Small and Medium-sized Enterprises in Curacao: Challenges and Opportunities

Speech by dr. E. Tromp, President Bank van de Nederlandse Antillen on the occasion of the “Siman di Empresario Chiki i Mediano”,
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Good afternoon ladies and gentlemen,

It is a pleasure for me to address you today on the occasion of the Siman di Empresario Chiki i Mediano. It has become a tradition in Curacao that every year we dedicate a week to the entrepreneur and his business. The “Siman di Empresario” is a unique opportunity for entrepreneurs to discuss and exchange ideas with fellow entrepreneurs, government officials, bankers, and other stakeholders concerning important issues affecting small and medium-sized enterprises. Today, I would like to add to these discussions by sharing with you my views on the challenges and opportunities facing small and medium-sized enterprises in Curacao.

Ladies and gentlemen, small and medium-sized enterprises, or SMEs, play a predominant role in most developed and developing economies, both because of their number and variety and because they are represented in all sectors of the economy. In most countries, SMEs make up the majority of businesses and account for the highest proportion of employment. Furthermore, small and medium-sized enterprises contribute significantly to Gross Domestic Product. For example, SMEs in the OECD countries account for more than 55 percent of Gross Domestic Product and 65 percent of total employment. In middle-income countries, small and medium-sized firms account for over 70 percent of Gross Domestic Product and 95 percent of total employment.

In addition to their contribution to economic growth and employment, small and medium-sized firms in mostly developed economies represent an important source of innovation. They tend to be in niche markets and follow competitive strategies that distinguish them from other companies.

In the Netherlands Antilles, the situation is no different. SMEs are of vital importance to the economy of Curacao, for example. SMEs are a large contributor to employment and economic activity on the island. According to the Central Bureau of Statistics, small and medium-sized enterprises comprise the majority of firms in Curacao and account for close to 35 percent of the island’s Gross Domestic Product. In addition, these enterprises account for over 50 percent of our island’s total employment. Needless to say, small and medium-sized enterprises are the backbone of our economy.

Despite these impressive figures, the SME sector in Curacao has not been able to realize its full potential.

Ladies and gentlemen, I believe there are three critical preconditions for small and medium-sized firms to realize their potential: (1) a sound and stable macroeconomic environment that supports private investment, (2) an investment climate that is conducive to the establishment and growth of SMEs, and (3) an environment that encourages an entrepreneurial culture. Allow me now to elaborate on these preconditions in Curacao.

First, with regard to the macroeconomic environment, we all know that fiscal stability, low inflation, sound monetary policy, and political stability support private investment by promoting transparency, reducing risk, and providing sound economic signals. These conditions are crucial for small and medium-sized firms in evaluating risks and investment decisions. However, Curacao’s macroeconomic environment has for many years been characterized by fiscal imbalances, related to high government debt and political instability.

Despite an expanding world economy, these domestic imbalances have suppressed our growth potential. As a consequence, our economy has been expanding only marginally with average real growth figures of less than one percent.

Therefore, it is encouraging that after years of fiscal consolidation and adjustment efforts, the economy of Curacao grew by 1.5 percent in 2006. It seems that our economy is finally benefiting from the world economic expansion. Growth in 2006 was mainly due to an encouraging performance in Curacao’s stay-over tourism. Rising occupancy rates triggered a wave of new hotel projects and expansion of existing hotels. Furthermore, the wholesale and retail sectors grew as a result of increased activities in the free-zone and tourism, and higher domestic spending. Activities in the construction sector also rose, due largely to investments in tourism and tourism-related activities on the island.
A continuation of this positive development is possible only if we address our fiscal imbalances and high public debt. Therefore, it is encouraging that the island government of Curaçao, in light of the upcoming constitutional changes, recently reached an agreement with the Netherlands to eliminate a considerable part of its unsustainable debt.

As we all know, our island has arrived at an important and historical crossroads. By December 2008, it is expected that the Antillean constellation will cease to exist and Curaçao will become an autonomous country within the Dutch Kingdom. The status aparte will give us the opportunity to address our social and economic problems in a more island-specific context.

The debt relief accompanied by additional capital injections related to the Social Economic Initiative will give Curaçao the opportunity to invest in important policy areas that have been lagging behind, such as health care, education, and poverty alleviation. However, it falls short of prompting an effective and common response to the increasingly intolerable inequalities in the human condition within the Kingdom.

The agreed-upon debt relief will go a long way toward alleviating the current budgetary imbalances. But the overall strategic objective of a full and complete debt forgiveness that I envisaged in my November 2005 proposal has been conceded for the short-term tactical objective of continuing to be able to borrow. Given the over-reliance on the forthcoming budgetary assistance from Holland to balance the 2008 draft budget, it should be all too clear to everybody that this tactical success has proven short-lived. Not only will it unnecessarily burden our budget with interest expenditures and hence make compliance with the forthcoming budgetary rules overly ambitious, but it will also create a constant source of potential conflict between the government and the financial supervisor. This situation will not be conducive to a harmonious relationship among the partners of the Kingdom.

The envisaged budgetary rule, the so-called interest rate norm, is also too ambitious. It is guided by political rhetoric that far exceeds our institutional capabilities. Furthermore, it will constrain the authorities from pursuing policies aimed at stimulating the establishment and the further development of the sector that we all agree is so essential for our economic progress, namely, the SMEs. Ladies and gentlemen, we need to ask ourselves whether we understand the historic moment in which we find ourselves.

The vital question we need to address is: What are the basic principles that should guide us if we are to succeed in fulfilling our historical vocation? The logical course one would think is a complete and full debt forgiveness coupled with a constitutionally mandated balanced budget. I still hope that this issue is being given constructive thought. The introduction of these safeguards, including a financial supervisor, will prevent a new build-up of debt to unsustainable proportions. By introducing this form of fiscal discipline, we will also improve our macroeconomic environment.

The second key precondition for small and medium-sized firms to flourish is an attractive investment climate. An attractive investment climate provides opportunities and incentives for all firms, irrespective of their size, to invest productively, create jobs, and grow.

Ladies and gentlemen, all too many studies have been conducted to identify the weaknesses in our investment climate. These weaknesses include complicated and time-consuming licensing procedures, high labor costs, rigid labor laws, a qualitative mismatch between labor demand and supply, difficulties in accessing finance, a complex tax system with opaque tax incentive schemes, and high utility costs. These weaknesses form an obstacle for the creation and growth of all firms, but they impose disproportionately more costs on SMEs than on large firms.

One of the obstacles that in my opinion adversely affect SMEs disproportionately in Curaçao is the bureaucracy or “red tape” on the island. Small businesses are relatively more susceptible to the high administrative costs of compliance with government regulation than are larger firms.

Too many and complex procedures for registering a business hamper and delay business start-ups. In addition, because potential entrepreneurs usually do not have the necessary resources - either financial or human - to deal with complex administrative procedures, “red tape” can discourage formal entrepreneurial activities.

Consequently, some potential entrepreneurs are discouraged from entering the market because of those perceived high entry barriers. In other cases, potential entrepreneurs choose to conduct their economic activities outside the formal regulatory environment. Evidence suggests that countries with costly regulations and heavy bureaucracy tend to have a rather large “informal” sector. One disadvantage of informal economic activities is that they do not provide workers with job protection and benefits, such as health insurance and pension schemes. In addition, informal firms have only limited or no access to investment facilities. Furthermore, since they take place outside the formal regulatory framework, informal activities escape taxation. As a consequence, the government forgoes considerable revenue.
With the introduction of the new constitutional status for Curacao, the government will have the unique opportunity to create an enabling regulatory environment for SMEs. The elimination of the double layer of government will reduce the administrative burden in the existing government apparatus considerably and facilitate the decision-making process of policies and projects. Therefore, the government should streamline its administrative procedures, aimed at eliminating all unnecessary bureaucracy, and simplify the procedures for obtaining business and work permits and business visas.

Furthermore, the introduction of one-window to serve potential entrepreneurs is highly recommended. These changes will encourage the creation of more formal business activities on our island.

Another constraint for small business creation and growth is our rigid labor market regulations, making it difficult for SMEs to adjust their workforce according to market fluctuations. Therefore, it is important to promote a more flexible labor market that ensures a reasonable balance between workers' preference for employment stability and firms' need to adjust the workforce.

Besides these regulatory rigidities, our labor market is also characterized by a qualitative mismatch between supply and demand. Insufficient or inadequate availability of personnel hampers the development of small and medium-sized enterprises, especially in those sectors of the economy with high-growth potential, such as the tourism and construction sectors. Our investment climate will benefit greatly from investment in education and training to reduce this qualitative mismatch. In this context, it is important to bring our education system more in line with the market realities. Our schools need to produce workers with the skills needed by the firms.

Ladies and gentlemen, difficulties regarding access to risk capital and long-term finance are another main barrier for investment by small and medium-sized enterprises in Curacao. Usually, institutional investors, such as pension funds and insurance companies, are the main suppliers of these types of financing. However, in Curacao, the market for risk capital and long-term financing is relatively underdeveloped. As a consequence, SMEs are mostly dependent on loans from commercial banks.

While the Bank has been pursuing a more liberal policy with regard to the domestic investment requirements for institutional investors, it has built incentives in the existing regulations to encourage the availability of more domestic risk capital. The Bank, therefore, cannot acquiesce the way domestic savings are being channeled by domestic institutional investors to finance foreign investment opportunities. With due regard to the optimal spread of risk, this issue will become critical in the context of the government's debt relief. For now, the Bank will continue to monitor the situation, and will act as needed to foster the further development of SMEs and sustainable economic growth.

One characteristic of small and medium-sized firms in this context is that they are usually more credit-constrained than larger firms. Information asymmetry, inherent in any bank lending relationship, is especially challenging for the small business sector because of the absence of a track record. In addition, SMEs' lending is usually associated with higher costs because of the relatively small size of loans. Because commercial banks generally consider loans to SMEs as costly and high-risk, they prefer safer investment options, such as investing overseas and holding high-yielding government bonds.

The access that SMEs have to finance is affected also by the high fiscal deficits and public debt, resulting in a substantial borrowing requirement by the government on our financial market. The extensive government borrowing has decreased the financial resources available for the financing of private investment projects, known also as the "crowding out effect". This situation has resulted in, among other things, an upward pressure on domestic interest rates.

However, given the upcoming debt relief, combined with safeguards for financial discipline, more funds will become available to finance private projects. In addition, less government borrowing on the financial market will exert a downward pressure on domestic interest rates.

Nevertheless, despite increased competition in the domestic commercial banking market and various incentives schemes, and financing possibilities through development agencies, such as Korpodeko and OBNA, SMEs in Curacao still face difficulties in obtaining risk capital and long-term financing. Therefore, in my view, we should promote other financing alternatives in our capital market. One such alternative is a venture capital fund for investment projects with a high risk profile. Through such a fund, equity financing of start-up firms with promising projects can be stimulated by offering higher than usual returns to investors.

Another alternative for the financing of especially the very small or micro firms is micro financing. Evidence suggests that in many economies, micro financing has a very positive impact on entrepreneurship and small business development. Best practices from abroad show that successful micro financing schemes include business support
services, such as training, mentoring, and capacity building of the potential entrepreneur. Furthermore, these micro financing schemes take into account the macroeconomic environment and the stage of economic development of a country. In addition, these schemes are usually commercially driven in a public-private partnership. We should take these factors into consideration when designing and implementing a micro financing scheme in Curaçao.

Ladies and gentlemen, last but certainly not the least important precondition for the development of SMEs that I would like to highlight today is a value system that encourages an “entrepreneurial culture” or “entrepreneurial spirit”. This value system includes factors that affect an individual’s willingness to consider becoming an entrepreneur.

But first, allow me to define an “entrepreneur”. In my view, an entrepreneur is not just a business owner. An entrepreneur is a person who creates and develops economic activity within a new or existing organization by being creative and innovative. Therefore, an entrepreneur is not afraid of risk-taking behavior. Moreover, an entrepreneur manages his or her organization soundly. Thus, it is partly intellect, partly organization, partly a drive to create and innovate, but more important, the willingness to take risk.

This definition highlights several crucial characteristics and skills of an entrepreneur including creativity, innovation, sound management, and risk-taking behavior. These skills and characteristics must be developed from a very young age. Consequently, our education system plays a crucial role. It should put more emphasis on creativity and problem-solving abilities. In addition, starting a business should be promoted as a viable career opportunity. Therefore, more publicity should be given to successful entrepreneurs within our society. These successful entrepreneurs could serve as role models to our young people. We should never be ashamed of our successes!

An individual’s decision to become an entrepreneur is also influenced by the perception of the risks and rewards involved.

When the perception exists that entrepreneurship means giving up benefits, such as health care coverage, a retirement pension, disability or unemployment insurance, the opportunity costs of self-employment increase, thereby enhancing the preference for payroll employment. In Curacao especially, the perceived risk to lose pension benefits and health care insurance coverage has been identified as a disincentive for self-employment. Therefore, in my opinion the government should explore incentives to make retirement pension schemes and health care insurance schemes more accessible for entrepreneurs.

Becoming an entrepreneur requires a different mindset. In our society, we have relied for too long on the government. Due to its own financial problems, the government today has become a part of our problems, not the solution. Therefore, as a society we should become less dependent on the public sector and take more initiatives on our own. In other words, we should become more entrepreneurial.

Ladies and gentlemen, small and medium-sized enterprises have always played a vital role in the economy of Curaçao. They make an important contribution to our economic growth and employment. I strongly believe that SMEs will continue to play a crucial role in our future economic development.

The economic outlook for Curacao is positive. To underpin the recent economic recovery, it is imperative for the authorities to continue to pursue a policy conducive to growth—that is, a policy of fiscal consolidation and structural reforms complemented by investments in our social infrastructure.

With the upcoming constitutional changes, we have the opportunity to achieve those goals and at the same time create an environment that is more conducive for the development and growth of our small and medium-sized firms.

The recent proposal to seek access to the Dutch healthcare system is an encouraging first step in the right direction. Not only do we benefit from economies of scale, but it also encourages competition, hence lowering social premiums and consequently business costs for SMEs. Increased competition in the banking sector, or the so-called, flexibilisation of the capital market, for example, resulted in a reduction in the average mortgage rate from 11% in the year 2000 to 8% presently. This represents a saving to society of almost Naf 900 million during the average lifetime of a mortgage.

In addition, for small and medium-sized enterprises to continue to thrive, we must promote and nourish the entrepreneurial spirit. This means a proactive attitude towards innovation, creativity, and risk to maximize the potential benefits from the development and growth opportunities ahead of us. But above all, ladies and gentlemen, the new Curacao should be a country that encourages success and solidarity by intensifying individual’s aspirations so that a better country can emerge.
Thank you for your attention.