



**SWP 27/87 THE APPROPRIATENESS OF INCENTIVES FOR
SMALL SCALE ENTERPRISE LOCATION IN LESS
DEVELOPED AREAS**

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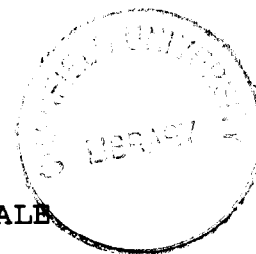
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There is apparently a need for research into the appropriateness of regional policy incentives for small enterprise location in less developed areas. In this piece of research, based on data collected from small firms in India, Japan and Britain, an attempt is made to fill this gap. The major conclusions are that the factors that motivate firms to locate in particular places are not static, rather they tend to vary according to the levels of development in terms of socio-economic variables. The importance of incentives in location selection appear to be more pronounced in advanced economies and larger firms, than in poor economies and smaller firms. Also, the differences in the schemes in operation in these countries suggest that the existing incentives need not necessarily be the best incentives.

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Inter-regional income disparities is one of the major problems faced by a large number of countries around the world. Over the years many policy instruments have been tried, with mixed results. There is no shortage of research studies examining the use of these policies for general industrialisation, and large industries especially. Although small scale enterprises (SSE) have been playing an important role in economic development, enough attention has not been paid to the question of the appropriateness of regional policy incentives to small enterprises location in less developed areas. This paper discusses the findings of a study of small business location and incentive schemes in three countries (India, Japan and the UK) that are different in terms of their levels of development and socio-cultural background.

Background to the Study

It is important in regional policy to identify the factors that attract industries to specific locations. Basically all location factors derive their importance from costs arising out of constraints to their supply. When constraints are removed as an economy develops, for instance through improvements in transport and communication facilities, their relative importance falls.

Thus along with infrastructure build up, the primary location factors such as proximity to home, and raw materials, and transport facilities fall in importance and social factors such as pleasant environment gain in importance. It is in this context that the process of location dynamics is to be studied in relation to the level of development.

In figure 1, as countries move forward on the development continuum, economic factors tend to fall in relative importance, and social factors rise. Empirical literature on firm location and regional development supports this model. These studies are generally based on data from large enterprises. The present study of SSEs in the three countries also tend to support the model (see figure 2).

The location factors identified by the present survey are to be examined in this background. In figure 2, the factors that are most important to SSEs when they choose locations are considered. The following conclusions can be drawn from it.

(a) Location factors tend to vary from country to country probably because of differences in the levels of economic development and socio-cultural factors.

(b) The factors that are not adequately available tend to be more important, such as the high importance of transport, communication, power and other infrastructure in Japan and India and the low importance of the same factors in UK.

Figure 1

LOCATION DYNAMICS

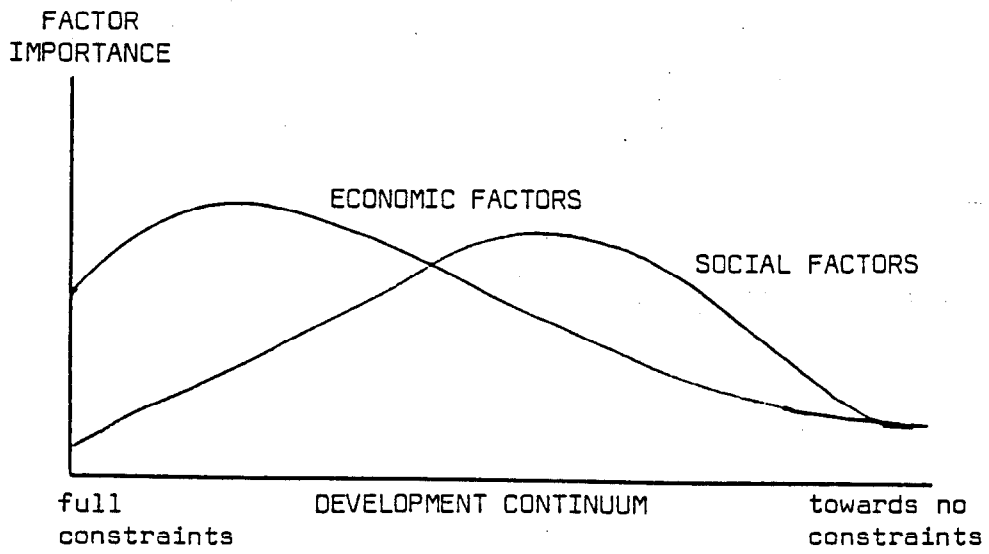
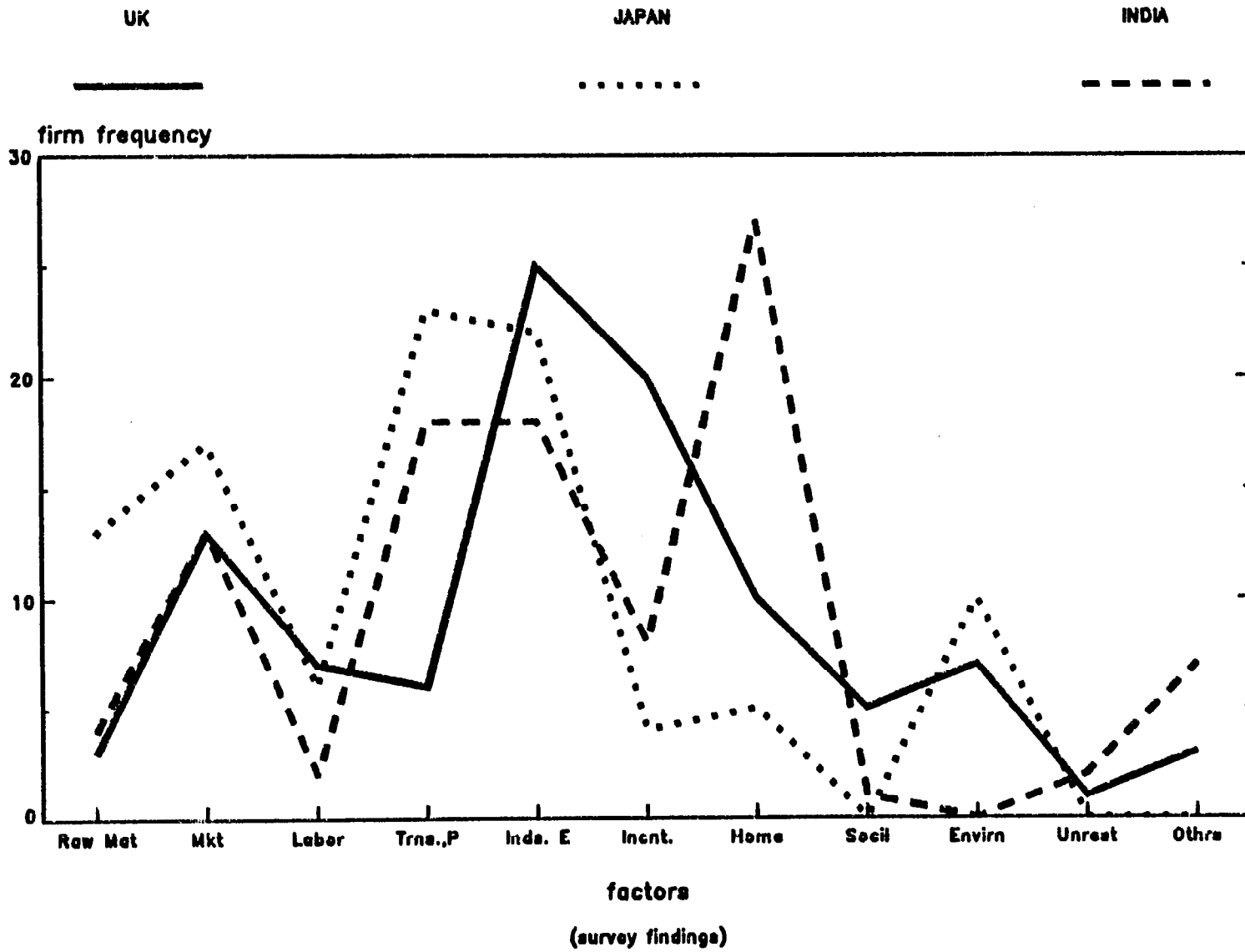


FIGURE 2

LOCATION FACTOR IMPORTANCE



(c) As development continues, non-economic factors tend to be important. Accordingly, pleasant environment is an important factor in UK and Japan; it is not at all important in India. Social factors such as clubs, theatres and restaurants are important in UK, though unimportant in Japan and India.

(d) Home proximity is an important factor in India probably because of the influence of strong cultural factors.

(e) Many entrepreneurs consider incentives themselves as an important location factor.

These conclusions are important while formulating regional policy. As non-economic considerations are important as latent location factors, attempts to attract industrial investment to less developed areas may not be successful by creating economic infrastructure alone; social and environmental factors are also to be considered.

Types of incentives

Regional policy incentives are in operation in a large number of countries across the continents. There are different types of incentives; broadly, incentives in different countries around the world can be classified into fiscal, financial, physical and others with inter-country variations. They may be capital or revenue in nature.

Fiscal incentives include corporate tax deductions, sales tax

exemption, import duty concession, and local authority tax deductions. Financial incentives may be capital grants as percentage of fixed capital investment, and subsidised rates of interest on borrowings. The most widely used physical incentive is industrial estate; there are others in this category such as power and water facilities, and raw material supply on a priority basis. There are other incentives such as training and consultancy services, assistance in marketing, and priority licensing policies.

Sample profile

Two regions each in UK (Corby and New Town in Mid Wales), Japan (Kumamoto and Miyazaki*) and India (Malappuram and Mahaboobnagar) were selected at the macro level and within them 42 SSEs in UK, 35 in Japan and 35 in India provided data at the micro level. The criteria applied to select the regions were: they should have no tradition of large scale individual entrepreneurship, they should be newly emerging urban centres, and the firms locating there must be eligible for regional development incentives. The criteria to choose SSEs were: that the firm must be at least one year old, that the employment per firm must be below 50, and that incentives must have been in operation in the region when the firms were set up. They belonged to the following industries: food, wood and furniture, mechanical and metal products, chemicals and plastics,

* Miyazaki had no response and so only Kumamoto was surveyed.

electricals and electronics, paper and paper products, and a few miscellaneous industries such as rubber and minerals. The firms are located within industrial estates.

Survey findings

The appropriateness of incentives for SSEs are discussed here based on the survey findings.

Table 1
PRESENT LOCATION AND IMPORTANCE OF INCENTIVES

(Percent of totals in parentheses)

Whether the present location would have been chosen without incentives	U.K	Japan	India
YES	18 (43)	14 (40)	27 (77)
NO	24 (57)	21 (60)	8 (23)
	42 (100)	35 (100)	35 (100)

As shown in table 1, in both UK and Japan a small majority of the firms would not have chosen their present location without incentives. However, in India more than three quarters of the firms surveyed would, in any case, have chosen their present location. The British and Japanese situations are not directly comparable as basically Japan does not have any capital grant scheme, one of the most important incentives for the British entrepreneurs.

An analysis of the location factors based on the number of people

employed indicate that these factors are a function of the firm size too. As shown in table 2, for smaller SSEs, the important factors are industrial estate, home proximity, and infrastructure facilities. For larger SSEs, the factors are industrial estate, infrastructure and incentives.

Table 2

LOCATION FACTORS
firm sizewise

Less than 10 employees	10 to 25 employees	Over 25 employees
1. Indus. Estate 2. Home proximity 3. Transport etc infrastructure	1. Indus. Estate 2. Transport etc infrastructure 3. Govt. incentives	1. Indus. Estate 2. Transport etc infrastructure 3. Govt. incentives

It could be concluded from the above that the importance of incentives is directly related to the level of development of the economy and the size of the firm. For larger firms and advanced economies, incentives, in general may have some effect.

The number of firms taking advantage of incentives varies from country to country and from scheme to scheme (see table 3). Among the fiscal incentives only the local authority taxes in Japan and rate deduction in UK are found to be attractive, while corporate tax deduction is not an attractive scheme in India. The Japanese tax deductions are generally at the time of asset acquisition, as against the Indian profit tax deduction that depends on the profits earned.

Table 3

INCENTIVES TAKEN ADVANTAGE OF

U.K	%	Japan	%	India	%
Regional Dev. Grant	27:64	Low intrst loan	35:100	Central subs	32:91
Sel. Fin. Ass/		Immovable asset		Low interest	
Mid Wales De.Gr.	18:43	tax deduction	21: 60	loan	25 :71
Rent/ Rate subs.	35:83	Munici. proprty		Income tax	
		tax deduction	18: 51	deduction	3 : 9
		Enterprise tax	--: --		
		Welfare subs.	2 : 6		
		Anti-pollution			
		facilitiy subs	2 : 6		

Between the two financial incentives (capital grants and subsidised loans) that are in operation in the three countries, capital grants scheme is more widely used; Japan does not have any capital grants scheme. As these grants are based on the cost of assets created, they are more attractive to capital intensive firms. However, firms have to make application for the grant specifically, while interest subsidy advantages flow to the firm automatically. Because of this difference, the benefits of the grant scheme are a function of the efficiency of administration too. The time lag in the receipt of the grant in UK is much less compared to India (see table 4), and as a result, the median system loss of administration in India is 16 percent of the grant offered, and this pulls the net benefit reaching the entrepreneur to 12.5 percent from an offer of 15 percent of capital investment.

Industrial estate with rent and/or factory cost subsidy is the

widely used physical subsidy in UK , India and many other countries. In Japan either of them is not offered. There the firm should have a minimum size to be eligible for some of the tax deduction schemes; since entrepreneurs come together and form industrial estate privately, they become eligible for such incentives in a collective way.

Table 4

TIME LAG TO RECEIVE BENEFITS

(Percent of totals in parentheses)

Time lag	U.K	India
upto 3 months	14 (52)	7 (24)
4 to 6 ,,	9 (33)	6 (21)
Over 7 ,,	4 (15)	16 (55)
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	27 (100)	29*(100)

* 3 firms have just applied

Among the other incentives, government purchase preference schemes in UK and India are worthy of mention. IN UK, firms located in regions eligible for incentives should receive orders for at least 25 % of the purchases by government departments/ organisations, provided their quotations are otherwise competent. In India, the incentive is a 15 % price advantage to small firms. There is no such scheme in Japan. Only very few firms find the scheme of any use.

A large number of firms take advantage of the incentives because they are on offer. As shown in table 5, the proportion of firms that considered the incentives out of those who took advantage of the incentives is around half or less than that in both UK and

India. In Japan, because entrepreneurs considered jointly all the possible incentives, but all did not get them, the percentage is more than hundred. From table 5 it comes out that a large number of firms would in any case have come up in their present location disregarding incentives.

Table 5
RATIO OF INCENTIVES CONSIDERED TO TAKEN ADVANTAGE OF

U.K	Japan	India
Regional Dev. Gr. 59 %	:Low Interst Loan 100 %	:Central subs. 63 %
Sel. Fin. Ass./	:Immovable Ass.	:Low interest
Mid Wales Dev Gr. 61 %	:tax deduct. 167 %	:loan 28 %
Rent/ Rate	:Munici. Property	:
Concession 40 %	:tax deduction 194 %	:

It may be concluded from the above analysis that all incentives are not equally attractive to SSEs. Even among those attractive, their influence on firm location choice is limited.

SSEs in all the three countries tend to favour incentives that accrue to them automatically; they tend to believe that incentives by negotiations is not beneficial. This is so mainly because small entrepreneurs do not have the time or resources to engage in negotiations and follow up. Among the three countries, UK firms are more tempted by negotiated incentives compared to Japanese and Indian firms.

Similarly if information about the incentive schemes do not reach

the potential investors, the whole purpose of the scheme is defeated. It is probably for this reason that in the UK, development agencies bring out attractive brochures detailing the incentive schemes, and also go on for various media publicity. In a large number of cases in all the three countries, information is passed over through fellow businessmen.

It may thus be concluded that Incentives are less relevant to SSEs where they are determined through negotiations because entrepreneurs are not skilled in that and they do not have time for it. Entrepreneurs also suffer from lack of knowledge about the schemes.

Entrepreneur mobility could be for economic reasons or socio-cultural reasons. As shown in table 6, entrepreneur mobility is relatively high in UK compared to Japan and India.

Even in the absence of socio-cultural factors, constraints of knowledge about the business environment in a new place, and also the risks associated with the investment prospects in a less developed area with uncertain environment may make SSEs less mobile. This entrepreneur mobility is a function of environmental risks, both economic and non-economic. It is worth mentioning that a stable socio-political and economic environment determines to a great extent the potential entrepreneurial flow into and from a region. The poor entrepreneurial growth rates in the less developed areas of India, also to some extent of Northern Ireland

are to be viewed in this perspective. Refugees often make the best entrepreneurs because they could afford to take high risks under any circumstances.

Table 6
EARLIER HOME TO BUSINESS DISTANCE

Distance from place where lived earlier to business location	UK	Japan	India
Upto 5 miles	6	31	18
6 to 10 ,,	1	1	1
11 to 25 ,,	12	--	8
26 to 50 ,,	5	1	3
51 to 100 ,,	11	--	3
Over 101 ,,	7	2	2
	42	35	35

The moves to bring entrepreneurs from longer distances have other consequences too. Entrepreneurs who move firms are only shuffling their resources in the broad sense of the term. It does not directly result in new entrepreneurship. Unless regional policy incentives are offered on a selective basis, their attractiveness for a selected few places will disappear.

From the above point it may be concluded that wherever entrepreneur mobility within or into a region is doubtful, it is better to focus attention on promotion of entrepreneurship from within.

Policy implications

The dynamic nature of location factors that one could tentatively conclude from the earlier analysis appear to have long term implications in regional policy formulation. There is need for further research in this area to determine the importance of location dynamics on regional problems.

The types of incentives differ considerably among the three countries. Apparently the importance of incentives in location selection tends to depend on the level of development of the economy and the firm size. The Japanese experience indicates that regional development policies need not necessarily have capital grants. The Indian experience supports this argument. However, more thoughts are to be given to this issue before making final conclusions. In the UK too, tentative evidence is that the efficacy of the grants is diluted by the widespread use of incentives.

All incentives appear not equally useful to SSEs. Also, even if they are useful, probably there could be better schemes. Since entrepreneur mobility is a function of both economic and non-economic factors, efforts to grow entrepreneurship from within the region are likely to be more long-term and sustained. SSEs may need, especially in regions with less entrepreneur mobility, incentives in the form of training and consultancy services.

Entrepreneurship tends to grow where the risk factors are reasonable. So stable socio-political and economic conditions are conducive for the development of entrepreneurship. There is need for further research in this area too.

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