



**SWP 8/89      PARTNERSHIPS OF LARGE AND SMALL  
FIRMS:  
LESSONS FROM THE THIRD WORLD**

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## INTRODUCTION

Technical advice and ideas normally flow from the so-called "developed" countries to the "developing", along with large sums of money; if the goal of "development" is to be developed, and countries such as the members of the European Community are perceived as being in that allegedly happy condition, the direction of the flow is appropriate. Increasingly, however, the distinction is coming to be seen as over-simplified, and information is moving in both directions. Many of the less successful developing countries are in fact developing at a slower rate than the developed, and any term which embraces such different countries as Singapore and Bangladesh must be of doubtful value. Crude classifications of this sort are not only meaningless, but also lead to false notions of superiority; we are in one world, and everyone has something to learn from everyone else.

The richer countries, including those in Europe, probably have as much to learn in the area of small business development as in any; many poorer countries have been actively promoting small-scale industry for far longer than any countries in Europe, and India in particular has accumulated some forty years of experience as a result of the original Gandhian emphasis on cottage industry, which was so intimately bound up with the whole philosophy of the struggle for independence. The small Business Administration in the United States has about as long a history, but the European economies were still preoccupied with the relatively early stages of recovery from the second world war at the time that India was already making special efforts to promote smaller enterprise.

Until recently, the decline of smaller firms' share of an economy was believed to be positively correlated with increasing prosperity, and as contributing to economic growth. Recent data from the United States and Great Britain suggests that there can be a peak in concentration, followed by a decline, which may result from new technologies which reduce the optimum scale of many operations, and enable tasks which had at one time to be done by one firm to be done by many separate smaller ones. The reduced concentration can also be caused by people's changing life-style preferences, and by failure of managerial economies of scale to keep up with technical ones.

Whatever the causes, this increase in the relative importance of the smaller firm sector in rich countries suggests that concentration of ownership and management is not necessarily inexorable and desirable; the authorities in poorer countries may therefore not unreasonably conclude that a growing small firms sector may be more than a hopefully short-lived phenomenon, to be reversed when growth takes off; their economies may even shortcut the path to prosperity, by avoiding the dangers of over-concentration.

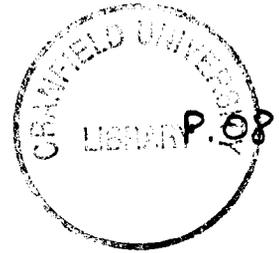
Most of the smaller partners in the various arrangements between large and small firms which will be described in this paper are very small, and many of the partnerships are designed to help local entrepreneurs actually start their firms, rather than working with firms that already exist. Many of the ideas are nonetheless relevant to richer economies; larger firms starting operations in relatively under-industrialised areas of Europe, or working in areas of major structural change, with massive unemployment of certain groups, face similar problems to those existing in poorer countries, and may be able to learn from what has been done in places where the problems are more serious, and more pervasive, but not fundamentally different in kind.

The arrangements tend also to rely less on formal financial partnerships, and there are few formal joint ventures of the kind which are familiar between large and small firms in Europe. This is to be expected, given the rudimentary nature of accounting practices in most poor countries, which makes it very difficult to separate the earnings of a company from those of its owner/manager, and thus to calculate the share of profits due to an outside investor. Large European companies may not find new and more ingenious forms of financial partnership in the Third World, but they may be able to gain some ideas as to how they can work more effectively, and more profitably, with smaller-scale, less sophisticated and younger enterprises, which may also be less expensive suppliers or more effective distributors.

#### THE ROLE OF SMALL FIRMS IN POOR COUNTRIES

The arguments in favour of a healthy and growing small enterprise sector need not be repeated, and it could be claimed that some European governments are over-doing their support for small business, or at least their rhetoric of support. The growth in self-employment, in the United Kingdom at any rate, owes more to unemployment than to government support programmes, but there is little doubt that the recent growth in the small firm sector is a healthy and long-term reversal of the earlier apparently inexorable trend towards concentration.

There are, however, a number of reasons why smaller businesses are particularly important in poorer countries, which have led the governments of such countries, and those advising and assisting them, to place great emphasis on this sector. Unemployment is still a problem nearly everywhere, including most of Europe, but figures of over ten per cent are unusual, except in particular hardcore pockets of adversity. In many poor countries, figures of thirty per cent and more are not uncommon, and there is no cushion of social security; hardly anyone is unemployed in the sense of having nothing to do, because idleness means starvation, but under-employment is rife; some eight hundred million jobs must be created in the Third World before the turn of the century, just to absorb the new entrants to the labour market, without improving the lot of those already at work.



European evidence suggests that smaller firms are usually less capital intensive than larger ones, although this is not true of every industry, and differences in capital intensity between industries are usually more important than differences dependent on firm size. In poor countries, the capital cost per work place may vary by a factor of ten times, between large and small firms in the same industry, making the same or equivalent products. Where labour is so much in surplus, and capital is so scarce, enterprises which employ more people for less investment are obviously to be preferred.

There are other reasons why smaller enterprises are particularly valuable for poorer countries, in a social as well as an economic sense. They tend to use less imports, of equipment, materials or, perhaps most important, people and expertise, than large ones, and they also place a smaller load on the communications and other infrastructure which are often so deficient. They are scattered, located where people live and produce and consume, they tend to be more equitable in their income distribution effects, and they tend also to foster rather than to destroy the family links that are so important in traditional societies.

Because of these advantages, governments and others in poor countries have made vigorous efforts to promote smaller enterprises, both by positive programmes of assistance and by efforts to remove or mitigate the effect of regulations, taxes and other constraints which often quite unintentionally place a disproportionately heavy load on smaller enterprises.

Not many of these efforts have been particularly successful. The fundamental goal of government is to stabilise, regulate, control and administer, while entrepreneurs want to change, to grow, to respond and to take advantage of the flexibility their small scale affords them. Official government-sponsored assistance programmes are therefore often totally out of sympathy with the aspirations of business, even when, or perhaps particularly when the local bureaucracy is capped by a further level of international donor bureaucracy.

As a result, there has been a search for alternative methods of assistance; voluntary agencies have recently started to play a major role in the promotion of enterprise, particularly at the informal, micro-enterprise level, in rural areas and in the slum and squatter areas of the cities. Larger companies are playing an increasingly important role in the task of assisting and promoting the development of modern sector small and medium scale enterprises. They do this not just because they want to promote economic and social development in general, but because it makes good business sense.

#### WHY SHOULD LARGE FIRMS WORK WITH SMALLER ONES?

There are a number of reasons why larger firms, and in particular those of foreign origin, should be involved in this activity. When a company whose products and operations have evolved in an industrialised environment attempts to start operations in a less developed country, it finds that the whole network of smaller businesses, on which it is accustomed to rely for all manner of services, does not exist. There are three possible solutions; one is to attempt to provide all the services "in-house", by setting up small units to make every component, and establishing company-owned distribution channels; another is to import everything from the home country, which of course does not solve the distribution problem, if the firm's product or service has a local market, and the third is to attempt to develop independent local firms which will be able to provide the necessary services.

The first solution is not usually economic, because so many supplies and services can more efficiently be provided by smaller firms, with lower overheads and the ability to respond quickly to the needs of the larger organisation; in earlier colonial times it may have been necessary to adopt this approach, particularly for remote plantation-based businesses, but it is neither practical nor economic for businesses which intend to make and sell their products in the less developed country.

Importing may also have been possible in earlier times, when colonial governments were not concerned to develop local industries, but local content and import substitution are now often demanded as a condition of establishing a new enterprise or expanding an existing one; the choice is therefore reduced to a make or buy decision, and if there is a preference for buying, and there are no local firms to buy from, the larger firm has to take steps to develop them.

Political pressure often tends towards the same approach; governments are eager to attract inward investment, but they are also sensitive to the dangers, real or imagined, of an excessive multinational presence. Political independence, it is often said, is meaningless unless it is accompanied by genuine economic independence, and this cannot be said to have been achieved if the majority of industrial and commercial investment is controlled by foreigners.

Public sector investments, usually on a large scale, may be one way of ensuring that the "commanding heights" of the economy are under local control, but the track record of the public sector is not good, and most governments believe that there is a need for local independent businesses; since government efforts to promote these businesses are so rarely successful, and insufficient local entrepreneurs appear able to do what is necessary without external support, it is clear that foreign, and local, larger firms have an important role to play.

In many countries there is also a need to promote the economic position of certain minority or even majority groups who for one reason or another are not as involved in the economic life of the country as their population numbers would imply they should be. They may be indigenous tribal people, as in India, the Philippines, parts of Latin America and elsewhere, who have been gradually excluded from the economy and have retreated into relative poverty in mountainous areas where the new majorities do not care to live, or they may be indigenous majorities, as in Malaysia, Indonesia or some parts of the South Pacific, who own the land and control the government, but are to an extent excluded from economic power by one or more groups of alien entrepreneurs.

Because the process of development is an uneven one, there may also be other groups whose aspirations can best be addressed by involvement in enterprise. These may be the educated unemployed, ex-combatants from civil wars or the struggle for independence, or retiring civil servants. There is a need to involve them in the economic mainstream, for common equity or to avoid political disruption, and one way to do this is to help them establish small enterprises. The problem may be an urgent one, and a large foreign-owned company may be in a very good position to establish a reputation for corporate responsibility, to make a contribution to political stability and economic growth which will in the long term be in the company's own interest, and to develop effective and loyal suppliers and customers.

As a result of these various pressures, many larger firms in poor countries have implemented a wide variety of forms of partnerships between themselves and existing and new local small firms. Many of these have been undertaken on the initiative of local management, rather than as a result of pressure from headquarters, and many of the best approaches are not part of any "programme" as such at all but are merely the response of local management to the local situation as they see it. It should be stressed that the motive for the more effective ideas does not usually arise primarily from the need to be seen to be doing the right thing, or from government pressure. These may be important by-products, but the main motive is profit.

It is convenient to classify the various examples of partnerships into those which relate to marketing, to supply and to staff development. Most of the instances which will briefly be described include some element of training, either in a classroom setting or, more commonly, on a one-to-one basis in the field. This is not surprising, since partnerships imply that the firms will in some way be working together, and, as we have seen, partnerships between large and small firms are an alternative to the larger partner performing the function for itself. If this alternative had been chosen, the firm would presumably have had to train its staff; it is not unreasonable for the firm to take upon itself the responsibility to train the people from other firms in the same way.

**MARKETING** Partnerships in the area of marketing are probably those which are most similar to those which are widely used in Europe and elsewhere, although the need to develop totally new marketing channels for unfamiliar products, and the very strong brand positions enjoyed by some firms in poor countries, mean that the relationship between the supplier and the retailer or wholesaler is closer to what would in Europe be called a franchise, although it is not often formalised as such.

The Bata Company which has factories in well over a hundred countries, has been particularly innovative, and successful, in developing distribution channels for its footwear, often in countries where the mass of the people did not wear any shoes at all until Bata arrived on the scene. In Kenya, for instance, they run regular courses for new and existing retailers, and the Bata representatives are perceived more as business consultants than as salesmen. Unilever, and Pernas Edar, the grocery distribution subsidiary of a state corporation in Malaysia, have offered a similar service to their retail customers, both in order to develop more efficient retail outlets for their products and to contribute to the government's objective to transfer retailing, in rural areas at any rate, to the indigenous majorities.

This approach may appear only to be economic when the larger company has a near-monopoly market share, but both these companies, and others whose sales representatives are trained to act as business consultants, even to the extent of discouraging clients from ordering their own employer's goods, have found that this stands them in good stead when competitors do arrive in the market place. The jobs of the representatives themselves have been substantially enriched, so that better people are willing to be employed in the field, and their ability to understand their customers' problems, and to advise on how they can be solved, also enables them to act as more effective communicators between their employers and their clients, in both directions.

African subsidiaries of British Oxygen, and the Singer Sewing Machine Company in Mexico, Brazil, Egypt, Jamaica and Indonesia have developed totally new outlets for their products by developing business "packages" designed around their welding equipment, or sewing machines, which they then introduce to customers by training them as independent welders or tailors. The prospective customers are in some cases willing to pay to be trained in this way.

The newly-trained customers may also be able to take advantage of official loan schemes for local enterprise. The financial institutions are delighted to find a way in which the risks of borrower failure can be dramatically reduced, and the larger firm obtains indirect access to subsidised credit instead of having to finance the new customer-businesses itself. Customers who have been trained on their supplier's equipment are far more likely to be loyal to that brand in future purchases, and these companies have created substantial networks of dedicated outlets, whose owners are in their turn an effective advertisement for people who may wish to purchase the same equipment.

The American Express Company, operating in a very different field, has also established very good long term marketing relationships with the owners of hotels, restaurants and shops in the Dominican Republic, by offering specialised training courses in various aspects of tourism development. This has contributed to the growth of tourism in the country, which is good for American Express, and also protects the company's share of the market for travel facilities. The courses have been so successful, for both sides, that they are now being extended to Brazil and Mexico.

The most familiar examples of this training approach to marketing are probably the almost ubiquitous local bottling plants for cola drinks. Many of the local entrepreneurs who received their introduction to business through soft drink franchises are now important industrial investors in more productive fields in their own countries, and nobody would accuse these particular multinational corporations of extravagant idealism; they have realised that training and human development is the best way to build and maintain market share, and have in so doing made a major contribution to management development in large numbers of countries.

#### DEVELOPING SUPPLIERS

In many poorer countries there are few if any small firms with the ability to supply goods or services to the standards required by modern producers. Numbers of larger businesses have had to adopt what might be called "backwards marketing", for want of a better term, in their search for more efficient sources of supply. This concept can best be illustrated by the example of a senior executive of one East African subsidiary of an international company, who was having problems with brand share of one of the company's soaps and with obtaining suitable supplies of palm oil. His reaction to the marketing problem was to question his own and his marketing department's approach; by contrast, he blamed the local palm oil producers, rather than his own company, for their failure to deliver what was required.

He failed to see that the customers who were not buying the soap and the smallholders who were not producing the palm oil were in many cases the same people, who needed a similar package of motivation and assistance to persuade and help them do what his company wanted them to do. The purchasing department was eventually asked to take a lesson from the marketers, and to appraise their own approach rather than to blame the suppliers. An appropriate "marketing" strategy was developed, to persuade the smallholders to do what was wanted, and the problem was solved.

A similar "needs-oriented" approach has been adopted by many other companies in their efforts to develop local suppliers, even when these are far more sophisticated, and far fewer in numbers, than the smallholder oil palm cultivators. Nestles provided a very comprehensive package of assistance to a village co-operative in Guatemala which was engaged in processing and marketing fresh and dehydrated vegetables. By advising on equipment purchases, training the manager, helping with the establishment of a quality control laboratory and supplying packaging at low prices Nestles was able to assist in the development of a reliable supplier, and also to provide a model which similar co-operatives and private processors could learn from, so as further to increase the number of competent suppliers.

In Brazil, an important American manufacturer of electronic and electrical equipment has adopted a number of innovative and apparently successful approaches in its efforts to develop local sources of supply. This company's products are exported all over the world, and every component must therefore conform to the same universal standards. The company has helped local suppliers to modify American production methods to take account of more labour-intensive methods, it has sent supplier staff for training and familiarisation tours in the United States, and has established its own testing facilities in suppliers' plants in order to extend quality control standards into the supplier's workshops.

The company has also gone so far as to help its new suppliers develop export markets, and even to sell to its own competitors, in the knowledge that a growing and successful supplier is more likely to be a competitive and economic one. As a result of these policies, the company was by the early 1980s buying from nearly four hundred suppliers; the numbers of their staff working wholly on this company's products was well over the number employed by the larger company itself. At the same time, however, the company maintains two or more suppliers of all important items, and also ensures that no supplier depends on the larger partner for more than seventeen per cent of its sales; management feel that in a fast-changing industry it is important to protect its suppliers against over-reliance on one customer and one product line.

Another American electronics company has followed similar policies in Malaysia, arranging for exchanges of engineering staff between itself and its suppliers, sending supplier staff for training at its headquarters in the United States, and helping new suppliers with advance payments and access to low cost sources of equipment and materials when necessary. They have also attempted to promote enterprises owned and managed by the indigenous people; this is not always easy, but the larger company feels that the effort is worth while in the interests of government relations and national stability.

In India, as might be expected given the long tradition of assistance for smaller enterprises, local public and private sector companies, and foreign firms, have developed a number of innovative approaches. This has partly been in response to official regulations, which restrict investment in the manufacture of nearly one thousand separate items to small-scale units. If there are no existing suppliers of a given item, it may not be possible for a larger firm to produce whatever is required itself. Smaller suppliers often prove themselves to be more flexible and able to offer lower prices than in-house manufacture could achieve, and they are also able to take advantage of the large numbers of grant and low interest loan schemes which are not accessible to large scale firms. In this way, the larger firm is able to have indirect access to low cost finance, and thus to achieve lower costs overall.

Newly established large manufacturing units must also in some cases adhere to fixed targets for the proportion of their supplies which are bought from small local suppliers, as opposed to being imported or made in-house. A number of large firms have established "ancillary estates" around their own factories, with premises built especially for their own suppliers. Both sides can take advantage of the close proximity this affords, and the boundaries between supplier and customer, which are often counter-productive, become blurred as both sides work towards a common goal.

Opinions differ as to the overall economic effect of the Indian policy of active discrimination in favour of smaller firms, and the effectiveness of many of the regulations and programmes is reduced by bureaucratic delays and corruption. Nevertheless, some success has been achieved; a scooter manufacturer developed some thirty suppliers on a green field site, a pharmaceutical firm promoted the establishment of twenty four new small firms around one of its factories, and Bharat Heavy Electricals, one of the largest public sector firms, has contributed to the establishment of nearly five hundred suppliers.

In the private sector, Phillips are buying from nearly five hundred smaller firms, and has an active programme to help its suppliers improve their services, not only to Phillips but to other customers. Hindustan Lever has set up a special section in its export department to seek out both suppliers and markets for the products of small scale firms, many of which have no direct relationship with Hindustan Lever itself. They have achieved major successes in the sales of shoes, carpets, cotton garments and engineering products; these transactions have helped to cover the costs of operations of the company's export outlets, and have also helped to prevent some of the potential ill-will associated with multi-national companies.

STAFF DEVELOPMENT

The current interest in entrepreneurship and smaller companies has led many European and American business schools to introduce courses where students are required to study or actually work in smaller firms. Many of these students then go on to start their own businesses, or to seek employment in smaller firms, but it has also been found that the small firm environment is a very effective training ground for management in a larger organisation, which can help trainee managers to develop the "intrapreneurial" ability which is necessary for success even, or particularly, in the very biggest companies.

In Sri Lanka, East Africa and elsewhere, a number of larger firms have extended this idea to in-company management development, and have found that they can at the same time develop more effective suppliers and customers, and develop their own staff. The Ceylon Tobacco Company, a subsidiary of B.A.T., set up CTC Services to offer consultancy to smaller firms and income generating development projects, at nominal cost. This gives their middle management the opportunity to develop their skills in the context of small independent units, untrammled by the bureaucracy of the large corporation. It also develops the smaller partners, and demonstrates the social responsibility of the larger firm. It could be argued that these attachments are a more effective and less expensive form of management development than sending staff to European management schools whose courses are often of doubtful relevance to conditions in poorer countries.

In East Africa, several multi-national corporations treated governments' demands for "localisation" of distribution channels as an opportunity for an innovative but effective approach to staff development. They assisted a small number of their most talented and entrepreneurial managers, most of whom would probably have left within a few years to start their own businesses, to go into politics, or to work for other companies, to set up as independent distributors of their erstwhile employers' products.

The assistance included generous credit terms, recommendations for loans, training and on-going advice. Since the new entrepreneurs had all worked for many years with the firms which were now their suppliers, and they came in most cases from the marketing departments, they were well introduced to the problems and opportunities of independent distributorship, and to the products they had to handle. Their suppliers maintained a degree of control through their financial involvement, and a number of these people have gone on to become important industrialists in their own companies, as a result of the head start they enjoyed.

The larger partners gained good, well-trained and reliable suppliers; they were also recognised by government as contributing to national development. They may have "lost" a small number of their best staff, but they found that new recruits, and existing staff, were encouraged to join and stay with the company by the possibility of eventual "promotion" to independent status. Management buyouts are usually treated as a way of disposing of activities which are extraneous to the main mission of the company; these companies took a more positive approach, and used the entrepreneurial ambitions of their staff both to develop local partners and to compete more effectively in the recruitment market.

#### CONCLUSION

It is impossible in any environment to disentangle the social, political and the economic motives for any form of company behaviour, and they are as inextricably mixed in the area of small firm relationships as any. It might be possible for a cynic, or an enthusiast for public relations, to claim that all the various forms of partnerships which have been described are motivated by the need to appear to be doing the right thing, rather than by immediate profit.

Even if this extreme view is accepted, however, the pressure for good public relations is no less important in Western Europe than in poorer countries, and larger companies can improve their image by being seen to promote smaller ones in just the same way as Governments, of all colours, work so assiduously to show how much they are doing for the small firm sector.

It is more reasonable, however, to conclude that profit is at least as important a motive for the larger firms as public relations, and the very success of many of these programmes demonstrates that they are basically different in kind from so many local and national government initiatives where the pay-off is measured in votes rather than profits. Many aid agencies are becoming disillusioned with governments as channels for assistance to smaller firms, and governments themselves are collaborating more with voluntary agencies and, albeit tentatively, with larger firms. Administrative capacity may be higher in Europe than in most poor countries, but governments everywhere are coming to perceive the limits of their own effectiveness. Possibly European governments too can learn from the experience of poorer countries, and will thus limit their activities to the provision of an appropriate policy environment, and recognise that the best institution to help a business, of whatever scale, is another business.

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May 1988

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