)
- Access to Finance (such as loan guarantees & loan interest subsidies)
- R & D and Innovation (such as R & D grants)
- SME Development (such as start up grants, business incubation services and e-business incentives)
- Enterprise Support (such as network development, provision of business advisors and trade fair participation abroad etc)

- Employment & Training (such as training grants)

The next slide (Slide18) lists some of the international names that Malta has been able to attract over the past four decades. One can note that even within the manufacturing sector there is a healthy blend of diverse range of sub sectors, such as growing list of pharmaceutical, ICT and Electronic companies alongside the older established mechanical engineering companies. In the initial years our first manufacturing units were largely textile orientated.

Malta Enterprise has to be credited with formulating the right incentive packages to help attract this impressive list of investors. However none of these companies would stay unless they remain satisfied that they find a productive working ethic, good infrastructural support, and a suitably qualified workforce.

Finally a few words on some of the most utilized programmes such as the 'Business Incubation Services' and 'Enterprise Support' programmes which I feel are especially relevant to the topic under discussion.

The Malta Business Incubator Programme (Slide 19) started operations in 2001 and the programme is focused on the immediate needs of start up companies and caters for the counselling, networking and linkages to finance throughout the incubation period. The maximum incubation period under this programme is 3 years which means that start up companies are only eligible for support for 3 years.

The process starts off with a pre-incubation phase during which the company is helped to develop a business plan. Upon approval of the plan, the company may have its project part-financed (maximum of Euro 15,000 at 45% part financing of capital expenditure). In addition to assistance in the form of financial support related to capital expenditure and business advice, the incubation programme also provides basic office space, shared office equipment, meeting rooms and so on. Moreover, the cost of any child care services needed by entrepreneurs participating in the programme are partly covered through the incubation centre programme. At the Malta Incubation Centre , there are 21 to 23 start up companies at any one time, and on average there are 4 to 5 new entries every year with the same amount of companies 'graduating' from the programme every year.

In the area of Enterprise Support Programmes (Slide 20) as provided by Malta Enterprise, one programme known as the Network Development

Programme is especially interesting. This programme encourages (and financially incentivizes) companies to come together and form networks of cooperation and mutual support in the areas of production, marketing and export promotion.

Thus for example, my company together with 3 other enterprises in the food and beverage sectors joined forces and formed a loose network known as the Malta Food & Beverage Network. The aim of the Network is that of promoting inter-firm cooperation through joint activities and initiatives including joint purchasing, co-marketing activities and joint trade fair participation. Perhaps one of the most valuable benefits arising from this programme is the realization that more often than not SMEs can achieve greater things by working with each other as opposed to working against one another.

Another Enterprise Support Programme (Slide 21) that has proven to be very useful is the International Competitiveness Grant Scheme whereby E.U. funds are made available to companies (especially SMEs) who provide an acceptable business plan indicating how they intend to improve their international competitiveness over a 2 year period. The programme may provide up to 50% of the funding required to implement the approved business plan up to a maximum of Euro 200,000 spread over 2 years. The Farsons Group has applied for assistance under this programme and has been granted support to cover 50% of the costs incurred. Eligible costs include the recruitment of a Business Development Manager whose tasks includes brand building overseas, the participation in selected international trade shows, the organisation of marketing and sales visits to specific markets, and the part reimbursement of consultancy expenses incurred in the company's brand development initiatives overseas.

Being a member of the European Union, Malta naturally has to comply and benefits from legislative programmes regarding Small Businesses. Recently the EU has championed the Small Business Act. In actual fact it is not an act in the true sense of the word. It is a set of political and administrative actions to put SMEs needs in the forefront of EU policy making through a package of multi-faceted initiatives, many of which are of general relevance and act as preconditions to the growth of SMEs worldwide. (Slide) Some of the key thrusts (Slide 22) include the following:-

- 1) Create an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded. A central tenet to the

creation of such an environment is the creation of an educational system (includes students, parents and teachers) that promotes an entrepreneurial culture among men *and* women from a young age.

2) Create a ‘second chance policy’ that gives entrepreneurs the possibility of overcoming the stigma of failure and providing them with the opportunity to start new ventures.

3) Reduce the administrative burden on SMEs and minimize regulatory constraints. This in effect means that rules and regulations should be designed according to the ‘Think Small First’ principle.

4) Make public administrations (Slide 23) responsive to SMEs’ needs. This may be done in various ways including the provision of suitable training to Government officials whereby they would be sensitized to the needs and priorities of SMEs.

5) Facilitate SMEs’ access to finance. In many countries the financing needs of the majority of start ups and growth of SMEs are met by personal sources of finance, bank loans and overdrafts. The provision of preferential access to finance (such as through reduced interest rates, easing of mortgage repayment dues, access to venture capital, and use of Business Angel Networks) is encouraged.

6) Promote the upgrading of skills in SMEs and all forms of innovation. This can be done in various ways including the training and up-skilling of workers via appropriate training programmes and grant schemes.

7) Enable SMEs’ to turn environmental challenges into opportunities. Initiatives could include the introduction of energy saving or green technologies in production via funding programmes and the provision of properly trained business advisors in this field.

8) Encourage and support SMEs to benefit from growth in international markets and to take advantage of improved market access through internationalization, investment abroad and/or the export of their respective goods, services, ideas and intellectual property. Some of the initiatives described previously with respect to the Enterprise Support and Internationalization initiatives of Malta Enterprise would fall into this category.

Closing Remarks (Slide 24)

Finance, Technology and Entrepreneurship are indeed drivers of SME growth. The need to have measures, programmes and incentives in place that facilitate access to finance, provide access to technology and promote entrepreneurship is indisputable. However, the mere existence of such programmes and incentives does not automatically imply that they will in fact be used by those who need them most.

The point I wish to make is that one of the most important preconditions to success is the adoption of a holistic approach to SMEs by Government and its business support agencies coupled with the creation of an effective three-way communication system between Government, business support agencies, and above all, SMEs.

At the end of the day, it is easy enough to design support programmes and initiatives to drive SME growth, however the real acid test of such support structures is ultimately measured by the extent to which they are actually used by the entrepreneurs for which they were designed.

(Slide 25 – Final Slide)

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